



Asset Management in the UK 2010-2011

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. The results are based on the questionnaire responses of 76 IMA member firms, who between them manage £3.3trn in this country (85% of total UK assets managed by IMA members).

We also conducted in-depth interviews with 30 senior figures from 23 IMA member firms. Their views are reflected both in the commentary and in the direct quotations, reproduced on an anonymous basis throughout the survey.

The survey is in six main chapters:

- 1 Overview of the UK Asset Management Industry**
- 2 UK Institutional Market**
- 3 UK Funds Market**
- 4 Operational and Structural Issues**
- 5 The International Dimension**
- 6 Market Interaction and the Impact of MiFID**

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

A number of general points should be noted:

- Unless otherwise specified, all references to 'assets under management in the UK' refer to UK assets under management by IMA members as at December 2010.
- Unless otherwise specified, the IMA survey and internal databases are the source of all data cited.
- Not all respondents have been able to provide information for all questions and not all questions have been answered on the same basis. Response rates, therefore, differ across questions.
- The survey has been designed with comparability to the previous 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.

Survey Foreword



Richard Saunders
Chief Executive

The IMA's annual survey is the most comprehensive account of the UK investment management industry. Our ninth annual survey's findings are based upon questionnaire responses from 76 IMA member firms (between them managing £3.3 trn in the UK) and in-depth interviews with 30 senior figures from 23 IMA member firms.

An industry in good shape...

Some two years after the deepest phase of the credit crisis, it is clear that the industry has come through relatively unscathed. Assets under management are at a record £3.9 trillion (see Chapter One), while industry revenues have recovered, and are now exceeding pre-crisis levels.

Since our first survey in 2002, assets under management have doubled, notwithstanding subdued investment returns. The FTSE 100 index rose only 27 per cent over that period, for example. The growth is therefore primarily the result of inflows from clients, a third of whom are outside the UK. At the same time, the industry has continued to evolve: in ownership terms it is increasingly independent of banking and insurance, while retaining its un-concentrated and competitive overall structure.

The UK retail funds industry had another strong year in 2010, with net inflows at their second highest level on record, following 2009, and many retail investors displaying an increasingly global outlook. Overall, authorised funds experienced retail inflows of £60 billion over these two years and saw total funds under management increase by 60% to a total of £579 billion.

...but facing challenges

Despite this positive commercial performance, the industry faces challenges. Although revenues are buoyant, many of those we interviewed are conscious of the growing appetite for index-tracking funds, increasingly in the form of exchange-traded funds, as well as the growing importance of platform intermediaries. Both developments could have implications for industry business models in the future.

Many of our interviewees believe that ten years of highly volatile stock market returns and a huge credit crisis in the Western world have left some investors nervous and distrustful of financial markets. In the retail funds market, we have seen strong inflows into managed and absolute return funds. And our interviews revealed growing interest from institutional investors in multi-asset strategies, although as Chapter Two shows, single-asset mandates still predominate.

How to respond?

Against this background, firms are seeking to foster investor trust and confidence. The majority of managers we spoke to believe that association with problems in the banking sector has contributed to a decline in trust among the industry's clients. But firms believe there is more that the industry itself should be doing.

This is why many managers are actively seeking to focus on meeting specific client needs by moving towards more outcome-oriented products and strategies (see Chapters One and Two). It is worth highlighting three such themes:

- Liability matching strategies for defined benefit pension funds and other clients. Assets subject to a liability-driven mandate are continuing to grow strongly.
- Default fund strategies within defined contribution pension schemes, which aim to provide appropriate asset allocation strategies for scheme members which evolve over time.
- Funds which aim to provide constrained levels of risk for clients, particularly retail investors, such as absolute return products.

Through a greater emphasis on areas such as asset allocation and an approach based upon specific client needs, many interviewees felt this could mark the beginnings of a renewed relationship with end clients.

International competitiveness

Over the last few years we have tracked growing concern that the many advantages enjoyed by the UK as a location for an investment management business may be eroding. We heard this even more strongly this year (see Chapter Five).

Several of those we interviewed said that massive improvements in communications and a shifting balance of global economic power were making the case for a global "cluster" for asset management less compelling. And, importantly for an industry drawing on talent globally, a lack of certainty about the stability of the fiscal, regulatory and immigration regimes could undermine the UK's position relative to other jurisdictions.

Nobody expects this to result in an exodus of established firms from London. But several members suggested that we could see more marginal decisions about incremental investment go against the UK in future. Just as mutual fund domiciles have migrated to Dublin and Luxembourg, so we may see other such moves over time. This is something to which the UK Government needs to be alert.

Regulation from Europe...

Regulation has risen significantly up the list of industry preoccupations. This is recognised as inevitable in the wake of the credit crisis, and indeed to some extent welcome. But concerns are growing about the volume and appropriateness of new regulation that is affecting the industry, much of it originating from the EU.

Frequently cited is the Alternative Investment Fund Managers Directive, which sought to tackle the regulation of hedge funds and private equity funds. Not only was their role in the credit crisis marginal, but the directive also brought a wide variety of other fund structures within its scope. Indeed, the importance of hedge funds is frequently overstated – the assets managed by IMA member firms at the end of 2010 were three times those of the global hedge fund industry.

The impact of the first wave of EU legislation, the last decade's "Financial Services Action Plan", has been decidedly mixed. For example, the Markets in Financial Instruments Directive was intended, among other things, to improve competitiveness in equity trading markets. But the majority of members reported that in practice the result has been a decrease in post-trade transparency and no reduction in trading costs (see Chapter Six).

When we conducted our interviews for this survey, the industry was facing the prospect of some 20 different legislative measures from Europe over the coming two years. This will have significant impact on firms' operating environment.

...and from the UK

The Financial Service Authority's Retail Distribution Review is the main current proposal for UK-originated regulation affecting the industry. Investment managers support the Review's objectives of a more transparent and consumer-friendly market, but our industry has concerns about whether this would indeed be the outcome. Some feared that the fund management industry might be put at a competitive disadvantage to life insurers. And there was widespread agreement that middle and lower income groups would find it more difficult to access advice in the future.

A further challenge will be the impact of the legislation expected later this year to replace the FSA with two new regulators, the Financial Conduct Authority and the Prudential Regulation Authority. This will inevitably result in further disruption as relationships with regulators undergo a fundamental change.

One group that may be disproportionately affected by the regulatory agenda is smaller specialist firms. Investment management has always had relatively low barriers to entry: with no requirement for large amounts of capital, investment managers are in essence much more akin to non-financial service sector businesses than to financial firms like banks. But some interviewees suggested that the increasing regulatory requirements could start to provide more significant barriers to entry than in the past, ultimately perhaps driving greater consolidation.

Conclusion

While the industry has ridden through the financial crisis well, it finds itself at a strategic crossroads and the mood among firms is generally reflective. The growing need for individuals to take responsibility for their own retirement provision continues to create an attractive long term prospect for the industry. But evolving client preferences, a difficult market environment and changing regulation at both UK and EU levels are combining to present firms with new strategic challenges, which they will have to face up to in order to grasp potential opportunities.



Richard Saunders

Chief Executive, Investment Management Association
July 2011

Key Statistics

£3.9trn

[£3.4trn in 2009]

Total assets managed in the UK by IMA member firms as at December 2010

£617bn

[£503bn in 2009]

UK-managed funds domiciled offshore

£1.3trn

[£1.1trn in 2009]

Assets managed in the UK on behalf of overseas clients

38%

[40% in 2009]

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

£579bn

[£481bn in 2009]

Managed in UK-authorized funds (OEICs and unit trusts)

£11bn

[£8.7bn in 2009]

Revenue earned by UK-based asset management firms in 2010

£2.2trn

[n/a]

Assets managed worldwide on behalf of UK institutional clients

Key Interview Findings

1 Investment increasingly globalised; product focus becoming less specialist

- Client interest in global investment opportunities, particularly emerging markets, continuing to increase at the expense of domestic exposure (see p. 21-22).
- Specialisation reaching limits with growing emphasis on solutions and more client-centric asset management services. LDI assets under management expanding; DC likely to be an area of significant focus in the UK (see p. 23-25).
- Increasing interest in multi-asset approaches as both a diversification delivery mechanism and a way to deliver specific outcomes (see p. 36-37).

2 A need to improve trust and better communicate the industry's role and objectives

- General recognition that client trust is an issue that must be addressed (see p. 26).
- Industry should be better at differentiating itself and its business model from other financial services (see p. 26).
- Changes needed in client-manager conversation in both the retail and institutional environment (see p. 26-28 and 37).
- Concerns to ensure transparency as product set evolves (see p. 27).
- Greater client scrutiny of operational process and risk management seen as a positive development (see p. 28).

3 Regulation should not work to the detriment of the industry's clients

- Acknowledgement that regulation can benefit both industry and clients; UCITS seen as a key success (see p. 73).
- But widespread concern about the potential impact of new UK and European regulation, amid recognition that regulation will inevitably tighten (see p. 74-76).
- Disbelief over the Keydata episode (see p. 76).
- Operating costs are rising as a result of the regulatory response to the credit crisis, but for some this is seen as a competitive advantage (see p. 74).

4 Ongoing unease about the attractiveness of the UK as an operating environment for the asset management industry in a changing global economy

- Continuing worries that the UK may be losing its competitive edge as an international asset management and financial centre (see p. 86-89).
- Evolution of technology and of the global economy eroding the natural advantages enjoyed by the UK (see p. 88).
- Firms point more to the danger of new capacity going elsewhere than of the imminent relocation of existing personnel, funds and corporate entities (see p. 89).
- In a changing global environment, the UK needs to signal unequivocally that it is 'open for business' (see p. 88).

1. Overview of the UK Asset Management Industry

Key Findings

1

Overall size and location

- Assets managed in the UK by all IMA member firms totalled £3.9trn as at December 2010, a rise of 17% from 2009. Total assets under management were boosted by a sharp rise in UK-authorized funds under management,¹ which rose 20% year-on-year to £579bn.
- Including a range of non-IMA firms (principally hedge funds, private equity funds and discretionary private client asset managers), we estimate total assets under management in the UK at £4.4trn.

Client type

- Institutional assets under management in the UK account for just under 78% of the total, with retail representing 21%. Private client money accounts for 1.6% of total assets under management.
- The largest institutional client type by the size of UK assets under management is pension funds (34%), followed by insurance companies (24%).

Overall asset allocation

- Of the £3.9trn under management by IMA firms, 46% was invested in equities, 36% in bonds, 9% in cash/money market instruments and 4% in property. The remaining 6% largely represents a range of alternative asset classes and liability-driven investment (LDI) strategies.
- Allocation to UK equities continued to decrease to 43% of the total (compared with 47% in 2009), which represents 38% of the UK domestic market capitalisation. Emerging market equity continued its growth, now representing almost 10% of the entire equity allocation.

Evolution of industry focus

- Interviews suggest greater attention being paid to specific client needs, which firms strive to meet by adopting increasingly different approaches to product design and delivery.
- Product transparency and client communication seen as key to improving trust in the industry.

¹ UK-authorized funds refer to UK-authorized unit trusts and open-ended investment companies (OEICs).

1. Overview of the UK Asset Management Industry

The UK is a leading asset management centre, with the industry serving a wide range of domestic and overseas clients. The majority of activity is concentrated in London, but there is also a significant Scottish cluster.

Although many asset management firms developed historically as part of larger financial institutions, such as banks or insurance companies, the industry uses a very distinct business model. It provides services to retail, institutional and private client investors on an agency basis, with a clear separation between operating companies and assets.

Total Assets Under Management

Investment services are provided in two broad ways: through a variety of pooled vehicles, which commingle assets from different investors, and through segregated mandates, where a client's assets are managed separately.

This survey captures all aspects of the industry's asset management activity. Total assets under management in the UK by IMA members were £3.9trn at the end of December 2010, up 17% from a year earlier and 30% above the levels seen in 2008.

The £3.9trn covers assets managed by IMA members in this country for both UK and overseas clients (see Figure 1). This includes:

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

Within the UK, we estimate that 14% of total assets (£550bn) 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.

As we discuss further in Chapter Five, overseas clients account for one-third of total assets managed in the UK.

Figure 1: IMA member characteristics

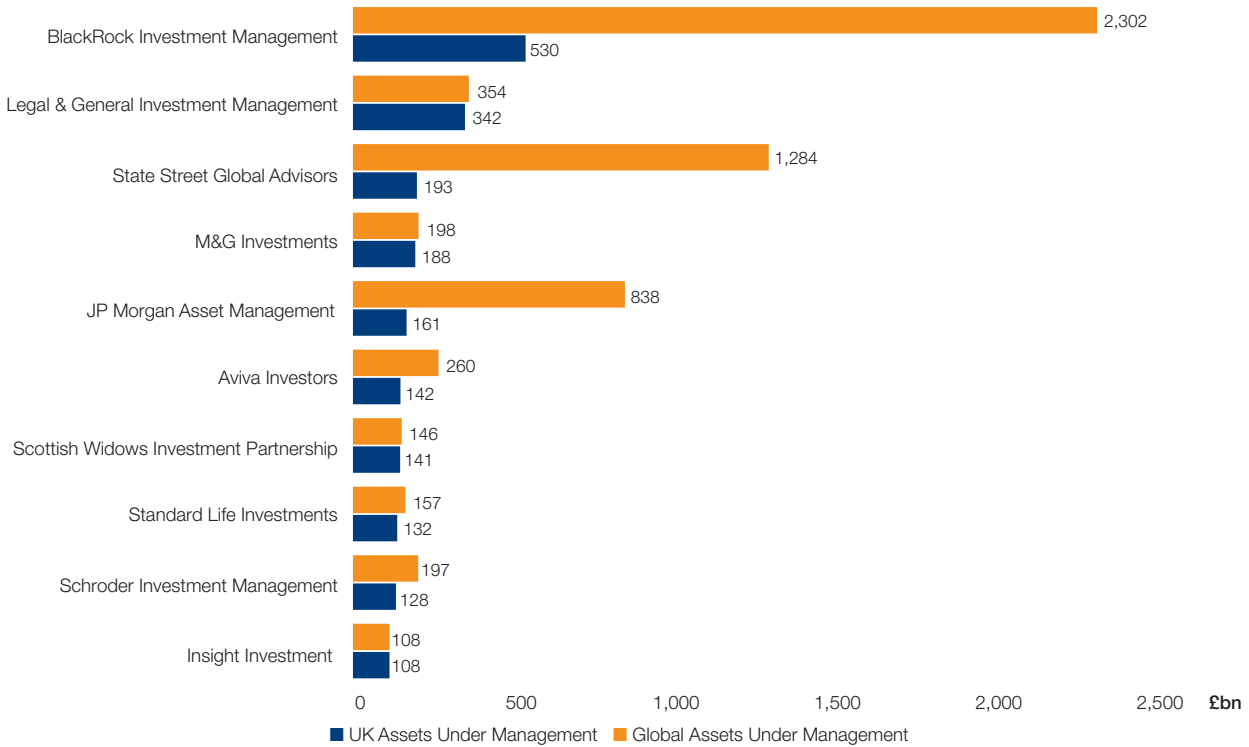
IMA members fall into five general categories:

- 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.
- Large and medium-sized firms, whose business is primarily UK/Europe-focused and which offer a diverse range of services.
- Firms whose business is primarily based on investment funds.
- Smaller asset management firms, which may be specialist boutiques or focused on the private client market.
- Occupational Pension Scheme (OPS) managers running in-house asset management operations.

Looking at the largest firms (see Chart 1 overleaf), the top ten as at December 2010 continue to be characterised by three 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. However, their range of activities goes well beyond this and they should not be defined solely in these terms.
- Despite the rise in significance of autonomous asset management firms (see p. 69), only two of the top ten firms are fully independent asset managers (BlackRock and Schroders). The other eight belong to insurance companies or retail, investment or custodian banks.

Chart 1: Top ten firms by UK and global assets under management



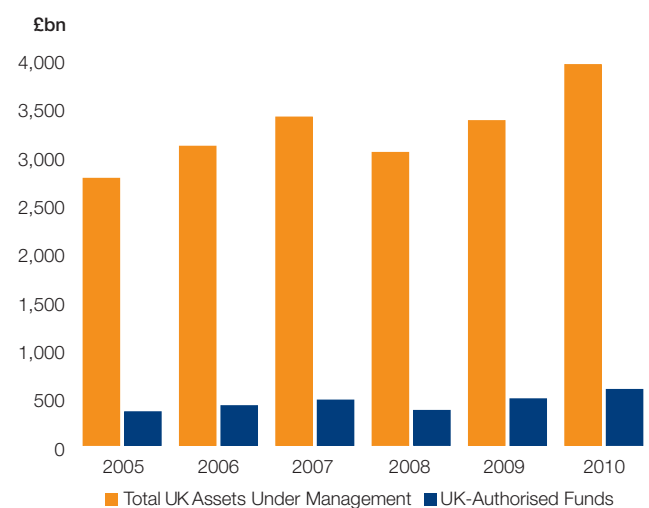
Assets and funds

Chart 2 shows the progress of assets under management since December 2005. It includes one of the most important sub-components: the UK-domiciled investment funds industry (authorised unit trusts and OEICs), which represents 15% of total assets under management, the highest proportion recorded since the survey began.

As we explore further in Chapter Three, one particularly notable feature of 2009-2010 was the spectacular growth in UK-domiciled funds under management, rising by one fifth year-on-year to a record £579bn at the end of December 2010. This was partly a reflection of asset mix and market movements, but also results from significant inflows.

Within the survey, we refer to assets under management as a 'catch-all' term covering all forms of management activity, both funds and segregated mandates. Where we are referring specifically to UK-authorized funds (unit trusts and OEICs), we use the term funds industry.

Chart 2: Total assets under management in the UK and in UK-authorized funds (2005 – 2010)

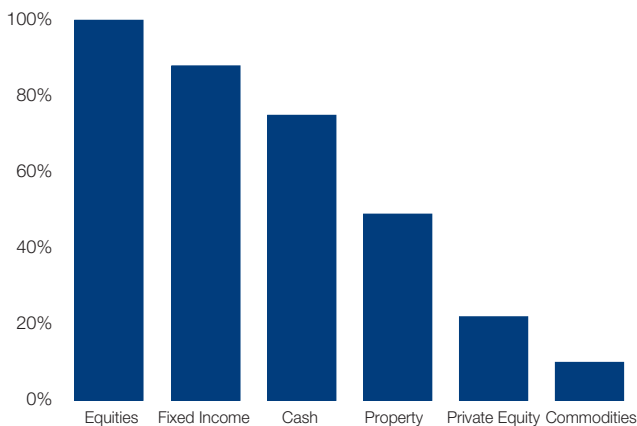


Wider Industry

IMA member firms operate across both the mainstream and alternative asset management spectra (see Chart 3):

- Almost all respondents to the survey manage equities, a substantial majority have fixed income capabilities and half run property mandates. A number of IMA firms also have specialist cash management expertise as opposed to those who are holding cash within portfolios for operational or diversification reasons.
- Survey returns suggest that IMA member firms manage no more than £30bn in hedge funds. This accounts for nearly 16% of total UK hedge fund assets at the end of 2010.² Private equity funds are operated by just under one-fifth of respondents.

Chart 3: Proportion of survey respondents managing different asset classes in the UK

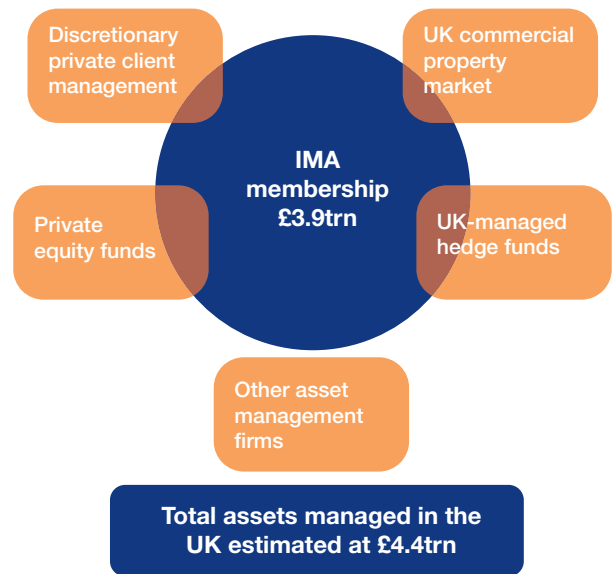


We estimate that IMA members account for 85-90% of total assets managed in the UK, with the total at £4.4trn (see Figure 2). The remaining components not covered by this survey are a range of niche firms outside the IMA membership base, notably:

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

There are also some mainstream asset managers who are not IMA members.

Figure 2: Wider asset management industry

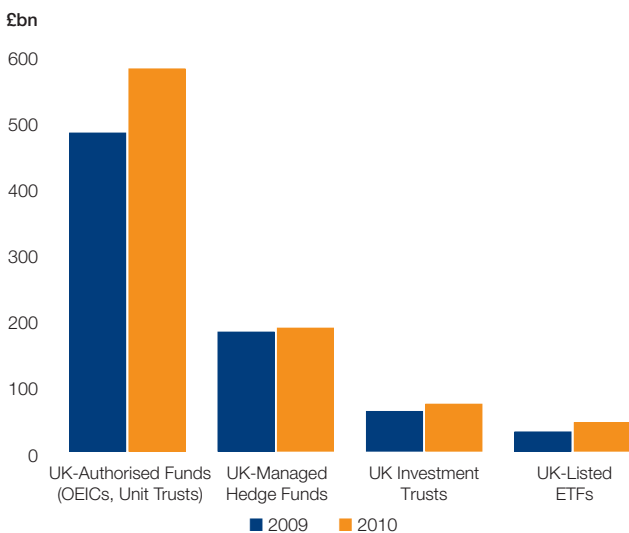


² Source: HedgeFund Intelligence.

As a proportion of total assets under management in the UK, hedge funds managed here remain a comparatively small part in asset terms with only £185bn in 2010. They are, however, significant in terms of export earnings and additional employment through around 400 firms based in this country.

While there has been a considerable focus on the rise of exchange-traded funds (ETFs), these also remain comparatively small in asset terms, when compared to the mainstream asset management industry (see Chart 4). Nonetheless, growth data from the ETF industry globally, and comments in interviews, suggest that this is an area that will continue to grow strongly, albeit from a low base in the UK.

Chart 4: Assets managed in a range of UK fund vehicles (2009 – 2010)



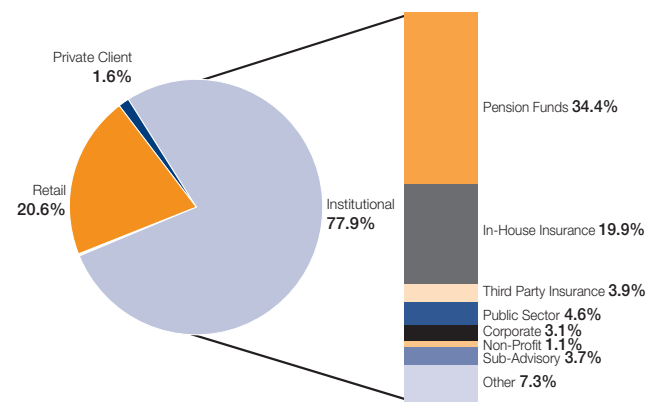
Source: IMA calculations based on data from the IMA, HedgeFund Intelligence, AIC, BlackRock

Client Type

Chart 5 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. We have introduced new categories this year in order better to segment the market, and we report in more detail on the UK institutional client market in the second part of this chapter:

- Institutional assets under management continue to account for just under 80% of the total, with the largest segments being pension funds (34% of total assets under management) and insurance companies (24%).
- After pension fund and insurance mandates, retail (21%) continues to represent the third largest client type.³
- Private client money accounts for nearly 2% 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).
- The other institutional category is concentrated on pooled assets where it has not been possible to identify the client. These include a range of funds, eg. investment trusts.

Chart 5: Assets managed in the UK by client type



³ 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 explains why the percentage share here is larger than implied by the IMA monthly data.

Chart 6 shows the split by client type since 2005 when the IMA started to collect the data in this specific format. These are headline numbers and therefore subject to some sample fluctuation. Nonetheless, they are highly representative of the industry and two features of the historic progression are quite striking:

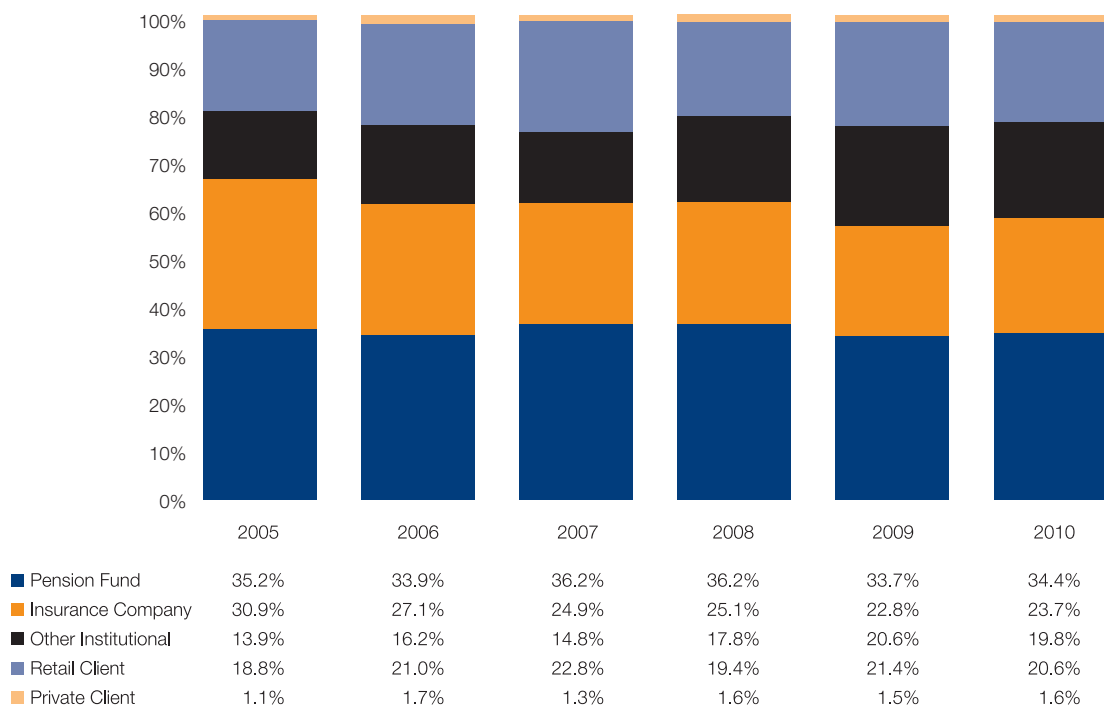
1. Rise in ‘other institutional’ categories. The proportion accounted for by the ‘other institutional’ category has increased steadily in recent years. This appears to reflect a number of factors. To some extent, there has been a broadening of the asset management industry’s international client base beyond traditional institutional categories (pension funds and insurance companies). Internationally, opportunities for third party asset managers are becoming ever more extensive, both in the corporate and public or quasi-public sector (see p. 80).

There is also increasing use of pooled vehicles by institutional clients, driven by a variety of factors, notably:

- The move into passive, where different forms of pooled vehicles can be accessed.
- Openness to specialists who may operate primarily through pooled vehicles. A number of firms previously associated more with the retail environment have in recent years reported institutional business in areas of excellence.
- The rise of multi-manager products, where the end client may be retail, but the relationships between managers and sub-managers are essentially institutional.

Points two and three are a particular feature of the wider trend towards the blurring of the retail and institutional markets.

Chart 6: Assets managed in the UK by client type (2005 – 2010)



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 five years. These assets are primarily run for life insurance parent companies and include products such as life funds and annuities.

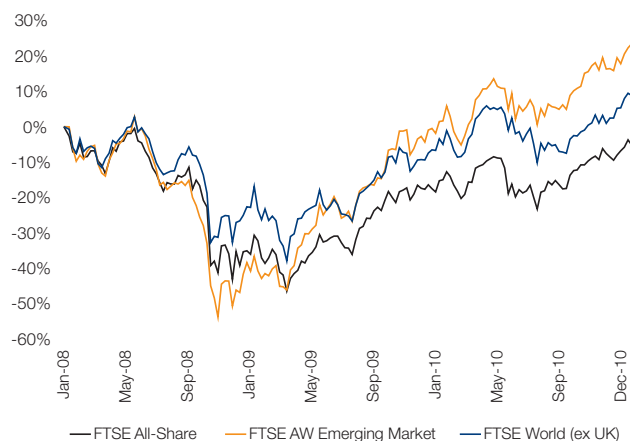
Looking back on the data in terms of total assets under management, the decline is relative rather than absolute. Figures from 2005 suggest total insurance assets under management by IMA members of £852bn, rising to £934bn in 2010 (an increase of 10%). Meanwhile, pension fund assets managed in the UK increased from £973bn to £1,355bn (39%) and the other institutional category, discussed above, doubled from £385bn to £779bn (102%).

Assets and Markets

The key theme running through 2010 was uncertainty about the direction of the global economy, despite two strong years for equity markets since the lows of the first quarter of 2009:

- Over the course of 2010, the FTSE All-Share rose 11% in capital return terms and almost 15% in total return terms (see Chart 7).
- Average stock market levels were 21% higher for the FTSE All-Share, which was positively reflected in industry revenue.
- International equity market indices also rose strongly, with notable gains in emerging markets, albeit at a slower pace than in 2009. The FTSE All-World Emerging Markets index rose 21%, having gained almost 60% over 2009.
- In the fixed income markets, corporate bonds performed less strongly than in 2009, with the IMA sterling corporate bond sector returning 7% over the year (14% a year earlier). However, with interest rates remaining low and inflation concerns persisting, the 'hunt for yield' remains an ongoing theme in investor behaviour (see also Chapter Three, p. 44)

Chart 7: Equity market movements (2008 – 2010)

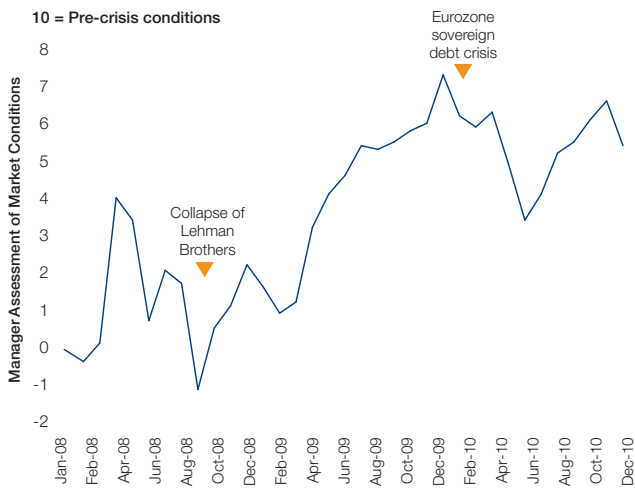


Source: Lipper IM (calculated on a capital return basis)

As this survey went to press in the summer of 2011, there were very mixed signals for the likely outcome for this year. Chart 8 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 of up to 10, where this level represents pre-crisis market conditions.

Last year saw a sharp recovery through the second half, after an unstable first half during which emerging fears about the sovereign credit crisis caused banks to unwind risk on their balance sheets. While 2011 started well, there are signs that the index is starting to falter as worries intensify once again over European sovereign credit, particularly in Greece.

Chart 8: Asset manager assessment of general conditions in fixed income markets (2008 – 2010)



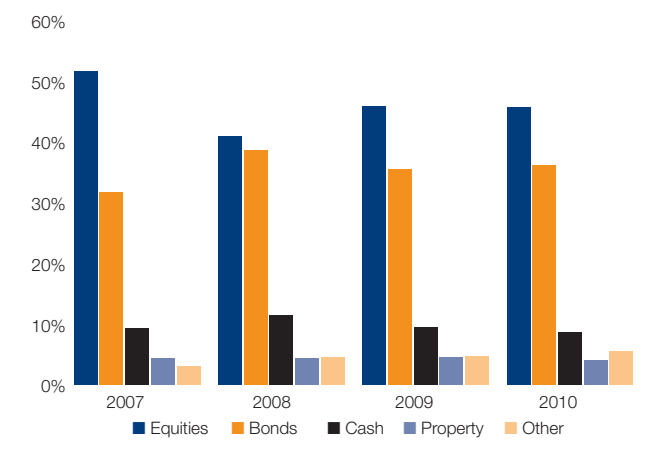
Source: IMA

Overall Asset Allocation

The overall mix of assets managed in the UK at the end of 2010 is shown in Chart 9, which also shows the progression from 2007:

- The changes in 2007-2008 were consistent with a shift out of equities towards fixed income, cash and LDI products.⁴ This appeared to result both from ongoing trends in institutional behaviour and a ‘flight to safety’ response, reflected in the rise in cash holdings.⁵
- The 2008-2009 changes are less pronounced and more consistent with aggregate market movements than significant shifts in overall client asset allocations.
- In 2009-2010, the changes are consistent with a movement out of cash, but also further movement, or at least rebalancing out of equities to the benefit of fixed income. While there is evidence that this reflects further adjustments in UK pension fund client behaviour, it is difficult to draw firm conclusions from aggregate data based on a range of client assets managed from this country, and therefore influenced by many different parts of diverse international markets.

Chart 9: Overall asset allocation of UK-managed assets (2007 – 2010)



⁴ 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.

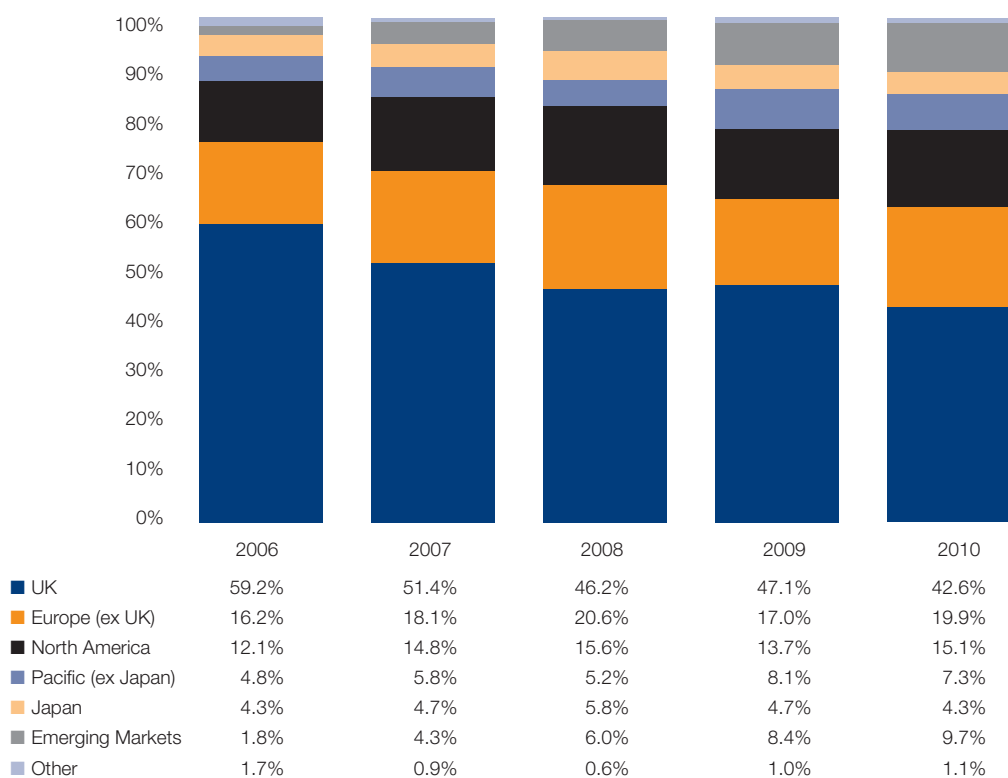
⁵ The cash category includes money market funds.

Equity allocation

The equity split by region is shown in Chart 10. Most striking in recent years has been the decline within equity holdings of UK equities, as the erosion of home bias by UK 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 the total UK equity market (41% in 1999, compared to 26% in 2008).⁶

The proportion of UK equities relative to the overall basket of equities has fallen again during 2010. Four years ago, UK equities represented close to 60% of total equities managed in the UK. This figure has now dropped to 43%. We estimate that IMA members now account for just over 38% of UK domestic stock market capitalisation, equating to £768bn.

Chart 10: Equity allocation of UK-managed assets by region (2006 – 2010)



⁶Source: Office for National Statistics, Share Ownership Survey 2008.

Looking back to 2006, the other striking feature of equities managed in the UK has been the increasing proportion of emerging market and Pacific (ex Japan) equities. A number of UK managers will also be running emerging market and Pacific mandates outside the UK, particularly in Hong Kong and Singapore.

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Major shift to emerging markets

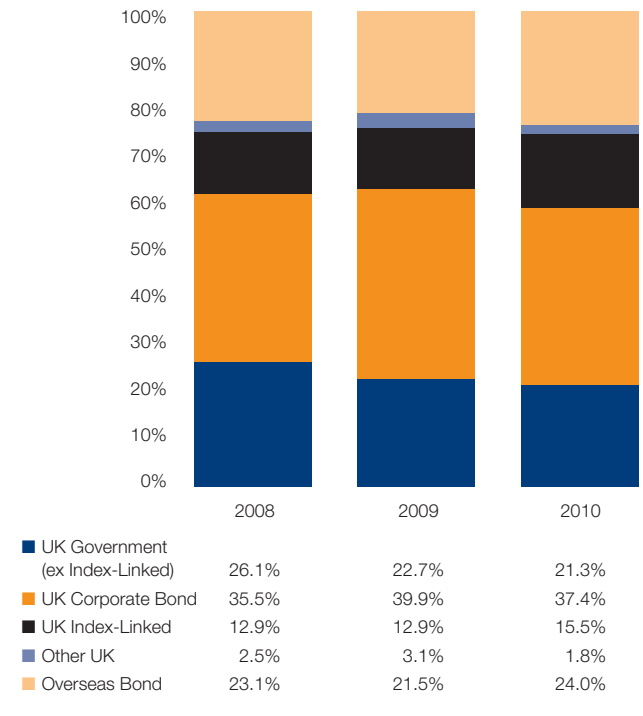
“ We have seen, both among UK clients and elsewhere around the world, the appetite for emerging market equity and debt continuing to grow strongly. There is a very strong mood to make larger and more explicit allocations to emerging markets. This is no longer about a small proportion of assets – to have 2-3% optionally – but about a strategic asset allocation, also evidenced by people increasingly saying that they will benchmark performance against ACWI (All Country World Index) rather than traditional developed markets.

All financial asset structures are susceptible to bubbles and it’s entirely possible that we’ll get a bubble in emerging markets. But the fundamental difference is that people now recognise that in terms of geo-political and economic realities, the level of wealth creation and need for wealth preservation in emerging market economies is dramatically larger and more sustainable than it was in previous times.”

Fixed income allocation

In terms of fixed income, the overall allocation is illustrated in Chart 11. The majority is sterling investment, with government and index-linked bonds accounting for 37% of the total.⁸ As a proportion of total gilts (including index-linked) in issue, this represents 53%.⁹ The fall in gilt holdings relative to index-linked over the past two years is particularly notable. Equally notable is the increase in UK corporate bond holdings since 2008, although as a proportion of overall fixed income managed in the UK, UK corporate bonds fell back in 2010.

Chart 11: Fixed income allocation of UK-managed assets by type and region (2008 – 2010)⁷



⁷ Earlier data is not available due to a change in reporting.

⁸ With large insurance-owned asset managers strongly represented in the respondent sample, the implied gilt (incl. index-linked) holdings may over-state the true position. The same is true of UK corporate debt holdings.

⁹ Based on market values net of Government holdings as at December 2010.

Evolution of Industry Focus

In our 2006 Survey, a year before the onset of the credit crisis, we pointed to eight key long-term trends in the industry. In many respects, these trends remain valid in 2011 (see Figure 3). However, in the past couple of years, the Survey has reported interview respondents focusing on a perception that client needs must be addressed more explicitly, even as the retail industry is

increasingly intermediated. We suggested that the limitations of the component-driven, specialised approach were increasingly apparent to a range of players within the industry. We also reported that a number of asset management firms were looking to a different role in helping their ultimate clients achieve their investment goals, particularly in the pension fund environment.

Figure 3: Key themes four years on

2006 – 2007 IMA Survey Findings	2010 – 2011 IMA Survey Findings
Greater polarisation brought about by alpha and beta separation and the commoditisation of certain beta products.	Intensification of separation and commoditisation as the ETF market develops.
Specialisation/fragmentation as active managers focus increasingly on alpha-seeking in specific asset classes, but signs of emergence of 'new balanced' approaches.	Wider acknowledgement of the limits of specialisation and significantly increased interest across the industry in asset allocation and multi-asset products.
Greater diversification as clients look towards wider sources of return (eg. hedge funds, infrastructure, commodities, private equity).	Ongoing client interest in alternative asset classes.
Convergence in certain areas between the hedge fund environment and 'mainstream' asset managers (eg. increasing demand for absolute return funds) and between the retail and institutional product offerings.	Ongoing signs of convergence, evident not just in certain forms of investment technique and objective, but in fund vehicles with wider use of UCITS powers.
Liability preoccupations driving the development of a range of LDI products designed to help pension schemes better manage their funding difficulties.	LDI continuing to grow substantially. An increasingly crowded commercial space as asset managers and consultants compete to offer a range of fiduciary and implemented consulting services.
Increased intermediation as new forms of fund distribution and assembly mechanisms emerge, turning asset managers increasingly into manufacturers selling their products through professional buyers in wholesale relationships.	Ongoing growth of platforms as a core distribution vehicle. Evolution of open architecture accompanied by a growing focus on guided architecture, particularly in the context of DC platforms.
Ongoing Europeanisation of the regulatory and commercial operating environment.	While changes in the commercial landscape remain uneven and slow, the European regulatory agenda is increasing significantly in the aftermath of the credit crisis.
Globalisation as a combination of new client and investment opportunities are provided by the gradual liberalisation of the international economy and by demographic shifts favourable to an enhanced savings culture.	Long-term secular shifts remain intact, with growing recognition among clients of a shift in global economic growth dynamics and consequent re-allocation of capital towards emerging markets.

Are clients getting the experience they expected?

“ One of my questions coming out of the 2007-08 dislocation was: did the clients that have invested in the markets and used our industry for their long-term savings and prosperity get the experience that they expected? Some did but a lot of them didn't. Why? Is it that they haven't understood the product offerings, have they not been positioned properly by the seller, has it been too industrialised? I don't think the industry behaved poorly, but I do question whether it has thought enough about what the client really needs. ”

“ I do think that our reputation as being trustworthy custodians of people's money is something we want to build on. It's going to be much more than saying: 'Here's the index, we've out-performed it and are top quartile in our peer group!' So, if you're 64 years old and closer to retirement, how are you going to deal with this? How will you convert the pension into an income stream? There will be a different role for asset managers. ”

Sitting behind this shift in emphasis is the observation that some clients may not have been best served by investment goals such as outperforming standard market benchmarks. At the same time, the value of those benchmarks even for specialised mandates has been increasingly questioned. There are a variety of responses to this:

- Greater use of absolute or target return products.
- Further development of unconstrained or benchmark-unaware strategies.
- A focus on tailored, more outcome-oriented approaches, particularly for individual pension funds.

As we pointed out last year, solution propositions represent an attempt by some asset managers to deploy their intellectual capital differently, reasserting their expertise base and developing their capabilities. While this has been given greater impetus by the dislocation of the credit crisis, it is also the culmination of broader trends, notably changing demographics and evolving regulatory demands on pension schemes.

Impact of demographics and regulation

“ A combination of demographics and regulation, particularly accounting regulation, creates a greater focus on liability matching as opposed to benchmark matching. For individuals this means that people are approaching retirement, and so they're moving out of an accumulation into a decumulation environment. For institutions it's maturing DB pension funds where it used to be about new joiners and growing assets, and now it's about winding them down.

That gets you focused on outcomes, and you care less about what the various benchmarks are. If you're focused on the outcome you ask yourself 'who can help me with that outcome', and institutions may decide they want to speak to a fiduciary manager or a consultant. ”

Three areas stand out in particular:

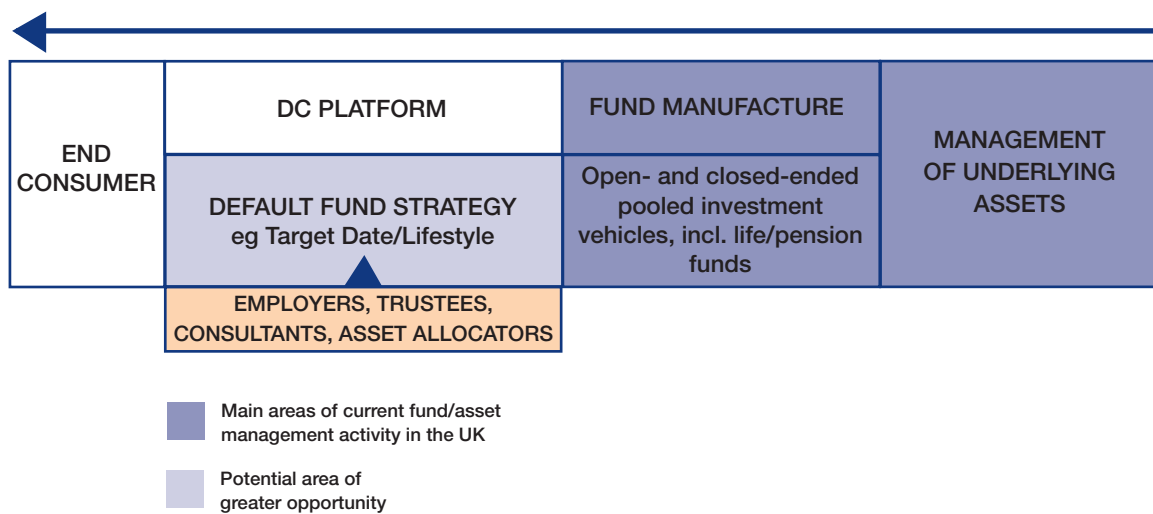
1. Defined benefit (DB) pension scheme liability matching.
2. The evolution of defined contribution (DC) default fund strategies (see Figure 4), where the UK market is not yet as mature as other parts of the world, particularly the US.
3. Broader risk mitigation/capital preservation strategies for clients, such as absolute return.

Commercially, this points to firms within the industry potentially offering a number of different product sets. Depending on their capabilities, some may be active in all areas:

- **Investment components**, either passive or active, which can be used as part of wider investment strategies whose outcome is not necessarily related to the fund objective.

- **Packaged solution provision** via pooled vehicles, such as target date funds with fairly specific goals related to investor savings requirements. These vehicles may operate via single- or multi-manager approaches, with multi-manager becoming increasingly popular with investors in the retail market (see p. 52-53).
- **Bespoke solution provision** that may involve services beyond asset management, such as asset liability modelling or manager selection. This is an increasingly crowded marketplace where asset managers, consultants and investment banks find themselves jostling for position as they offer fiduciary or implemented consulting services.

Figure 4: Potential opportunities in the DC pensions environment



Improving Client Trust

Clearly, as in all industries, trust is a key component of client relationships. The majority of firms we spoke to believe that more could be done by the industry in this area. One immediate concern in the context of the credit crisis is the need to distinguish the asset management industry from other parts of the financial services industry and to ensure that clients better understand what firms are trying to achieve on their behalf. This implies a significant communication task for asset managers.

At the same time, transparency is felt to be particularly important in the context of an investment environment characterised by:

- Increasingly sophisticated investment objectives and delivery mechanisms.
- End consumers who frequently lack a strong understanding of investment products, but who will be increasingly exposed to those products (particularly through DC pensions).
- Increasing degrees of intermediation, putting ever greater distance between asset or fund manager and end client.
- More intrusive regulation.

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Trust issues and identity

“The industry is suffering from a lack of trust and consumers tell us. Individual companies may not have a problem because, typically, the customer says ‘I don’t trust others, but my firm is good’. There’s a big difference between the general and the specific in customer trust and the closer you get to the individual choice that the customer’s made, the greater the trust. So you could say that trust is strong if you’ve had a strong brand and if you’ve kept up your client communication.

But as an industry we’re now ranked as low as banks. And in Europe, the reason is because many are owned by banks and therefore the differentiation as to whether it was the product that failed or the bank advice or the bank, the consumer doesn’t know.”

“Even the most sophisticated investor can’t distinguish properly between the role of investment management, investment banking and retail banking. We have senior policy-makers that confuse this, so what chance has the consumer? If you asked an ordinary person to name five investment managers they’d struggle, and even then they’d probably name those owned by investment banks.”

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The importance of transparency and communication

“We need to get the essence of the product and the risk in a simple, digestible form, and we need to be available to answer questions. One of the biggest frustrations that I have is that we do produce a lot of information, some of it regulated almost to the point of being impenetrable, but the problem is that it doesn’t reach the customer. So the big challenge that we haven’t grappled with is how we form a direct communication relationship with our customers without undermining the role of good quality intermediation and good quality advice. After all, we’re not advisers in the retail space.”

“One of the things that has really accelerated is the erosion of that artificial distinction between long-only and alternative. We’ve got hedge fund managers launching long-only funds and active managers launching hedge funds and absolute return type funds. I don’t think it is just a question of marketing in terms of working with the customer to make sure they understand what’s going on and they’re protected. It’s also incumbent on our industry to ensure that due diligence on portfolio construction, on all the operational issues – particularly surrounding the use of derivatives in these funds which are an efficient means of constructing a portfolio – are of the highest order.”

Transparency is a particular concern in the retail space and has been expressed consistently to us by a small number of interviewees in the last three surveys as absolute return funds have grown in popularity (see p. 51). While absolute return remains extremely small as a proportion of overall investment funds under management (less than 3%), there is no expectation that investor demand will diminish for products that attempt to move towards more tangible return objectives than the traditional index benchmark.

Furthermore, an emerging trend towards the use of UCITS¹⁰ vehicles for less mainstream strategies (eg. by hedge funds) also worries some of those to whom we spoke with respect to potential threats to a highly successful international brand.

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Reputational risk

“If we’re moving into target return or absolute return funds, it’s incredibly important that, in terms of building the industry’s trust and reputation, we make sure we’re putting stuff into the marketplace that stands a reasonable chance of doing what it says on the tin. We need to be as transparent as possible about the way in which these portfolios are put together.”

“The problem is that it’s quite hard to manage expectations for these things, both internally and externally, and it does worry me about the industry in general that there is a potential for disappointed expectations when people buy what they perceive as absolute return products. We hope that most of the assets are going to be uncorrelated, but they’re obviously not going to be all uncorrelated in a crisis. The ‘diversified growth’ name applies to a very wide variety of approaches at the moment, so it’s an area where it’s easy for people to get something different from what they thought they were buying.”

“UCITS had an extraordinary run and it really ought to be considered one of the major successes of the European single market initiative. On the other hand, I think there’s every chance that this gets thrown away over the next few years amid all the pressure for more flexible investment strategies. At some point, some UCITS fund will go down, having done something really stupid, and people will wonder how on earth we allowed it to happen.”

A number of interviewees also identified cost control and charges as an issue that the industry should consider more carefully. This is clearly a contentious area with some strong views both within and outside the industry, which raises the broader question of cost versus overall value for money, and how this can be measured.

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Cost control and value for money

“I would not pay two-and-twenty to anyone, not even myself. In a world of low nominal returns, I do think we, as an industry, have to keep a control over cost. Otherwise, too great a share of the gross return is going to us and not enough to the end client.”

“The danger is that people only focus on the cost rather than getting value for money and the worst outcome from my point of view would be rushing into passive because they think it’s cheaper but then actually ending up with high risks relative to their wealth because they’re positioned in expensive stocks. But we, as an industry, don’t have the right to tell them what to do.”

¹⁰ UCITS refers to the Undertakings for Collective Investment in Transferable Securities Directives.

Finally, as we reported last year, those we interviewed generally made the observation that clients were increasingly scrutinising asset managers, particularly around investment process and operational risk issues. In this respect, trust is also linked to being able to satisfy client concerns in these areas and firm size was once again cited as an increasingly important factor (for further comment, see p. 74).

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Greater client scrutiny

“If you look at the due diligence that we are subject to in terms of our institutional mandates, it is much more focused on risk and operational management than it was before. On a scale of 1-10, the focus of due diligence visits to our headquarters is 7.5 on operations and risk management and 2.5 on performance. It’s exactly the reverse of five years ago. Clients are much more concerned about the health of their asset managers, banks and financial counterparties than they were before.”

“Our clients are asking for more information. The risk management that we develop internally we also use in our marketing and communications so it meets our internal requirements as well as the new requirements from our clients. This is another consequence of the greater focus on risk. Everyone expects to have information instantly about every possible kind of risk, including liquidity, which has not been focused on as much before.”

“There’s greater scrutiny, not only regulatory but also from the client side. Clients want to know where the company they’re dealing with will be 12 months from now. And it doesn’t fit in with the current perception of ‘big is bad’ and ‘boutique is good’ so maybe there’s going to be a rethink around that.”

Taken together, these developments create a range of opportunities, but also challenges for asset managers (and other players in the market):

1. Effective innovation and delivery without over-promising.
2. Effective communication, particularly in a highly intermediated retail environment.
3. Effective competition with other players and the maintenance of a level playing field.
4. Potential vulnerability to reputational damage in the event of product failure within the broader industry (see in particular the discussion on ETFs, p. 77).

2. UK Institutional Market

Key Findings

Market size

- The UK institutional market as served by IMA members (regardless of where assets are managed) is estimated at £2.2trn, with the overall market estimated at £2.4 – £2.5trn.

Client type

- Within the UK market, pension funds and insurance companies continue to represent the largest institutional client types for IMA members, with 50% and 34% of institutional assets respectively.
- The third largest client type is the 'Other Institutional' category (9%) which consists primarily of pooled assets. While it is not possible to identify the underlying client type in this category, the majority is likely to be institutional clients.

Asset allocation

- Over 38% of third party institutional client assets are invested in equities, with fixed income representing 37%. Multi-asset mandates account for nearly 11%. 'Other' specialist mandates represent almost 8% and consist mostly of LDI and alternatives.
- The geographic distribution of specialist institutional equity mandates clearly exemplifies increasing internationalisation (only 36% by value of their assets are invested in UK equities). As one would expect, fixed income mandates remain strongly focused on the domestic market with 84% of total assets invested in UK bonds.

Separation of alpha and beta

- Passive institutional mandates account for 38% of total third party institutional client assets, with 41% of total pension fund assets managed by IMA members on a passive basis.

Specialist vs multi-asset

- Specialist mandates account for almost 90% of total third party institutional client assets. Despite an increasing client focus on multi-asset and flexible strategies evident from interviews, there is little evidence of significant change.

Outlook for the UK institutional market

- Boundaries within the industry are becoming increasingly blurred, with traditional and alternative as well as retail and institutional sectors converging.
- The upcoming automatic enrolment reforms in the UK present an important development for UK retirement provision and savings behaviour more generally. For the asset management industry, there are both challenges, particularly in terms of product development, and commercial opportunities.

2. UK Institutional Market

In the last Survey, the broad message was 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 focus on liabilities and putting in place viable solutions for meeting these.
- An ongoing move out of equities by occupational pension schemes and a continued erosion of home bias in remaining equity holdings.
- An interest in absolute/total return strategies and alternative asset classes.

These all remain true in 2010. However, as we explored in the previous chapter, a theme that has come more to the fore in this year's Survey has been that of how to ensure greater flexibility in terms of investment decision-making processes, moving away from more static, traditional benchmark-driven asset allocation approaches, particularly for pension funds, towards more tactical management. According to those we interviewed, this is seen in a number of ways:

- Greater interest in multi-asset investment strategies among institutional clients.
- Greater openness among clients to benchmark unaware processes.
- Growth of interest in fiduciary management/implemented consulting.
- Changes in internal pension scheme governance, with a number of schemes appointing in-house CIOs.

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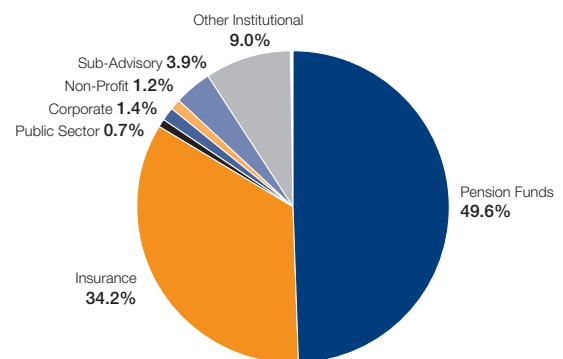
Towards greater flexibility

“The manifestation of diversified growth, implemented consulting and fiduciary management may be the same phenomenon in different guises. It's the same desire to transfer the responsibility for tactical decisions to a more nimble organisation. A number of the larger plans in the UK have also formed small committees or appointed CIOs.”

Overview of UK Institutional Data

This year, we have started collecting data specifically on the UK institutional client base (see Chart 12). It includes mandates from UK clients, regardless of where the assets are managed. Our first estimate of the size of the UK institutional market served by IMA members is £2.2trn.

Chart 12: UK institutional market by client type



Of this, nearly a half is managed on behalf of pension funds, with insurance companies accounting for just over 34%.¹¹ The majority is in-house insurance (30% of total assets), with third-party insurance accounting for 4%. The wide usage of institutional pooled vehicles by clients has complicated precise estimates of client assets in that around 9% of assets are in pooled vehicles where managers were unable to make a client determination (eg. unauthorised unit trusts, investment trusts). Those were the majority of assets classified under the 'Other Institutional' category.

Taking account of non-IMA members and using external sources of information on institutional clients, we estimate that total UK institutional assets under management are in the region of £2.4 – £2.5trn. IMA calculations suggest that total assets for UK DB schemes accounted for £1.2trn as at the end of 2010 with occupational DB and DC together accounting for £1.3 – £1.4trn.¹²

¹¹ Pension fund data primarily includes occupational (ie. trust-based) schemes and covers DB and DC across corporate pensions, local government pension schemes and other schemes such as charities' pension funds. A more detailed breakdown is provided in Appendix Two. However, the complex nature of pension provision in the UK means that DC assets, as seen by asset managers, will be accounted for in both the pension fund and insurance categories. Investment into pooled vehicles also makes some DB and DC money difficult to identify.

¹² This estimate is arrived at using data from the DCLG, LCP, NAPF, ONS, TPR and PPF.

Overview of Third Party Institutional Business

This section presents an analysis of third party UK institutional assets (as managed by IMA members).¹³ We estimate the total to be £1.5trn. For more detail see Appendix Two.

Asset allocation

The overall institutional asset allocation data is shown in Chart 13. Within the sub-components, there are striking contrasts between pension schemes (see Chart 14), with local government and 'Other' pension schemes still more exposed to both equities and multi-asset solutions than corporate pension funds. The combined weight of the fixed income and 'Other' categories for corporate pension funds illustrates the extent of both bond holdings and LDI mandates, the latter of which remain concentrated in a small number of firms. We estimate LDI assets under management on behalf of UK pension schemes at £200 – £250bn.

Chart 14: UK pension fund mandates by asset type ¹⁴

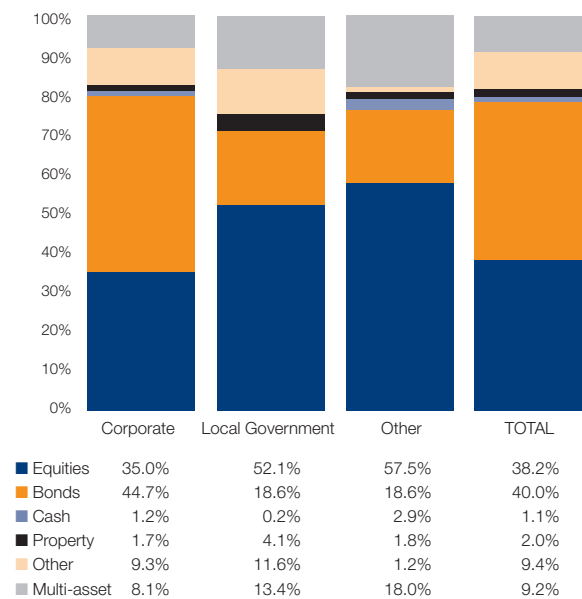
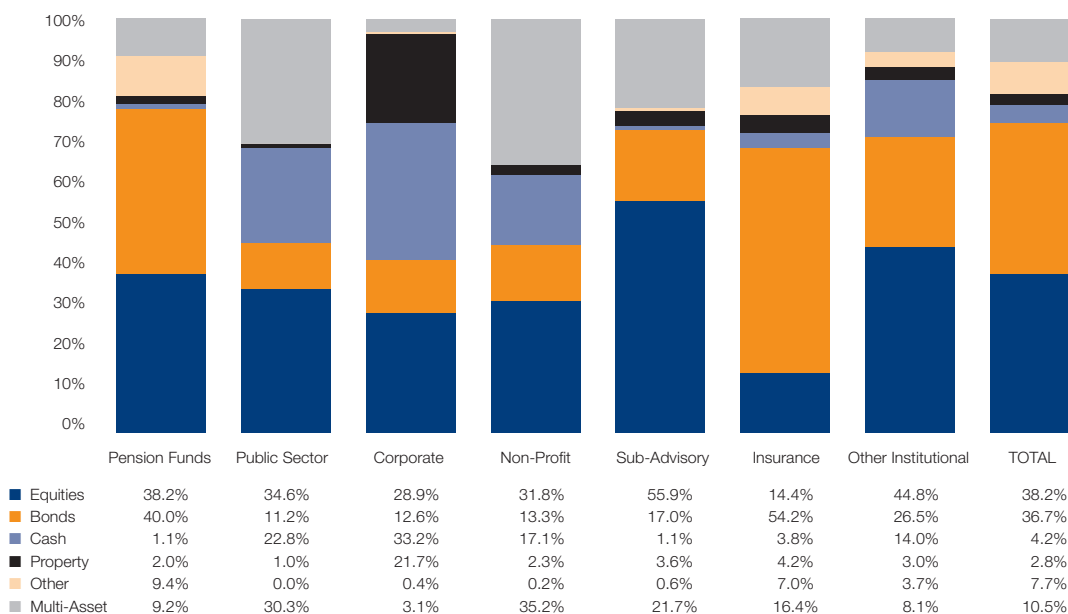


Chart 13: UK institutional mandates by asset type



¹³ Third party excludes the in-house insurance category and internally-managed OPS.

¹⁴ The 'Other' category includes pension funds that do not fall into the corporate or local government segment, notably those operated by non-profit organisations (eg. charities, trade unions).

Looking at the geographic split of specialist equity mandates (see Chart 15), UK pension funds are well down the path of international diversification, with UK equities accounting for only 36% of specialist mandates (by value of assets). This is the same proportion as for the total UK third party institutional client market, and is evidence of an erosion of home bias that was a strong characteristic for many years. While we do not have a historical dataset for UK mandates split out by global vs specialist overseas, it is apparent that global rather than specialist international equity mandates are increasingly popular as clients try to take advantage of broader opportunity sets. This is also linked to rising interest in unconstrained mandates.

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Popularity of unconstrained mandates

“The challenge for firms is to reorganise themselves for a world where asset allocation structures are going to shift much more, and to make up their mind as to whether they are going to stay a component provider with a narrow niche or whether they’re really going to embrace more holistic fund management. The other thing is, if you start making dynamic asset allocation decisions, somebody somewhere is going to get it wrong. Closet indexing – which is what so much of the industry has done when you have been asked to just beat the All-Share index – can’t be done in this kind of world. In fact, some of our strategies no longer have any market benchmark whatsoever.”

“Benchmarks have done a terrible job for people, compelling them to allocate a large amount of capital to banks at one point, and then technology several years earlier. That message has sunk in. It is inevitable that benchmark-unaware will at times underperform the index, but it’s difficult sometimes to explain to clients the framework under which we work. Consistency is very important in terms of behaviour. When you take on benchmark-unaware business, you need to explain your process and stick with it. We have won vast amounts of business from people who had a similar proposition to us and then under pressure during the credit crisis changed their process. At that point, they were absolutely dead in the water.”

Chart 15: Specialist equity allocation by client type

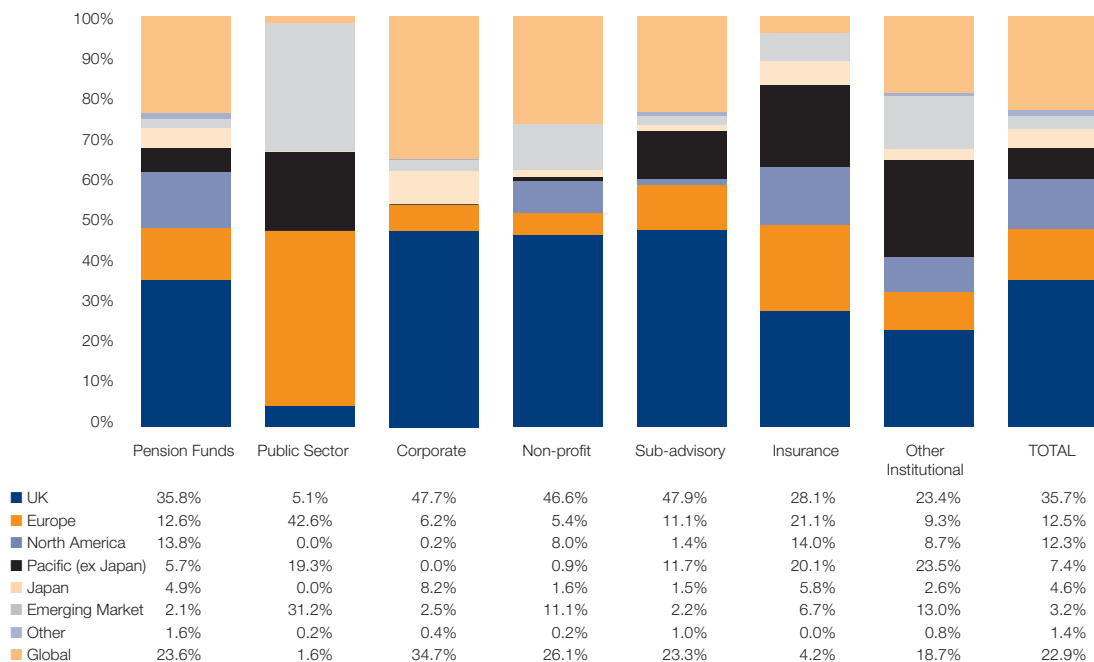
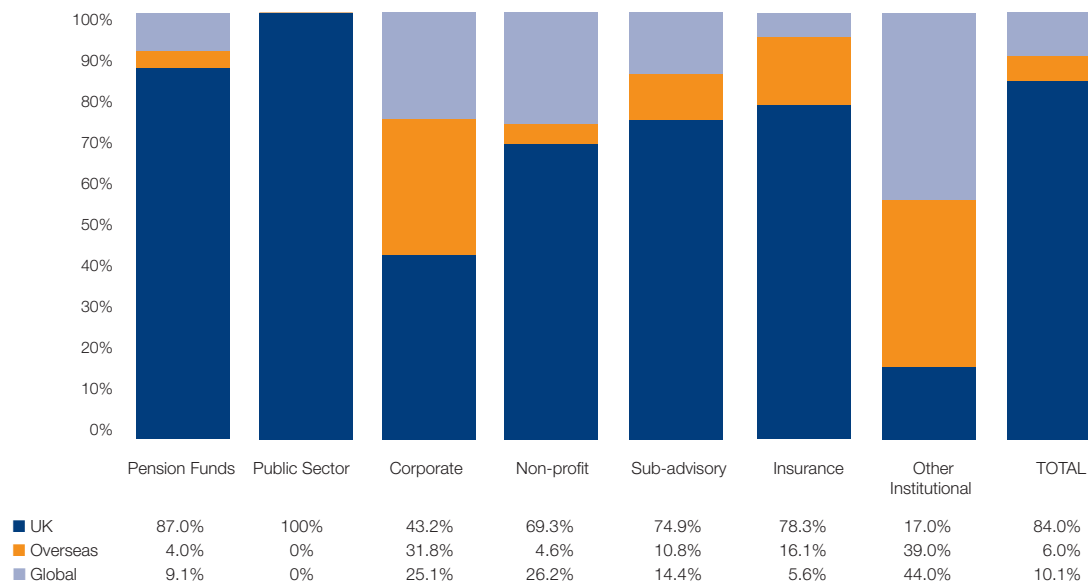


Chart 16: Specialist fixed income allocation by client type¹⁵

In contrast, fixed income mandates remain very domestically focused (see Chart 16). This is not particularly surprising given the objectives of pension funds and insurance companies (eg. indexed pension payments or annuity provision) in the context of a resolutely national inflation and interest rate environment.

Active vs passive

The overall split between active and passive is illustrated in Chart 17 overleaf. Taken as a proportion of total third party UK institutional assets under management, passive mandates represent 38% of the total, with the most extensive use seen in pension funds (41%).

In this respect, there is a strong contrast between the extent to which indexation is used in corporate pension funds (45%) and local government pension schemes (22%), with the latter still more oriented towards active management.

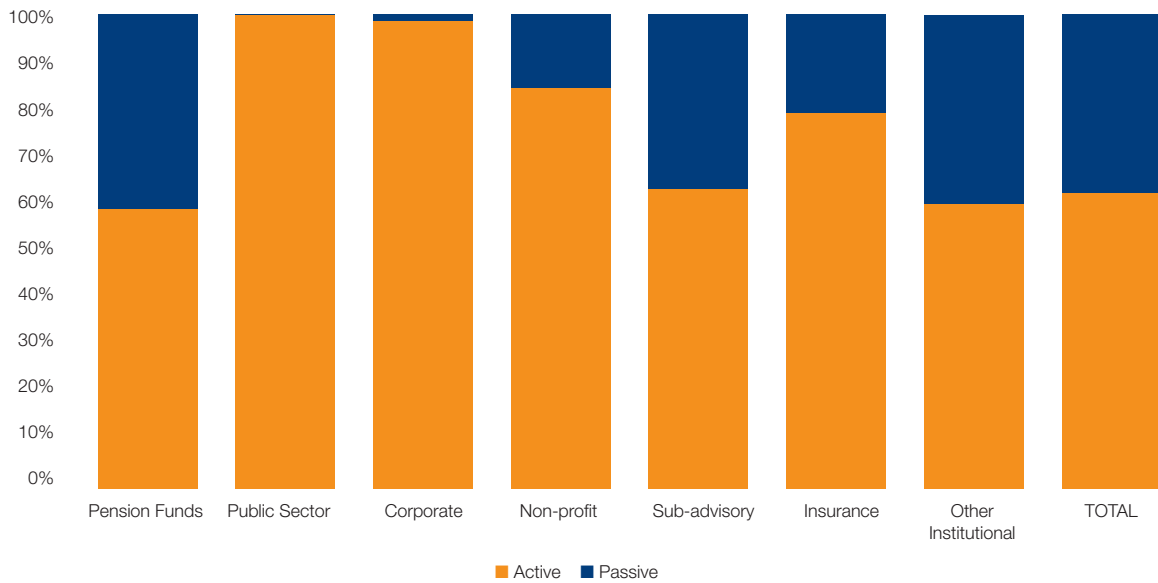
Despite the increasing prevalence of ETFs, the provision of passive management in the institutional market remains, in asset terms, highly concentrated among a small number of players. In this respect, our headline survey results are likely to over-represent the scale of passive mandates across the wider market. Measuring IMA member passive mandates against our estimate of the wider UK occupational scheme universe suggests the overall figure is closer to 30%. This estimate is more compatible with data from WM/State Street Investment Analytics, based on actual pension fund holdings data.¹⁶

Active managers we spoke to expressed the view that the active industry faced a range of challenges in the institutional market. In addition to the debate on cost vs value for money, issues include changing demands in the product space (linked partly to the solutions debate) and client frustration over timing and manager performance.

¹⁵ The results of the 'Public Sector' category should be treated with caution due to sampling distortions.

¹⁶ See WM UK Pension fund Annual Review 2010, which suggests that passive accounts for 27% of total pension scheme assets, from 17% in 2000.

Chart 17: Active and passive mandates by UK institutional client type



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Perceived dangers for active managers

Adapting to changing client requirements

“ Ultimately, it is now about the generation of a certain amount of return regardless of where you source it, and that leads to big changes. You can see them already; UK equity as a share of equity in portfolios is disappearing. I still believe there will be active management, but it will be much broader. It is one of those natural selection moments where you have enough creative destruction and enough new things coming that you may see complete change in the next five to ten years. ”

Frustration over timing and performance

“ A part of the institutional market is frustrated by active management. Some of that reflects the recognition of the difficulty of picking managers at the right time. Ideally you’d buy them after they’ve under-performed, and you’d want to sell a manager after they’ve done extremely well. That creates frustration which engenders a move to passive, and consultants haven’t really been able to challenge the natural tendency to mis-time entry into the cycle. ”

Segregated vs pooled

Chart 18 shows the split between segregated and pooled mandates. There are several notable features:

- The use of pooled funds by corporate pension funds remains much greater than that seen in local government pension schemes, with 41% and 31%, respectively (see Chart 19). This partly reflects the greater use of indexing among the former.
- Sub-advisory and third party insurance business is predominantly segregated.
- The 'Other Institutional' category, as we explain on p. 30, is primarily accounted for by pooled vehicles where it has been difficult to make a determination as to the precise nature of the end client.

Chart 19: Segregated and pooled mandates among UK pension funds

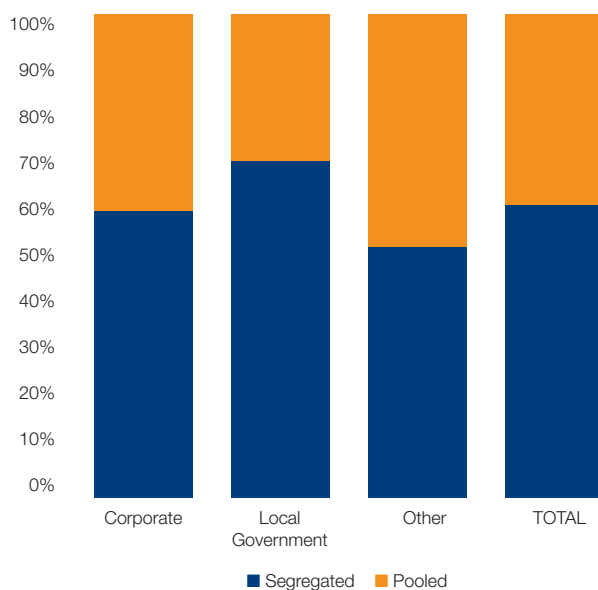
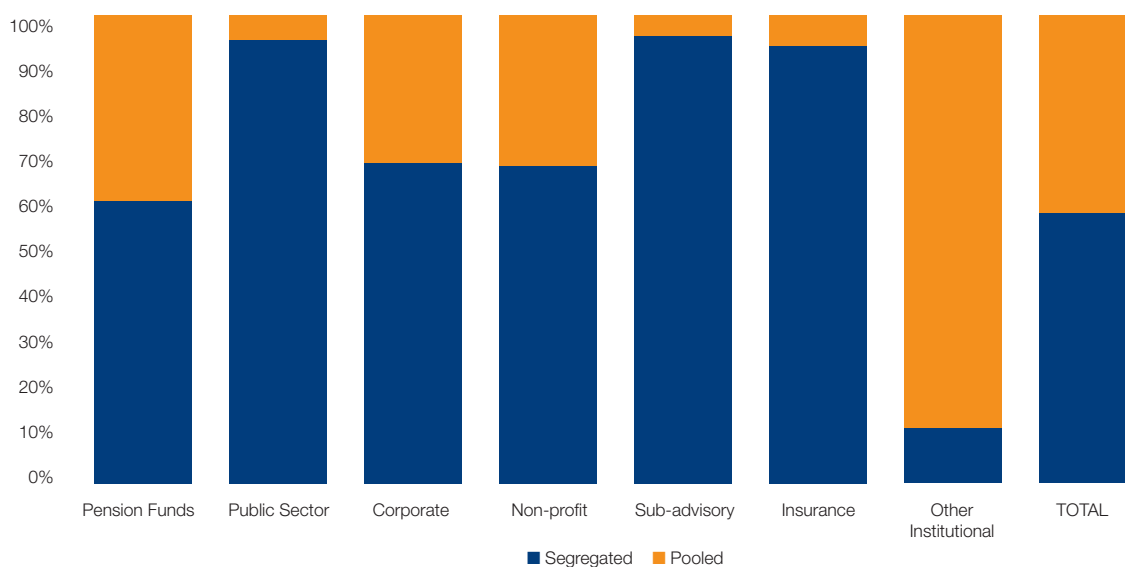


Chart 18: Segregated and pooled mandates by client type



Multi-asset vs specialist

The significant move towards specialisation in the UK institutional market seen over the last decade came after a period when asset managers had enjoyed greater control over asset allocation through wide use of balanced mandates. Since interviews began for the Survey four years ago, a small number of firms have emphasised their belief that ‘new balanced’ approaches were going to become more prominent. In contrast to ‘old balanced’, new balanced mandates tend to be characterised by greater asset class and geographic diversification, and cash- or inflation-linked benchmarks.

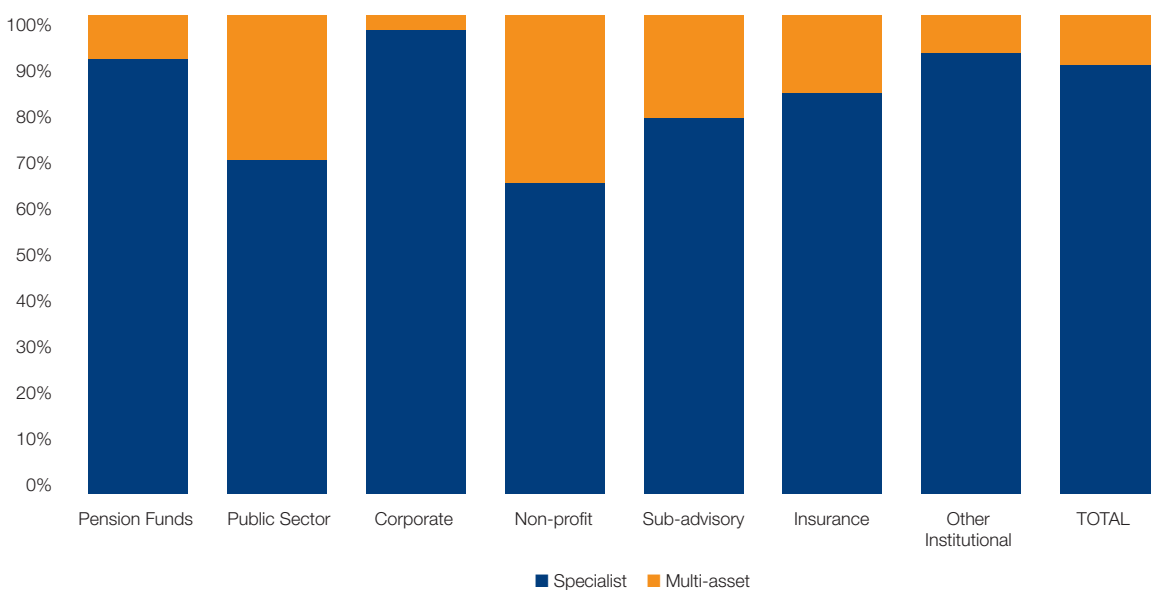
For now, our data points to specialised mandates still being dominant (see Chart 20), accounting for almost 90% of assets. However, as we point out in Chapter One, there is a growing consensus in the industry that greater involvement is needed in the asset allocation process. Especially evident in this year’s interviews has been the belief that specialisation may have gone too far. None of the firms we spoke to disagreed with the observation that multi-asset approaches were likely to become increasingly important, even if likely commercial positioning varies. While we do not yet see an extensive move towards multi-asset fund or asset

management offerings in the institutional market, it is notable that multi-asset funds are enjoying very significant interest among retail investors (see p. 52-53).

The greater focus on multi-asset within the industry is the result of a wide range of factors:

- A renewed interest among clients in approaches that can offer more flexible and tactical asset allocation, particularly in the aftermath of the crisis. This may be achieved through new balanced or diversified growth mandates, which also tend to be more outcome-focused, using cash or inflation benchmarks. Equally, it can be achieved structurally (with different commercial implications). Some pension funds are substantially boosting their in-house investment expertise or working with external advisers through fiduciary or implemented consulting arrangements.
- A belief in the industry that managers have more to offer in the asset allocation space, given the importance of this aspect of behaviour to long-term investment returns. This is coupled with a perception in some quarters that some consultants may not have performed effectively in recent years.

Chart 20: Specialist and multi-asset mandates by client type



- A conviction that asset managers are able to offer more diverse and sophisticated multi-asset solutions than previously seen in the era of the balanced mandates used by many UK pension funds prior to the specialisation trend.

This is not an issue that will be confined to DB schemes. As DC becomes increasingly significant in asset terms, attention will focus on the design of the default funds which is likely to be central to the experience of the majority of scheme members.

Several of those we spoke to also pointed out that multi-asset is a natural commercial repositioning for active managers, who may be increasingly squeezed by the move to passive in a number of developed markets.

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The appeal of multi-asset

“The new multi-asset offerings are presented in a more thoughtful way and the client is engaged. There isn’t a wholesale change, but the industry has matured.”

“All the things that have happened over the last few years have made clients realise that they need help. The old way of doing it where you’d review your equity manager every three years was quite mechanical, and all the things that have happened have made clients reach out and ask how they can make things better and who can help them do it. It might be a fund manager, it might be a consultant or it might be that the client decided to set up an investment sub-committee.”

“People recognise that, although the old strategic asset allocation model was blown up in 2007-08, diversification is key. People are revisiting multi-asset, sometimes with tail-risk hedging, sometimes with a risk overlay, sometimes with a tactical asset allocation input.”

However, not everybody sees themselves in the solutions or multi-asset space. Indeed, some specialist managers have drawn a similar conclusion about meeting client needs, while remaining focused on their core expertise. One firm commented that the big lesson of the credit crisis was that even where a client uses a specialist mandate, they expect you to think about them: “Managers need to increase their client direction capabilities. It’s not just a salesman pitching track records, it’s a conversation.”

The theme of a better conversation with clients picks up a point made in Chapter One about the need for improved communication. This is seen by firms as holding true for both retail and institutional clients, particularly in the context of the changing nature of products on offer. A number of asset managers we spoke to believe that the move towards a fiduciary route or greater in-house investment oversight is being driven by the complexity of some of the investment vehicles and strategies now being deployed.

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Challenges posed by changing investment approaches

“One big challenge is client knowledge and that is genuinely difficult stuff. It may be better for clients, but they have a loss of control when it comes to alternative asset classes. The good thing with a benchmark is that you can walk into an asset manager and say: ‘Here’s the benchmark, I see you’re 2% underweight BP or 3% overweight Glaxo’. So you’ve got an automatic frame of reference. With alternative classes, you have a range of issues arising – liquidity, valuation, duration. And very often, people can confuse what they think is a lack of correlation with a lack of liquidity.”

This remains an incredibly difficult area. Not because alternatives won’t offer good returns but it is incredibly difficult for clients to put in place a governance framework. We have at the same time seen some of the larger in-house managed funds increasing their level of in-house expertise so that they can take greater ownership of decision-making and knowledge-building across a broader range of strategies.”

Outlook for the UK Institutional Market

Much of what we report above is a reflection of the boundaries within the industry becoming increasingly blurred over the last five years, in particular:

- **Traditional and alternative.** The notion of the ‘traditional’ and ‘alternative’ asset management industries is breaking down very quickly. Mainstream investment houses are frequently using techniques and instruments that are more usually associated with alternatives (eg. long-short funds). The move by some hedge funds into UCITS structures only reinforces this. At the same time, a number of asset managers are developing increasingly sophisticated approaches to deal with the management and mitigation of longevity risk.
- **Asset management and consulting.** Asset managers are offering a broader range of services in the institutional market, seen for example through the emergence of fiduciary mandates, while investment consultants, banks and others are also looking to gain traction in this area.
- **Retail and institutional.** While the changing nature of distribution is the main reason for the erosion of the retail and institutional distinction, the greater focus on precise client needs also has the potential further to break down boundaries. Liability matching and more targeted approaches have been associated with the institutional rather than the retail market. However, as firms reflect further on DC and individual investment needs, it is starting to become apparent that comparable techniques may gradually be introduced in a part of the pensions market where the choice set for individuals gives it a more retail than institutional hue.

Indeed, DC is an area that will be crucially important for the asset management industry, even if DB remains the largest single component of the UK pensions market in asset terms for some time to come. In this respect, there are a number of significant policy developments:

- 2012 will mark a significant milestone in UK pension provision with the gradual introduction of automatic enrolment into workplace pension schemes. Although auto-enrolment has already been introduced in New Zealand, the UK exercise is likely

to be the largest of its kind ever conducted. It has also seen the creation of the National Employment Savings Trust (NEST), a government-established occupational pension scheme with a requirement for universal service provision. NEST will serve employers who do not wish to choose a pension provider in the private sector. In asset management terms, NEST will operate using the services of a variety of third party asset managers.

- 2010 saw reforms to UK retirement income regulation that has resulted in the abolition of what was effective compulsion to annuitise over the age of 75. It is expected that the reforms will pave the way for a gradual shift in the retirement income product market. This is likely to result in more drawdown and ‘third way’ products that bridge the gap between the pooled risk approach used in an annuity, and the individual risk seen in pure income drawdown products.

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The role of NEST and the commercial challenges of DC

“Pre-packaged solutions are going to be key here; 90% of participants will in my opinion go into a pre-packaged solution driven by their employers. The only big issue is NEST; what kind of competitor is it going to end up being for the private sector? It would be unhealthy for there to be only one solution in the marketplace. You need to foster competition. The big challenge with DC is whether we are going to be able to save enough money in it to pay for our retirements. There’s no way the investment results are going to generate enough return if you don’t put enough in. You can’t offset that contribution reduction with investment returns.”

“There are opportunities and it will take some time, culturally, for a mindset shift to really embrace DC. Perhaps it will be a generational shift because people in the UK are really used to DB. The 401(k) system was introduced over 30 years ago in the US and now it’s just part of the process. There’s also an opportunity for that to happen here. It will take engagement and persuasion but the market has a potential to grow. But there needs to be a fundamental shift in the thinking of an entire population.”

Interviewees also pointed to the fact that DC raises the question of the provision of advice (implicit or explicit) that we explore elsewhere in the Survey (see p. 78). This creates a range of challenges across both the workplace and individual marketplaces as individuals are faced with potentially difficult decisions that will often see the use of 'default' fund options rather than active choice.

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Advice and DC

“Just like some expensive consumer goods, advice may become available only to a relatively wealthy subset. At some point that'll have to reverse because more people need either advice or somehow advice-packaged products from us. Between NEST and the execution-only fund platforms, you're going to need more advisers again or more people who bake some fiduciary thinking into what they are selling.”

With most asset managers unlikely to build their own bundled proposition in DC, a number of choices present themselves:

- Provide components for default or self-select strategies.
- Provide solutions-based approaches (eg. target date funds) for default or self-select strategies.
- Explore products that bridge the accumulation and decumulation phases, now that the effective compulsion to annuitise has been abolished.

The UK industry as a whole is in the early stages of deciding how to position itself in the face of these choices.

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The challenges and opportunities of DC

“This is going to raise questions for some houses about what an asset manager is. In a DC world, which bits are you actually doing? Are you simply providing a fund which has a set of risk and return characteristics that has a place in a portfolio of a DC platform or do you offer something broader than that? And in particular, are you looking to influence the content of the default fund on a DC platform, and if you do that, what are the fiduciary risks that go with it?”

It's quite clear that over the next ten years we're going to see acceleration in the shift from DB to DC, a big change in the mandates that are on offer and I think there's going to be a huge increase in the competitive environment because the institutional world belonged to return manufacturers and investment consultants. The DC world is going to be very competitive; there's going to be fund managers, banks, actuarial consulting firms and insurance firms, all looking to compete in that lucrative, pretty crowded space.”

“The bull in me thinks that this is the most fabulous industry to be involved in for the next 20 to 30 years. The banks typically won't get it right for two reasons: they are mentally still savings and loans institutions and their interest in the medium-to long-term savings market is cyclical. The insurers are split into two camps, those with capital and those without. Those without capital will effectively be competing with the asset management companies. In the UK we probably have more of those than anywhere else. Those that are not capital-rich will effectively become asset management companies. Those with capital will have a huge opportunity.”

“My concern is that over the next 20 to 30 years, the degree of social and political pressure from the DC and discretionary savings market on the industry is going to grow massively. The opportunity is absolutely enormous, but I do not see an industry yet that is well geared up to make the most of it.”

3. UK Funds Market

Key Findings

Total funds under management

- Total investment funds (including both UK- and overseas-authorized funds) managed in the UK are estimated at £1.2trn.
- UK-authorized funds totalled £579bn as at December 2010, a 20% rise year-on-year.

Sales trends

- Total net sales (retail and institutional) of UK-authorized funds showed an inflow of £49.8bn compared to £34.4bn in 2009.
- This was the largest ever recorded inflow in our data, and was driven by both retail and institutional investors who invested £29.5bn and £20.2bn, respectively, during 2010.
- Retail investors further globally diversified in 2010, with Global Bonds, Global Growth and Global Emerging Markets sectors all reporting the highest net retail sales on record in 2010.

Asset mix in investment funds

- Equity funds accounted for the largest proportion of assets under management at 57% with bond funds at 17% and balanced funds at 14%. Property funds represented just over 2% of total funds under management.

UK industry concentration and structure

- Fund sales are becoming more concentrated with the top 100 funds taking 55% of total gross sales in 2010 compared with 47% in 2005.
- While the top ten firms' share of the funds market is steady, the share of the next ten firms is increasing at the expense of the smallest firms.
- Nevertheless, the funds industry remains very unconcentrated compared to other parts of the financial services industry.

European comparisons

- European investment fund assets reached a record €8.0trn in 2010 (from €7.1trn a year earlier).
- The comparative asset class mix once again illustrates the difference across European markets. The UK has a much higher equity allocation (57% of UCITS funds) compared to the European average (32%). Money market funds have a larger profile in Europe (22%) whereas they have a minimal uptake among UK retail investors (0.7%).

3. UK Funds Market

This part of the survey covers UK-authorized unit trusts and OEICs. These funds are thought of primarily as retail vehicles, although institutional investors such as pension funds and insurance companies may also invest in them. A small number of authorized funds are purely institutional vehicles. As we outlined in Chapter Two, increasing intermediation in the distribution structure makes it also harder to identify retail end clients.

The analysis in this section is based on internal IMA fund 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 flow data on a monthly basis.

As at December 2010, there were a total of 2,574 UK-authorized funds (from 2,524 in December 2009) classified in the IMA universe. The IMA collected data on 2,483 of these funds.

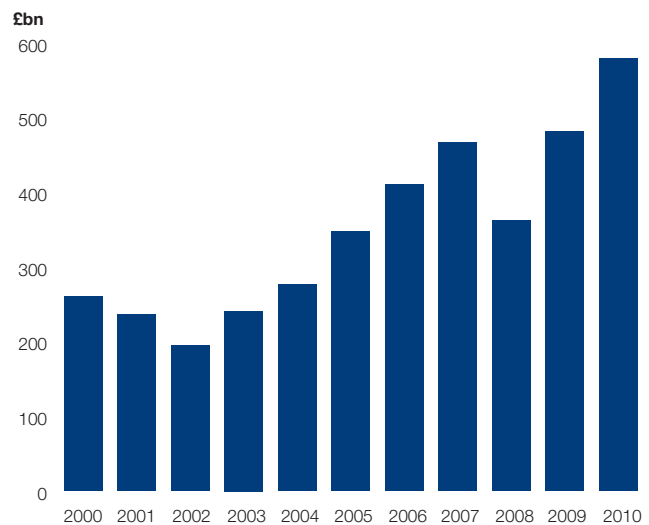
Sales of funds of funds have normally been excluded from IMA industry statistics to avoid double counting, but they have been included in this survey. Estimates of sales of funds to funds of funds, however, have been excluded since these are internal to the industry. This approach gives a more accurate picture of retail investment behaviour in particular and will soon be adopted in the IMA's regular monthly statistics.

Total Funds Under Management

Total funds under management at the end of December 2010 were £579bn, an increase of 20% from a year earlier. This was the highest ever recorded figure. Including overseas-domiciled funds managed in the UK (£607bn), total investment funds managed in this country are almost £1.2trn.

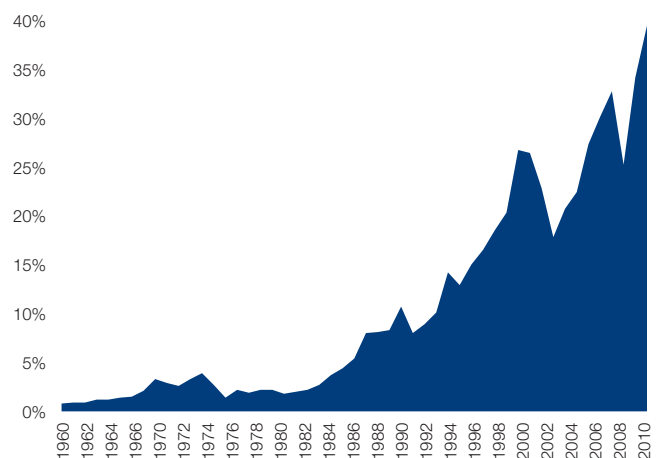
As Chart 21 shows, the industry has grown in nominal asset terms by 67% over the last five years and by 122% since the end of 2000. During the past decade, despite the economic dislocation of the dot.com crash and the credit crisis, the compound annual growth rate is 8.3% in nominal terms and 5.5% in real terms. This compares to a compound rate for the FTSE All-Share of 3.7% in nominal terms including re-invested income.

Chart 21: Industry funds under management (2000 – 2010)



Looking back over a longer historical period, the annualised growth rate from 1960 to 2010 is around 17% in nominal and 11% in real terms.¹⁷ Such expansion rates are clearly greater than those for UK GDP, with fund industry growth rates particularly strong in the 1980s. At the end of 1960, funds under management equated to less than 1% of GDP (see Chart 22). By the end of 2010, the figure was almost 40%.

Chart 22: Funds under management as percentage of GDP (1960 – 2010)



¹⁷ The GDP deflator has been used to calculate the inflation impact.

Flows vs performance

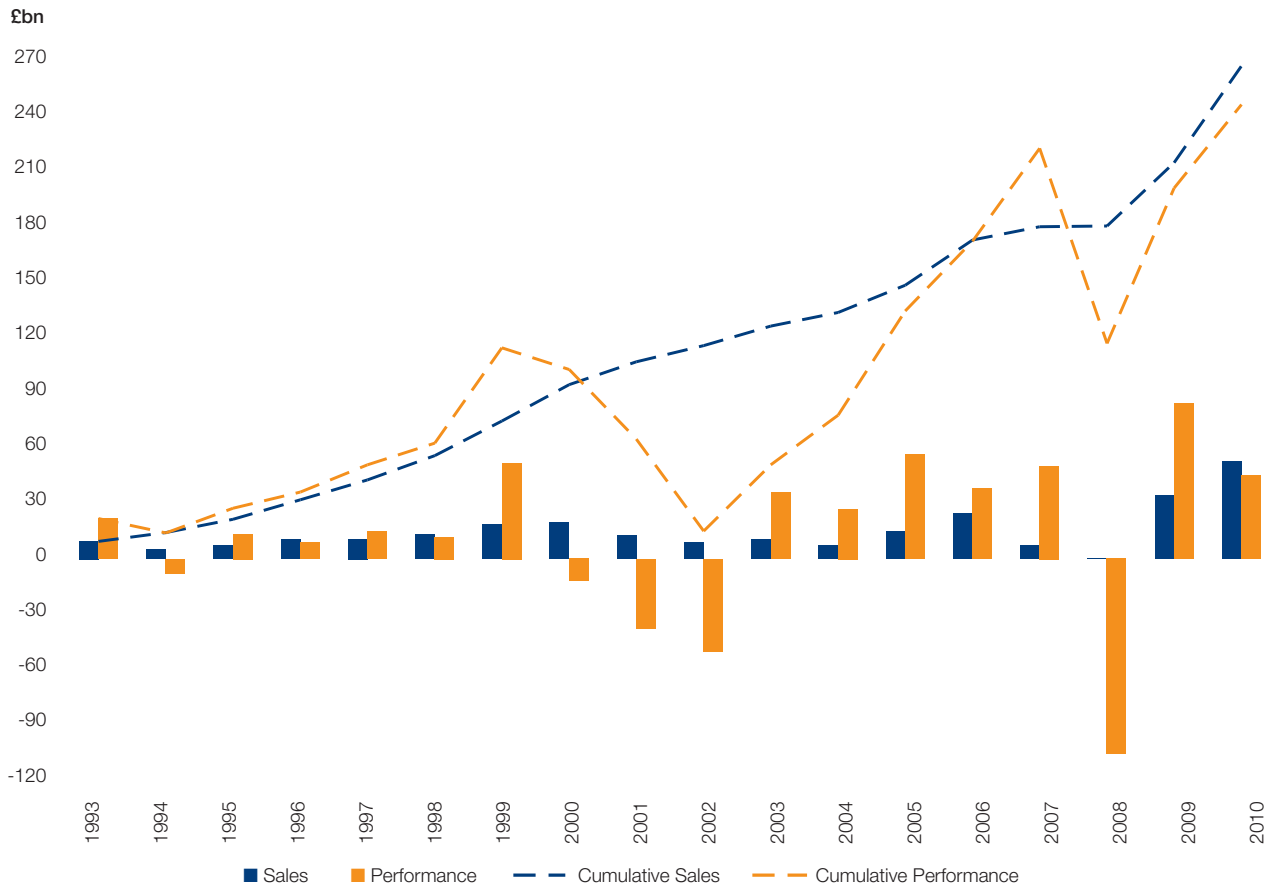
Total net investment (retail and institutional) into the UK fund industry was a record £49.8bn during 2010, comfortably beating the previous high of £34.4bn seen in 2009:

- The main driver of total net sales for 2010 was retail investors who invested a net £29.5bn, just below the 2009 record high level (£29.8bn).
- Net institutional investment was also a high at £20.2bn, more than three times the previous record of 2006 (£6.2bn). This largely reflects funds re-structured into OEICs.

The annual rise in UK-authorized funds under management was due to an equal combination of record net investment inflows and market returns. Market movements were responsible for 48% of the increase in annual funds under management, while new money accounted for the remaining 52%.

Chart 23 shows the changes in funds under management since 1993, broken down into net flows and performance of the underlying assets. Looking year-on-year, asset performance is the main driver of annual fluctuations in funds under management. Long-term, however, net inflows make a more significant contribution to funds under management, and they have accounted for just over half of the increase in funds under management since the beginning of 1993.

Chart 23: Changes in funds under management by total net sales vs performance (1993 – 2010)



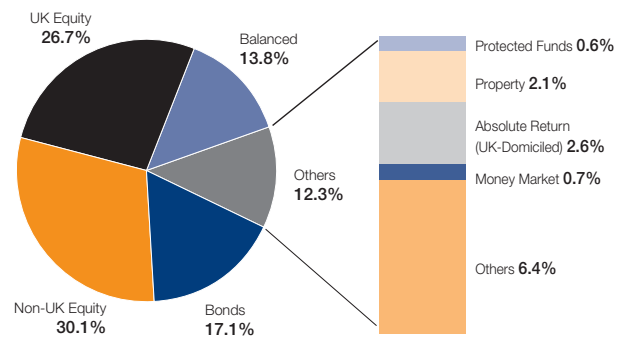
Asset mix

The overall asset mix of UK funds at the end of December 2010 is shown in Chart 24:

- Equities continue to account for the largest proportion of funds under management at 57% (from 58% a year earlier).
- Bond funds under management fell slightly to 17% (18% a year earlier).
- The market share of property funds increased year-on-year to 2.1% (from 1.9%), but is still down from over 3% at their peak in 2006.
- UK-authorized absolute return funds continued to increase in significance, up from 1.7% in 2009 to 2.6% of total funds under management.

- 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 0.7%.

Chart 24: Funds under management by fund/asset type



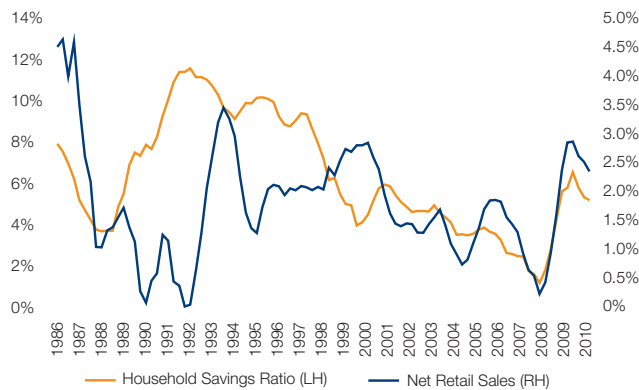
Retail Investor Behaviour

Retail investors made a net investment of £29.5bn into funds in 2010, the second consecutive year of very high sales (£29.8bn in 2009). These figures compare with £19.1bn net retail sales in 2000 at the peak of the dot.com boom. At that point, net investment was mainly into equity funds whereas last year it was spread across a range of asset classes.

Drivers of behaviour

Although detailed information on consumer behaviour is unavailable, in the context of rising savings rates, it is perhaps not surprising that fund flows have been so high. However, the history of the last 20 years does not offer evidence of a straightforward link between the household savings rate and net retail sales of the fund industry. Indeed, as Chart 25 shows, there is some evidence of an inverse relationship between flows and the savings rate in the early 1990s recession.

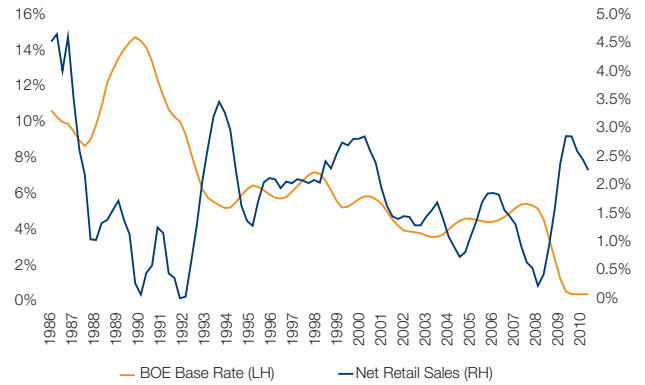
Chart 25: Quarterly net retail sales as percentage of retail funds under management vs household savings ratio (Q4 1986 – 2010)



Source: IMA, ONS

One obvious feature of this earlier period was very high interest rates and, at this level, there appears to be a more direct connection between interest movements and fund flows (see Chart 26). Given the record low interest rates of recent years, it seems likely that retail flows have been, in part at least, driven by a search for yield.

Chart 26: Quarterly net retail sales as percentage of retail funds under management vs Bank of England base rate (Q4 1986 – 2010)



Source: IMA, Bank of England

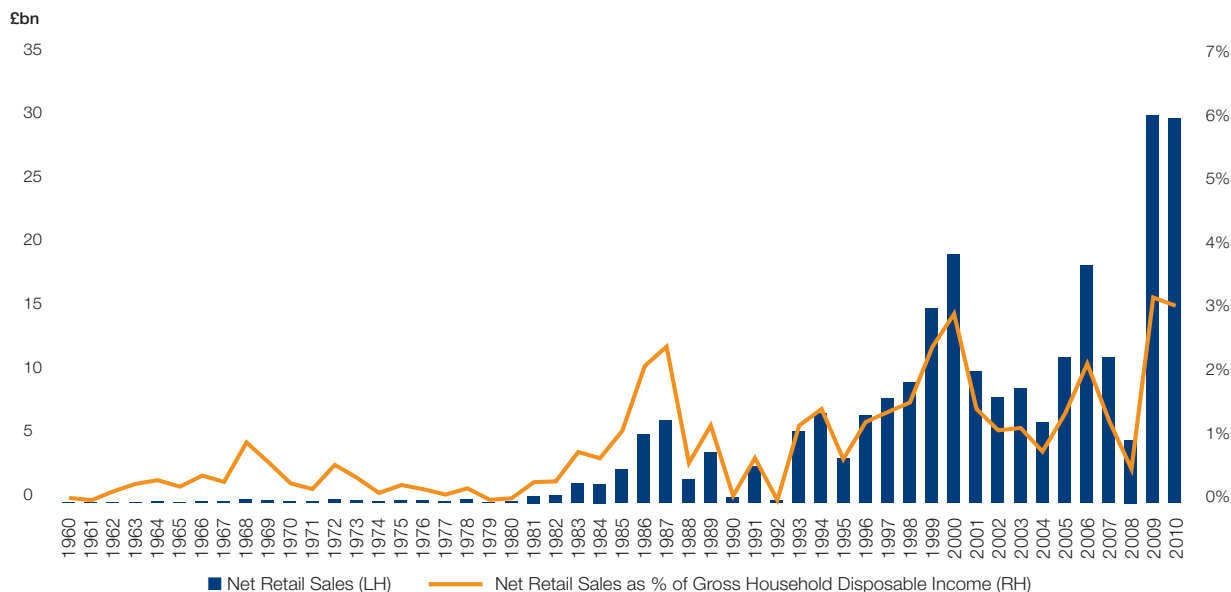
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The hunt for yield

“ There has been a very slow reduction in risk aversion and risk sensitivity and it has been prompted more in the retail segments where you have retirees or the partially retired looking for yield and income. People are being forced out of their comfort zone because they’re just not getting the return on their investments that they need to live on. ”

“ There’s an underlying theme here which you can see in the global markets at the moment; we’re back in the hunt for yield. The investors have known what they’re looking for and they continue to do so, and have followed that strategy through. ”

Chart 27: Net retail sales vs sales as percentage of gross household disposable income (1960 – 2010)



Source: IMA, ONS

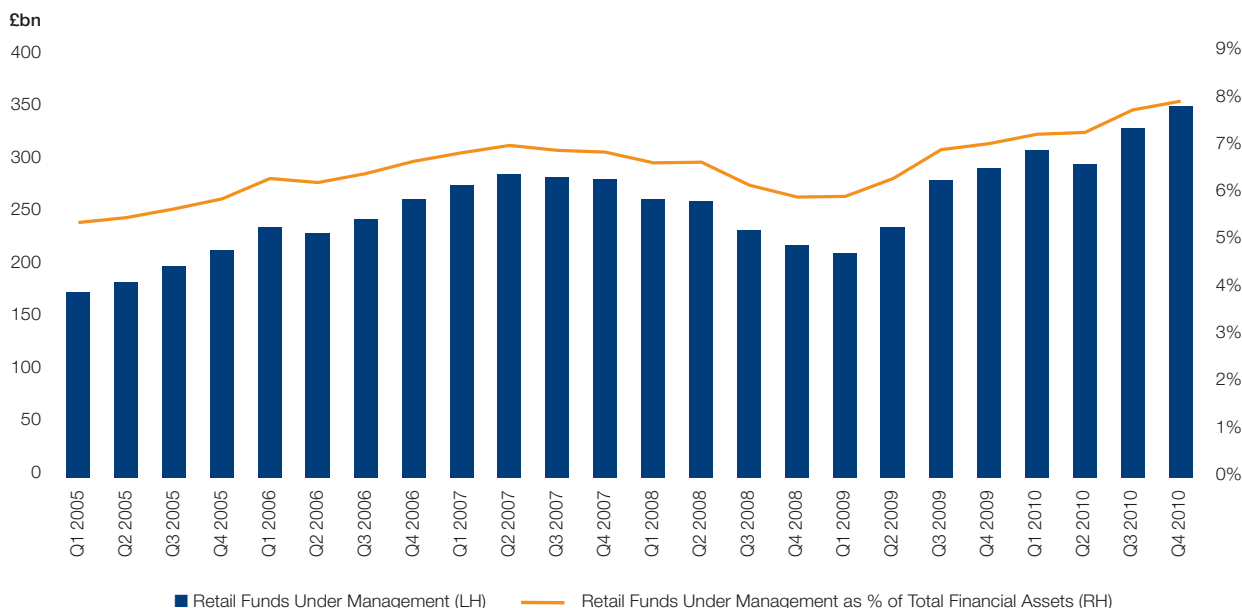
Whereas investors could get a high return from investing in bank and building society accounts in the early 1990s, this has not been true since the latest recession. Indeed, funds have often offered better income returns as well as the potential for capital growth.

Looked at in terms of household income (see Chart 27), investors saved a greater proportion into funds in 2009 and 2010 than ever before. Net retail investment into

funds represented around 3% of household disposable income in 2009 and 2010. This compares to an average 1.7% in the 2000s and 1.1% in the 1990s.

By the close of 2010, funds under management in retail funds were 8.0% of the gross financial assets of the household sector, the highest figure since 2005 and up from 7.1% a year earlier (see Chart 28). This increase reflects both new investment and the growth in unit values.

Chart 28: Quarterly retail funds under management vs funds as percentage of total gross financial assets of the household sector (2005 – 2010)



Source: IMA, ONS



ISAs

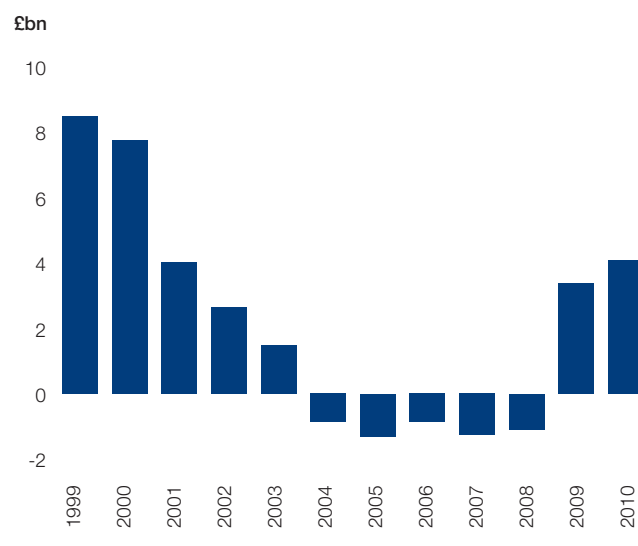
A substantial chunk of the net retail flows went into tax-advantaged wrappers, including Individual Savings Accounts (ISAs). The IMA collects information on ISA-wrapped sales where the ISA wrapper is provided by the fund manager or one of five large fund platforms (Cofunds, Fidelity Funds Network, Hargreaves Lansdown, Skandia, Transact). IMA figures account for around three-quarters of the total value of funds held within ISAs, with the majority of the remainder being wrapped by distributors.

As shown in Chart 29,¹⁸ net ISA sales in 2010 were £4.1bn, the highest level since 2001. This was the second consecutive year of positive net ISA inflows after five years of disinvestment.

A key influence on this turnaround was an increase in the ISA allowance from £7,200 to £10,100 in October 2009 for the over 50s, and in April 2010 for everyone else.

Nevertheless, sales remain lower than in the first couple of years after ISAs were introduced in April 1999. ISAs took a much larger share of total net retail sales in 1999 (57%) than in 2010 (14%).

Chart 29: Net ISA sales (1999 – 2010)



¹⁸ As of April 2008 PEPs were consolidated into stocks and shares ISAs. All ISA data shown for periods prior to April 2008 also combine PEPs and ISAs, except in the case of fund supermarkets where they reflect ISAs only.

Asset class choices

The difficulty with interpreting retail flows, however, is that at any given time aggregate flows reflect a wide variety of behaviour and preferences on the part of fund investors.

Table 1 shows quite a high dispersion of sales across different fund types, and our analysis below identifies a number of features of behaviour during 2010:

- Ongoing strong movements into bond funds.
- A sustained recovery in risk appetite.
- Strong sales of global funds, including funds investing in emerging markets.
- A renewed interest in tracker funds.
- Continued interest in absolute return offerings.
- Strong sales growth in balanced funds and funds of funds.

Table 1: Net retail sales by fund type (2009 – 2010)

Fund type	Net retail sales (£bn)	
	2009	2010
Bond funds	10.0	7.1
Balanced funds	3.8	6.8
Equity funds	7.8	6.8
Absolute return funds	2.6	2.4
Property funds	1.8	1.8
Money market funds	0.0	-0.2
Other funds	3.8	4.8
TOTAL	29.8	29.5

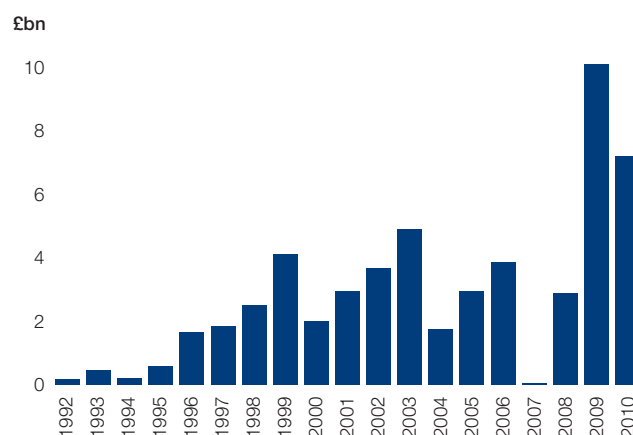
Bond fund sales

The 'hunt for yield' story in the context of low interest rates is well supported by the data from 2008 and 2009 when the £ Corporate Bond sector was the best-selling sector for two years.

Overall, bond funds again sold well in 2010 with £7.1bn in net retail sales (see Chart 30). However, the type of bond fund purchased in 2010 shows an interesting shift in investor preference. As corporate bond yields fell for the second consecutive year, net retail sales of the £ Corporate Bond sector were just £658m, £5.3bn down on 2009 levels (£6.0bn). Instead, retail investors opted for a different approach to bond investment, with the £ Strategic Bond sector seeing net retail inflows of £3.0bn in 2010, up 48% on 2009 (£2.1bn).

The popularity of both the £ Strategic Bond sector and the Global Bonds sector, the latter attracting retail investment of £2.4bn, points to the intensification of a trend familiar from equity fund patterns: the erosion of home bias, and rising interest in overseas stocks and securities.

Chart 30: Net retail sales of bond funds (1992 – 2010)



Recovery of risk appetite

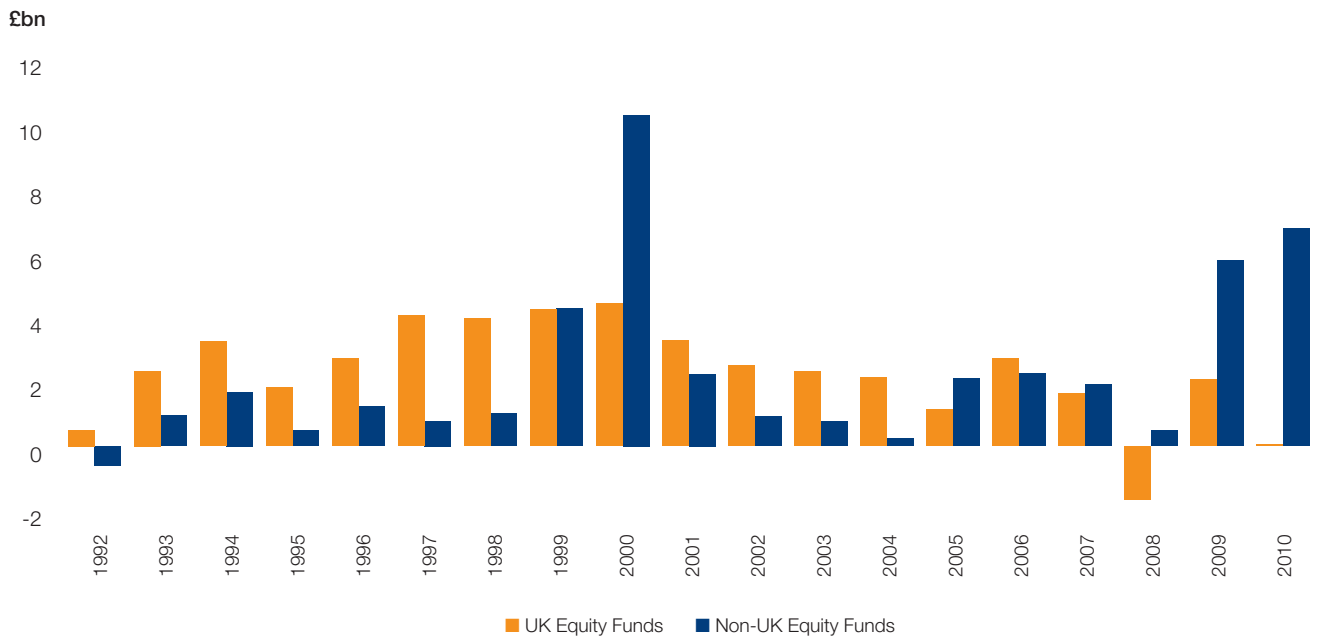
While some investors undoubtedly remain focused on yield, others are more strategic, and the recovery in the equity markets through 2009 and 2010 saw an increased risk appetite among retail investors. Net retail investment into equity funds was £6.8bn during 2010, with 2009 and 2010 seeing the highest annual inflows since the dot.com boom of 2000.

Net retail flows in 2010 went mainly into non-UK funds, continuing a recent shift away from domestic equities in

favour of non-UK equity funds.¹⁹ Chart 31 shows net retail equity sales since 1992 split by those classified as UK equity funds versus non-UK equity funds. Non-UK equity net retail sales totalled £6.8bn in 2010, once again dwarfing sales of UK equity funds (£52m).

Although the UK equity sectors saw a minimal combined net inflow in 2010, UK retail investors continue to invest heavily in their home market. The UK sectors still accounted for 47% of the industry's total equity funds under management at the end of 2010.

Chart 31: Annual net retail sales of UK and non-UK equity funds (1992 – 2010)



¹⁹ The non-UK equities category includes regionally-focused funds (eg. Europe ex UK) as well as global funds.

Table 2 shows a full breakdown of net retail sales by equity sector:

- In 2010, the Specialist sector was the leading equity sector choice for the first time in terms of net retail sales (£1.9bn), followed by the Global Growth sector with £1.8bn and Global Emerging Markets taking another £1.6bn. The latter two sectors have seen strong growth for several years, a trend that is in stark contrast to the first half of the 2000s when the bulk of net retail investments into equity funds went into UK funds. Non-UK equity funds have now
- outsold UK equity funds in five out of the last six years compared to only twice in the thirteen years prior to that.
- The Global Growth and Global Emerging Markets sectors amounted to £3.4bn of £6.8bn net retail equity sales in 2010, a strong showing given that these sectors made up only 16% of equity funds under management at the beginning of 2010. The Asia Pacific Excluding Japan sector also received substantial net inflows (£1.1bn).

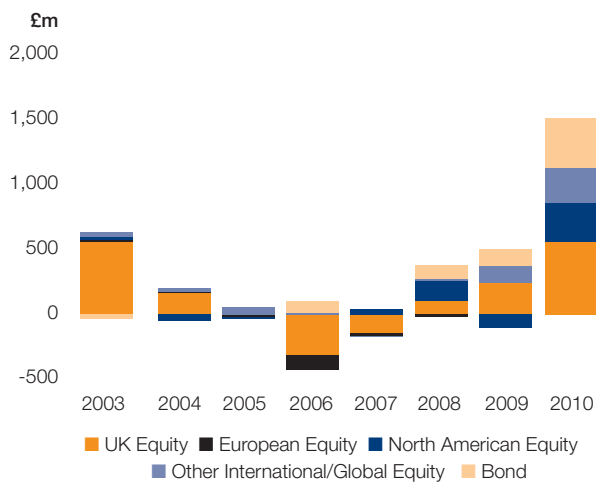
Table 2: Net retail sales and total funds under management among equity sectors (2009 – 2010)

Sector	Net retail sales (£m)		Funds under management (£m)
	2009	2010	2010
Specialist	1,652	1,865	24,389
Global Growth	1,427	1,761	49,971
Global Emerging Markets	808	1,641	13,836
Asia Pacific Excluding Japan	1,368	1,066	30,423
UK Equity Income	1,858	761	54,450
North America	975	550	21,645
European Smaller Companies	123	287	3,258
Japan	-256	177	7,708
North American Smaller Companies	40	112	1,182
Technology and Telecommunications	10	94	713
UK Smaller Companies	-87	93	7,391
Asia Pacific Including Japan	42	46	1,563
Japanese Smaller Companies	-18	7	296
Europe Including UK	-26	-11	3,231
UK All Companies	311	-803	108,067
Europe Excluding UK	-382	-843	33,147

Index tracker funds

Index tracker funds saw net retail inflows of £1.5bn during 2010, more than treble the amount in 2009 and the highest figure since the dot.com boom in 2000 (see Chart 32). Together with substantial institutional investment and rising stock markets around the world, strong performance in 2010 helped to take total funds under management in index tracker funds to £38.3bn at the close of the year, up 33% from 2009 (see Chart 33).

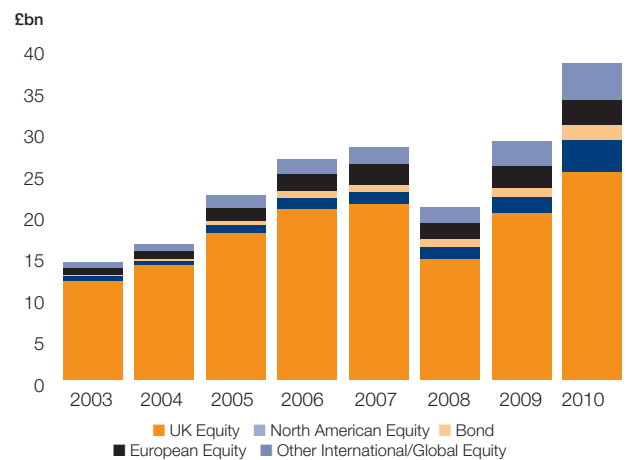
Chart 32: Net retail sales of tracker funds by index investment type (2003 – 2010)



These funds now represent approximately 6.6% of industry funds under management. Over the last five years the average annual growth rate in tracker funds has closely matched that of the overall industry:

- While there have been increased flows into funds that track bond indices in recent years, most funds continue to go into equity tracker funds, which account for 95% of tracker funds under management.
- The proportion invested in non-UK equity tracker funds has risen from 19% to 30% in the past five years as investors seek to diversify equity tracking investments.
- There have also been substantial inflows into ETFs. While the IMA does not collect detailed data on these products, ETFs with a primary London listing reached £43bn in funds under management at the end of 2010.

Chart 33: Funds under management of tracker funds by index investment type (2003 – 2010)



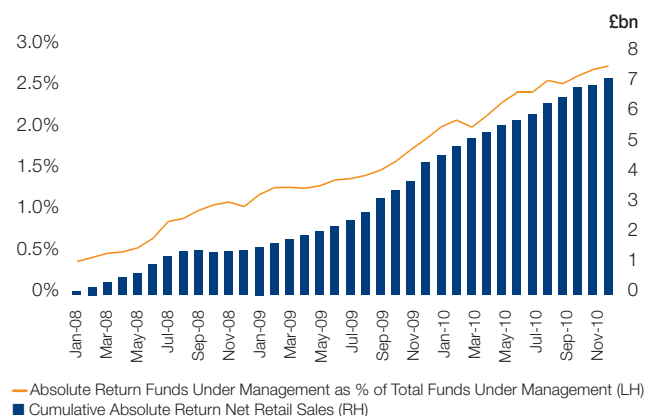
Ongoing move towards absolute return

A further theme among retail investors in recent years has been a strong interest in absolute return funds. Absolute return funds have been represented by an IMA sector since April 2008. This sector contains funds that are domiciled both in the UK and offshore.²⁰

While the industry experienced net outflows during 2008, absolute return funds were favoured by retail investors in the face of volatile market conditions. This popularity has continued through the following years as industry sales flourished, with 9% of retail net inflows during 2009 and 2010 going into absolute return funds.

As a consequence, total funds under management have grown very rapidly and at the end of 2010 stood at £18.2bn (2009: £10.3bn). This was mainly due to inflows from institutional investors. Retail investors invested a net £2.7bn during 2010, just below 2009 levels (£2.8bn). This took the proportion of absolute return funds under management to 2.7% of the total (see Chart 34).

Chart 34: Monthly net retail sales of absolute return funds vs absolute return funds as percentage of total funds under management (2008 – 2010)



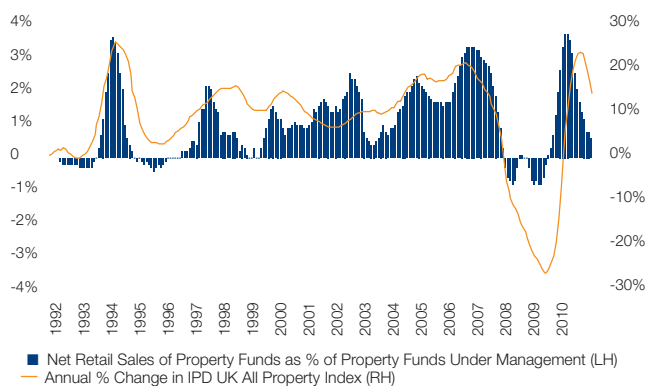
Despite the strong investor appetite for absolute return funds, it still remains unclear whether this is a cyclical or secular phenomenon. As we report elsewhere (see p. 23-25), there are those in the industry who believe that product offerings will have to change in order better to accommodate investor preferences. However, even among the latter, there is caution about the term ‘absolute return’ and whether it implicitly promises a stability and predictability that it is not possible to deliver consistently.

Property funds

A key feature in the run up to the credit crisis had been the popularity of property funds. While property funds suffered net outflows in 2008, net sales returned to positive territory in 2009 as the market showed signs of stabilising. As already shown in Table 1 (p. 47), 2010 net retail sales were over £1.8bn for the second year in a row, but slowed throughout the year.

Property fund sales have tended to follow the market closely. Chart 35 shows the correlation between the two, with the years since 2006 particularly striking.

Chart 35: Net retail sales of property funds vs IPD UK All Property Index (Jan 1992 – 2010)²¹



Source: IMA, Lipper IM

²⁰ All data in the absolute return sections relates to UK- and offshore-domiciled funds.

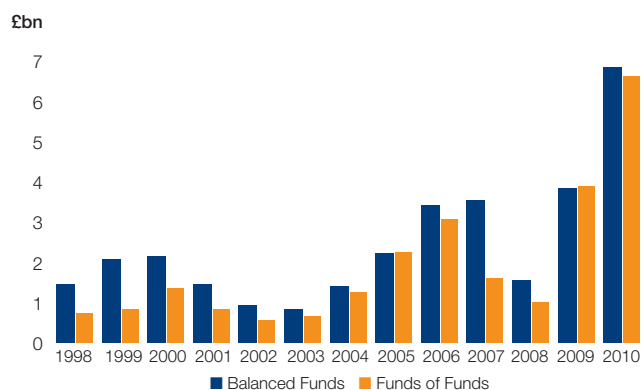
²¹ Net retail sales of property funds are charted as a six-month moving average of net retail sales as a percentage of property funds under management over the period. The IPD UK All Property Index performance is charted as the year-on-year change of the IPD UK All Property Monthly TR Index.

Popularity of balanced funds and funds of funds

The very strong sales of balanced funds and funds of funds were one of the most notable features in 2010. We review these together because the two are very closely linked. Around three-fifths of funds of funds (in terms of funds under management) sit in balanced sectors, in particular Active Managed, Balanced Managed, Cautious Managed, and UK Equity and Bond Income. Net retail sales for balanced funds and funds of funds are shown in Chart 36.

As can be seen from the chart, last year was a bumper year for both balanced funds and funds of funds. Net retail sales of balanced funds were £6.8bn, up from

Chart 36: Net retail sales of balanced funds and funds of funds (1998 – 2010)



£3.8bn in 2009 which, until last year, was itself the best year ever. Similarly, funds of funds saw net retail sales reach £6.6bn in 2010, up from £3.9bn the previous year, which had been the best year until then.

In 2010, the Cautious Managed sector took the greatest net inflows followed by Balanced Managed and Active Managed, the same as in the previous year (see Table 3). All these sectors saw big increases in net retail sales. Despite the substantial retail flows, total funds under management in the Cautious Managed sector, including institutional holdings, still lag behind the Balanced Managed sector.

As already noted, retail investors often choose balanced funds that are funds of funds. This can be seen as part of a greater shift towards funds of funds:

- Funds of funds under management hit their highest level on record at the end of 2010, rising 36% year-on-year to £57.9bn. This is a higher rate of increase than for the funds industry as a whole (20%).
- These funds of funds now account for 10% of total industry funds under management. Ten years ago, the share was only 5%.
- During 2010, funds of funds attracted a record £6.6bn of new retail money.

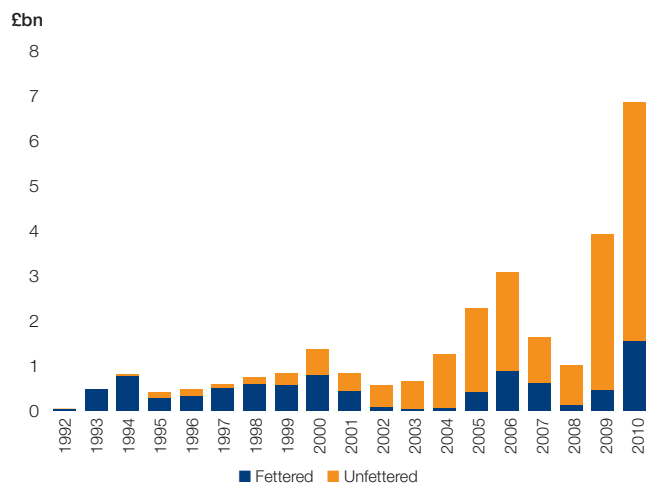
Table 3: Net retail sales of balanced funds by sector (2009 – 2010)

Sector	Net retail sales (£m)		Funds under management (£bn)
	2009	2010	2010
Cautious Managed	2,569	4,049	31.4
Balanced Managed	824	1,893	37.9
Active Managed	589	1,004	14.9
UK Equity & Bond Income	-141	-108	3.6

Chart 37 breaks down net retail fund of funds sales by fettered (internally invested) and unfettered (externally invested) since 1992:

- As the UK funds of funds market has matured, retail investors have directed sales mainly into unfettered rather than fettered funds.
- Unfettered funds have taken in 79% of net retail investment in the past decade. Consequently, the proportion of funds under management held within unfettered funds was 48% at the end of 2010, very different to ten years earlier when the figure was only 25%.
- This may reflect the shift to open architecture and “best-in-breed” manager selection practices in the past decade.

Chart 37: Net retail sales of fettered and unfettered funds of funds (1992 – 2010)



industryview

Multi-asset and multi-manager funds

“Retail investors don't want to take on the risk of making specific investment decisions themselves, and they are looking to funds and fund managers that can be flexible enough to adapt to the market. Funds that offer an investment solution – or where the fund manager has built up their reputation brand – result in huge inflows. The multi-asset side in particular is continuing to grow as investors say that they don't want to make investment and asset allocation calls themselves.”

“Multi-manager is a much stronger part of the market than it was. We've seen increased demand for global type offerings rather than country offerings, and increased demand in the wholesale and retail market for multi-manager diversified.”

Ethical funds

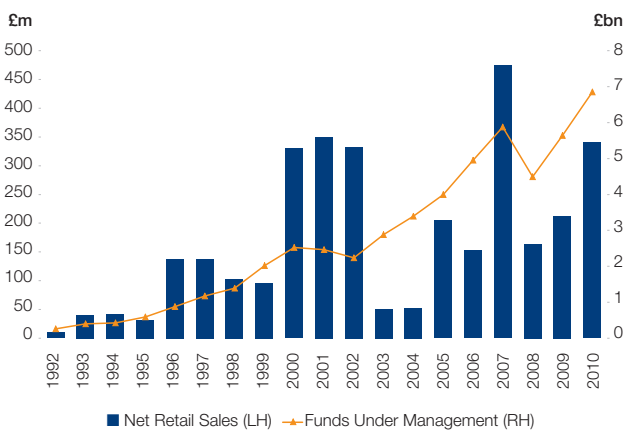
The IMA flags ethical funds in accordance with classification by EIRIS (Experts in Responsible Investment Solutions).

At the end of 2010, ethical funds under management had increased by 21% year-on-year to £6.9bn although the number of funds dropped to 57 (from 61 in 2009). Funds are spread among various IMA sectors, with the UK All Companies and Global sectors showing greatest concentration.

As a proportion of total funds under management, ethical funds have grown by over 22% each year on average since IMA records for this fund type began in 1992, which is a higher rate of increase than for the industry in general (15%).

Chart 38 shows the progression of ethical funds under management and net retail sales from 1992 to 2010. Net retail sales of ethical funds were £340m in 2010, 60% up on 2009.

Chart 38: Ethical net retail sales and funds under management (1992 – 2010)



However, there are some issues around definition, which make the concept and broad scope of socially responsible investment (SRI) quite difficult to determine consistently.

industryview

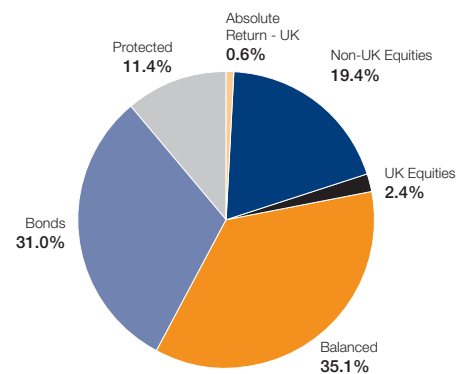
The advantages and challenges of SRI

“SRI is an advantage for active houses because you demonstrate that you can really do something active about it. The issue is that it's becoming too wide. SRI is starting to address all sorts of issues: employment practices, nature preservation, deforestation, etc. and it's becoming way too dispersed.”

Newly launched funds

During 2010, the IMA collected data on 153 newly launched funds, into which retail investors made a net investment of £2.6bn.²² As can be seen from Chart 39, newly launched fund sales followed the trend of the wider market with non-UK equity, bond and balanced funds taking the majority of sales.

Chart 39: Net retail sales of newly launched funds by fund/asset type



²² This figure is based on the number of funds launched during 2010 which the IMA collects data for.

Offshore-Domiciled Funds Distributed in the UK

In January 2010 offshore funds were included in the IMA sectors for the first time. These funds are FSA-recognised funds domiciled overseas and sold into the UK with distributor status. From the end of May 2012, this will become “reporting status” – offshore funds will need to report their income to UK investors but will not have to distribute it.

The IMA has collected data on these funds since July 2006:

- The number of funds for which data is collected stood at 601 at the end of 2010, up from 573 a year earlier, and it represented funds from 37 firms. Total funds under management on behalf of UK investors were £27.3bn, an increase of 8.4% compared to December 2009.
- Net retail sales of non-UK domiciled funds into the UK were £1.4bn for 2010, down from £1.6bn the previous year.
- A substantial part of this net retail inflow was within the IMA Absolute Return sector, which received £320m from retail investors.

The low level of assets in non-UK domiciled funds sold to UK investors contrasts strongly with the sizeable portion of non-UK domiciled funds whose assets are managed here (see p. 83).

Distribution Dynamics and their Implications

Back in 2000, one-half of gross retail fund sales were made direct to investors by fund companies. This decreased to 13% last year, mainly through company sales forces or tied agents.

Meanwhile, fund platforms have become a significant feature of fund distribution, taking 38% of gross retail sales last year when changes to the IMA's statistics collection enabled separate data to be collated for these platforms for the first time.

These figures show that fund platforms made net sales of £13.2bn in 2010. The IMA also collects more detailed information on the five large platforms, which by the close of 2010 had £107bn funds under administration. This was up 29% over the year, boosted by net sales as well as rising markets and re-registrations of funds to these platforms.

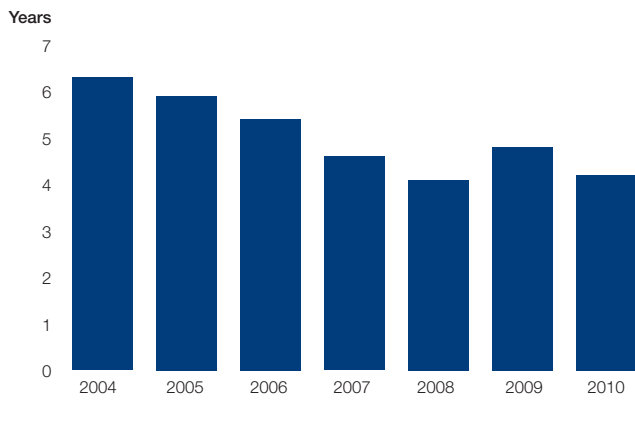
Fund platforms have become especially prominent in the ISA market. Gross ISA sales by these five platforms were £8.7bn in 2010 compared with £6.6bn by fund companies themselves. Just two years earlier, platforms and fund companies were selling similar proportions to one another.

For these platforms, tax-wrapped products generated the majority of 2010 gross fund sales, with personal pensions (incl. Self-invested Personal Pensions) accounting for 28%, ISAs taking 27%, and on-shore and offshore investment bonds 9%. The remaining platform sales did not benefit from a tax wrapper.

The web has made it easier for investors and financial advisers to buy and sell funds. It has also made it easier for them to monitor the performance of their investments. Fund platforms have played a big part in this change and these developments are likely to be one reason why fund managers are experiencing greater flow volatility. The estimated average time for which investors hold funds has shown a decline in recent years.

Chart 40 shows a declining trend in the average holding period for retail investors, based on a calculation of the inverse of the average annualised redemption rate for all retail funds.

Chart 40: Estimated average holding period of retail investors (2004 – 2010)

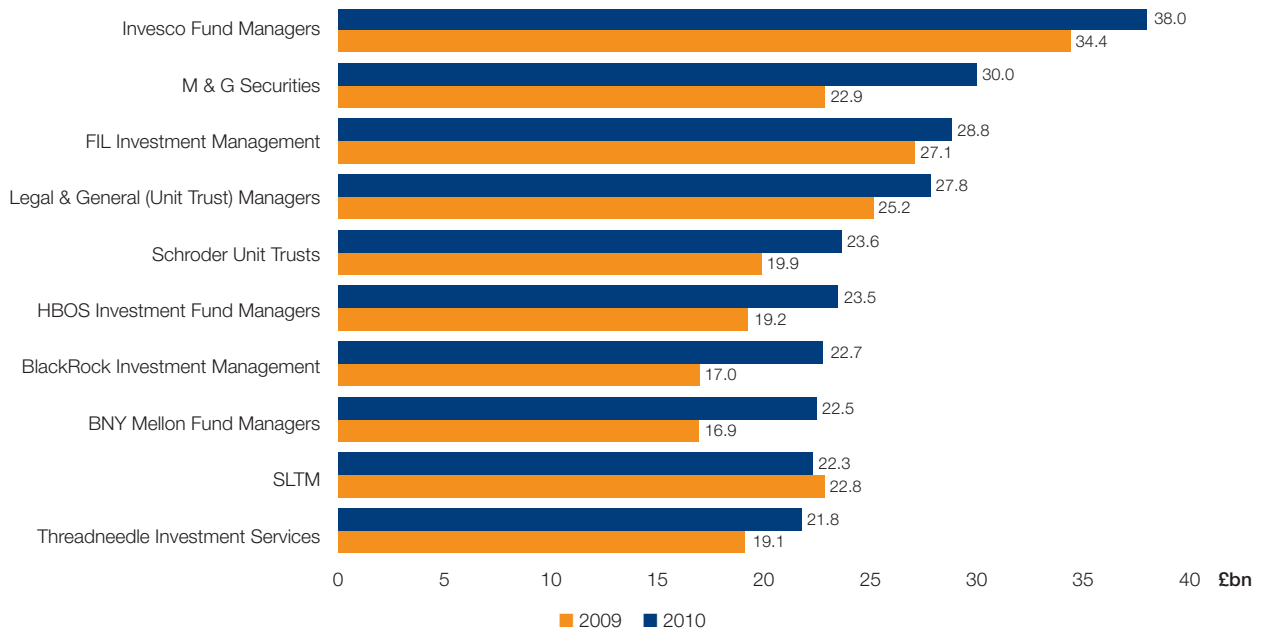


UK Industry Concentration and Structure

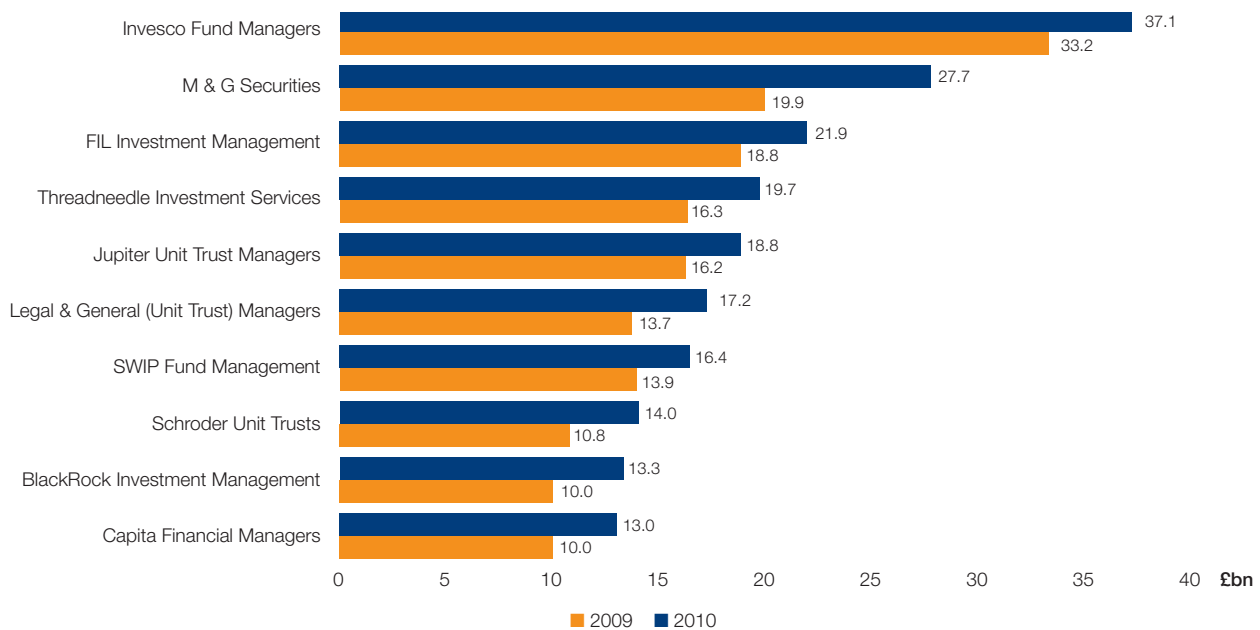
By the end of 2010, there were 101 fund companies (ie. companies operating funds but not necessarily responsible for managing the assets) in the UK, down from 118 five years earlier. The drop is due to a combination of a number of small-level closures and consolidation (mainly mid-level acquisitions during 2010). The effect of this activity has seen a corresponding decrease in top-level concentration. However, as we outline below, it has also seen an increase in mid-level concentration.

The UK fund management industry remains a highly competitive environment, with the top ten firms representing approximately 45% of total industry UK- authorised funds under management at the end of December 2010, a similar level to the early 1990s. Chart 41 shows the top ten fund companies by total retail and institutional funds under management at the end of December 2010, while Chart 42 overleaf shows the top ten firms in terms of only retail funds under management.²³

Chart 41: Top ten UK fund companies by total funds under management (2009 – 2010)

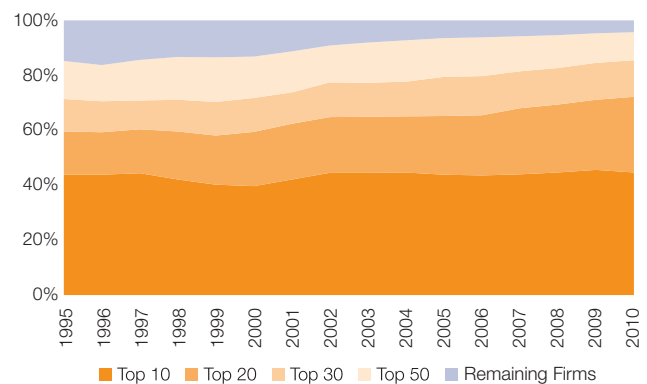


²³In this context, retail funds are defined as funds with a minimum lump sum investment amount of up to £10,000 and with at least one third of gross sales over the preceding three years being retail.

Chart 42: Top ten UK fund companies by retail funds under management (2009 – 2010)

As can be seen from Chart 43, the share of the top ten firms in terms of total funds under management has changed little over the last fifteen years. However, while the share of the top ten companies has stayed the same, the composition has changed significantly. Only six companies have remained in the top ten since 1995. The top ten companies today had between them 33% of the market in 1994.

Bigger changes have taken place outside the top ten. The combined market share of the fund companies ranked between 11th and 20th increased from 16% to 28% between 1995 and 2010. Thus the top 20 companies increased their share from 60% to 72%.

Chart 43: Combined market share of top firms by funds under management (1995 – 2010)²⁴

The market share of companies ranked between 21st and 30th also increased marginally – from 12% to 13% over the same period. Overall, the top 30 companies took 86% of the market at the end of 2010. However, the market share of companies outside the top 30 declined substantially from 29% in 1995 to 14% in 2010.

²⁴ The market shares are presented as cumulative percentages in Charts 43, 45 and 46.

Measuring concentration

A common metric for the measurement of industry concentration is the Herfindahl-Hirschmann Index (HHI) which applies a greater weighting to those firms with larger market shares. The clear conclusion from applying this measure is that the fund industry is historically and currently very unconcentrated.

A reading on this index of over 1,000 is usually taken to indicate mild concentration and a value over 1,800 indicates high concentration. The reading at the end of 2010 for the UK funds industry was 298 compared with 312 a year earlier.

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

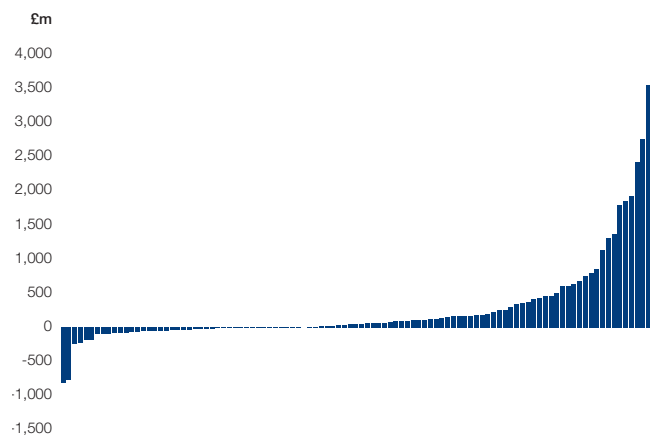
It is also interesting to look at the sales figures in this context since sales can be a forward indicator of trends in funds under management. Firms with larger shares of sales than funds under management will tend to increase their share of funds under management over time.

At the close of 2010, the top ten companies (as per the size of their funds under management) had a 36% share of gross fund sales compared with a 45% share of funds under management. The next ten companies had a 39% share of fund sales and a 28% share of funds under management. There is no indication here that the top ten companies are strengthening their grip on the funds market.

Notwithstanding the lack of change in the firmly unconcentrated nature of the funds market, there were clear winners and losers amongst fund managers in the competition for retail sales in 2010.

Chart 44 shows the distribution of net retail sales across all fund managers. In a year of strong inflows, there were more fund companies with inflows than outflows – 61 companies experienced net retail inflows and 42 companies had net outflows. Three companies had net retail inflows of more than £2bn and two companies experienced net outflows greater than £500m.

Chart 44: Fund operator net retail sales



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

Fund platforms and the web have made it easier for investors and advisers to monitor fund performance and switch between funds. One can therefore also look at whether flows into individual funds have become more concentrated in recent years. Chart 45 shows the shares of the top ten, 20, 50 and 100 funds in terms of funds under management and Chart 46 does this in terms of gross sales:

- As noted earlier, there were 2,574 funds at the close of 2010. Just ten of these funds accounted for 11% of funds under management and the top 100 funds took 43%. Both were slightly down on 2009 but in line with most of the last 15 years.
- Fund sales are more concentrated than funds under management. As with funds under management, the market share of the top funds has fluctuated over the years. However, there has been some evidence of an upward trend developing particularly over the last two years. In terms of gross sales, the top ten best-selling funds took 17% in 2010, up from 16% a year earlier and 13% in 2005. The top 100 took 55% of total sales compared with 52% a year earlier and 47% in 2005.

In addition, this recent trend towards concentration can be seen in Table 4, with the median fund size rising more slowly than the mean fund size. Whilst the top ten funds in 2010 had an average £6.2bn under management, one-half of all funds managed less than £74.1m. The distribution of fund sizes is highly skewed.

Chart 45: Combined market share of top funds by funds under management (1995 – 2010)

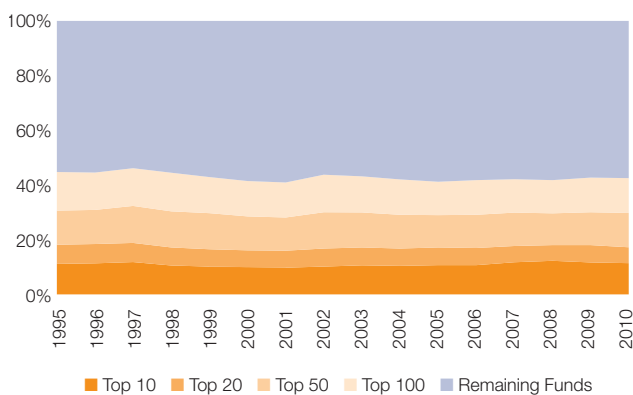


Chart 46: Combined market share of top funds by gross sales (1995 – 2010)

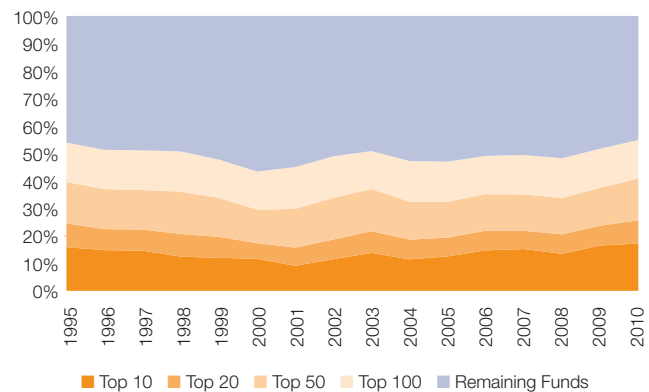


Table 4: Mean and median fund sizes (2001 – 2010)

	No. of funds	Mean (£m)	Median (£m)
2001	2,507	126.5	39.1
2002	2,512	103.4	30.9
2003	2,381	131.1	40.6
2004	2,396	147.6	47.2
2005	2,354	185.1	63.0
2006	2,406	215.9	71.3
2007	2,499	230.6	69.6
2008	2,600	165.5	46.6
2009	2,524	217.0	59.6
2010	2,574	278.8	74.1

In summary:

- The top ten firms control 45% of funds under management, broadly the same as 15 years ago.
- Although the HHI indicator confirms that the industry as a whole continues to be unconcentrated, there is a trend towards greater concentration in the mid-market, in particular firms ranked 11th to 20th, at the expense of smaller firms.
- Gross fund flows have also become more concentrated in recent years, with the top 100 funds taking 55% of sales last year compared with 47% in 2005.

The European Context

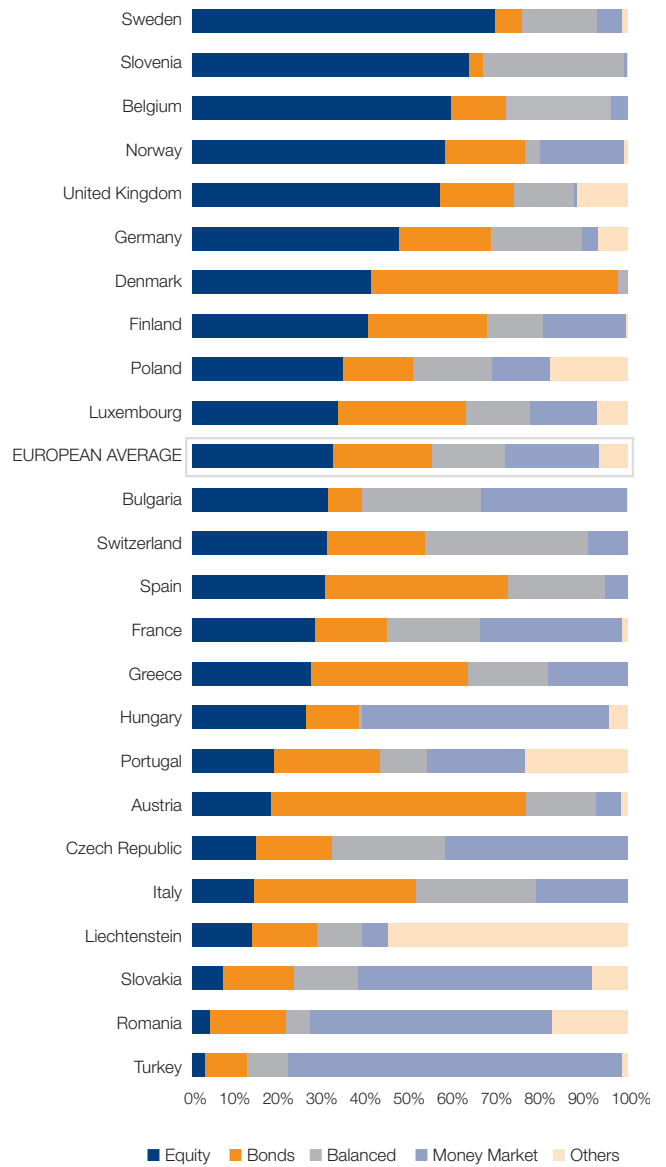
Focusing just on the market for UCITS funds, which accounts for 75% of funds under management across Europe, industry funds under management rose to €6.0trn by the end of 2010, just short of the record level of 2007 (€6.2trn). Total European investment funds reached €8.0trn, up from €7.1trn a year earlier.

The European funds market remains very different from the UK, both in terms of distribution and fund preferences:

- Whereas UK retail fund distribution takes place mainly through IFAs, continental distribution remains dominated by banks and insurance companies.
- At the end of 2010, some 57% of UK funds under management were in equity funds compared with an average 32% in the rest of Europe.
- Money market funds have a larger profile in Europe, accounting for 22% of retail investment. In the UK, on the other hand, they have a minimal uptake among retail investors (0.7%).

However, the UK is not alone in this strong equity bias among investors, and a wide dispersion of asset preference across countries continues to be a striking feature of the European funds market (see Chart 47).

Chart 47: Breakdown of UCITS funds under management by fund domicile

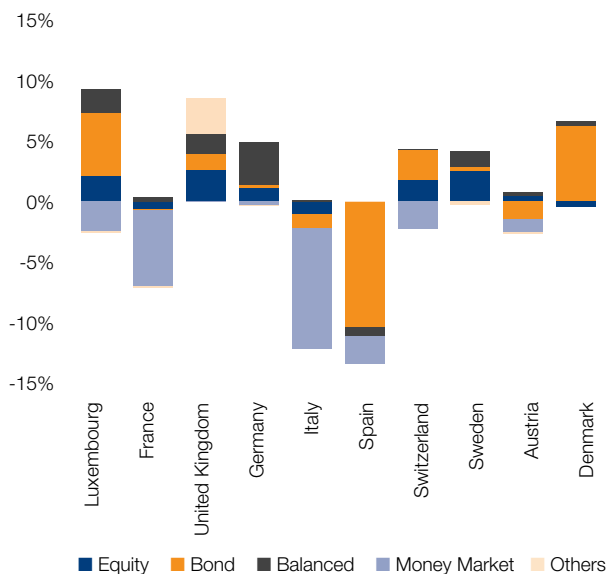


Source: IMA, EFAMA

In terms of sales, the strong inflows of €150bn seen during 2009 were bettered in 2010 with net inflows reaching €166bn. This was despite money market funds suffering outflows of €126bn. These money market flows in continental Europe reflect very different traditions of usage of such funds by investors compared to the UK where bank and building society deposits are the norm for such savings.

Chart 48 displays net sales of European UCITS funds by asset class for the top ten countries (ranked by the size of their total funds under management),²⁵ expressed as a percentage of average UCITS assets during 2010.

Chart 48: Net sales of UCITS by asset class as percentage of total UCITS funds under management, selected countries

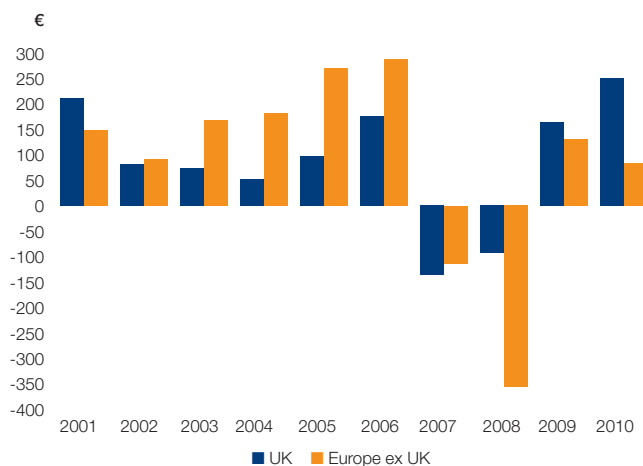


Source: EFAMA

Despite the contrasting cultures, European investors were putting increasing amounts into equity funds ahead of the financial crisis, catching up with the UK in terms of equity investment. This can be seen from Chart 49 which shows net UCITS sales of equity funds per capita in the UK and in Europe over the last ten years.²⁶

As seen in Chart 49, both UK and other European investors began to sell equity funds during 2007. The following year, European investors sold equity funds worth €356 per capita compared with net sales by UK residents of €92 per capita. These net redemptions by non-UK European investors amounted to 6% of funds under management in equity funds at the beginning of the year compared with 1% for UK investors calculated on the same basis.

Chart 49: Net sales of equity funds per capita, UK and Europe ex UK (2001 – 2010)



Source: IMA, EFAMA

Both UK and other European investors returned to net investment in equity funds in 2009 and 2010. UK investors showed greater confidence, adding to their holdings of equity funds at a higher rate than other Europeans.



²⁵ Excluding Ireland, as granular asset level data is not available.

²⁶ These figures cover all sales both to retail and institutional investors as EFAMA do not show retail investors separately.

4. Operational and Structural Issues

Key Findings

Revenue and fee structures

- Survey data suggests that total industry revenue (net of commission) rose 26% in 2010, taking the overall estimate to £11bn. As a percentage of average assets under management, this equated to 30bps.
- Costs rose by 24% to an estimated £7.3bn (£5.9bn in 2009), having fallen for the two previous years.
- The industry operating margin was 34%, still below 2007 levels.
- The use of performance-based fees increased slightly in 2010 (85% of respondents as opposed to 82% in 2009), although at 16% it still accounts for a comparatively small amount of the total UK-managed asset base. Performance fees are most commonly used in institutional, absolute return and hedge fund product offerings.

Employment

- Estimated total direct industry employment increased by over 4% this year to 25,000 (24,000 in 2009). Employment thus approached pre-crisis levels on the back of continuing industry recovery and increasing investor confidence.
- This figure, however, still understates overall industry employment due to increased outsourcing of a number of business activities to third-party providers. In 2010, 78% of respondents outsourced some part of their business.

Industry concentration and consolidation

- Although the market share of the top ten asset management firms remains above 50%, M&A activity measured in asset terms has slowed down in 2010 compared to 2009.
- The combined effect of industry consolidation and asset growth has solidified the predominance of autonomous asset managers, accounting for nearly 40% of UK assets under management.
- Boutique members of the IMA had a strong year, experiencing an average year-on-year increase in UK managed assets of 38% compared with 14% among IMA members overall.

Regulatory environment

- Despite widespread acceptance of tighter regulation, concerns remain over the potential for adverse consequences resulting from poorly targeted or insufficiently coordinated measures.
- Greater regulatory scrutiny, resulting in increased operating costs, may provide a competitive advantage for larger firms.

4. Operational and Structural Issues

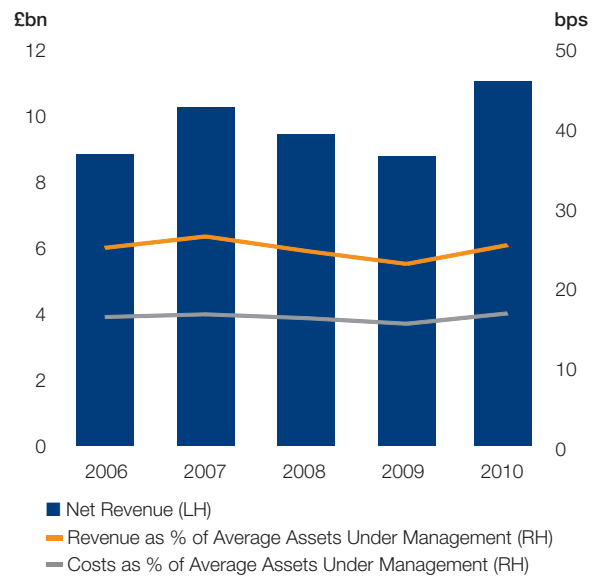
Revenue and Costs

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

- Total industry revenue (net of commission) rose 26% during 2010, having fallen 7% during 2009 and 8% during 2008. This takes the overall estimated revenue to £11bn, from £8.8bn in 2009. While this is above the level seen in 2007 (see Chart 50), expressed as a percentage of average assets under management, 2010 revenue was lower (30bps vs 32bps in 2007).
- Total costs rose by 24% during 2010, having fallen 8% over 2008 and 2009, and are now estimated at £7.3bn. As a proportion of assets, this represents 20bps (from 18bps in 2009 and 20bps in 2007). Cost increases have been driven by a range of factors, including higher headcounts, variable compensation arrangements, business development and regulatory compliance.
- The overall industry gross operating margin was 34% (from 33% in 2009).²⁷ This is still lower than in 2007 (37%).

Expressed as a proportion of GDP, industry net revenue represents 0.7%.²⁸ This is an increase on the levels seen in 2006-2009, driven by higher revenues and little change in the UK GDP numbers. The revenue contribution of the wider asset management industry (including hedge fund and private equity) is estimated to be close to 1.2%. Factoring in downstream and outsourced activity will lead to a significantly higher contribution. In balance of payments terms, ONS estimates suggest a positive contribution of £2.9bn in 2009.

Chart 50: Industry net revenue vs revenue and costs as percentage of average assets under management (2006 – 2010)



Performance Fees

Just under 85% of respondents use performance fees in parts of their business, a small increase on last year (see Table 5). However, the majority of firms using performance fees are doing so on a comparatively small proportion of their assets (see Table 6 overleaf) and responses suggest that the total asset base subject to such fees is only 16%.

Table 5: Proportion of firms using performance fees (2008 – 2010)

	2008	2009	2010
Proportion of firms using performance fees	83%	82%	85%

²⁷ Calculated as net revenue less costs divided by net revenue.

²⁸ This is based on net revenue adjusted for output that may be accounted for in other market sectors.

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

- Nearly a half of respondents identified their institutional business.
- Just under a third pointed to absolute return and hedge funds.
- The remainder pointed to other areas such as retail funds and investment trusts.

Table 6: Proportion of assets under management subject to performance fees

Proportion of assets under management subject to performance fees	Percentage of respondents	Total UK assets under management (£m)
0%	15%	52,001
1-5%	23%	1,005,582
6-10%	13%	750,865
11-25%	23%	440,193
26-50%	8%	256,125
>50%	17%	370,864
TOTAL	100%	2,875,631

While institutional business still predominates with respect to the use of performance fees, responses over recent years suggest that there is increasing interest in their application to retail products. Just under a half of the respondents (47%) to this year's Survey indicated that they were using performance fees for retail products, up from over a third in 2009 and from just under a quarter in 2008 (see Table 7). However, this refers to retail funds where the assets are managed in the UK and not necessarily funds that are distributed in the UK.

Table 7: Use of performance fees in retail products (2008 – 2010)

	2008	2009	2010
Proportion of firms using performance fees in retail products	24%	37%	47%

The change in performance fee usage over the past year and expectations for future use are shown in Table 8. One can see that over 80% of those who have seen increases over the past year expect further increases in the coming year, identifying institutional business as the area of likely increase.

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

Has the use of performance-based fees in your product range become more prevalent over the past year?	Percentage of respondents	Total UK assets under management (£bn)	Percentage of total assets subject to performance fee
Yes	36%	1,621	15%
No	64%	1,270	18%
Of those who answered Yes, do you expect further increases in the coming year?			
Yes	84%	1,327	13%
No	16%	295	25%
Of those who answered No, do you expect further increases in the coming year?			
Yes	9%	19	23%
No	91%	1,250	17%

Employment

From questionnaire responses, we estimate direct employment numbers for UK-based asset management activity at 25,000, up from 24,000 last year. The over 4% increase in overall headcount is likely to be a further reflection of industry recovery on the back of buoyant market performance and strong inflows. Direct employment in 2010 thus significantly approached the headcount levels in 2007, when it stood at 25,500 (see Chart 51).

Chart 51: Industry headcount estimate (2006 – 2010)

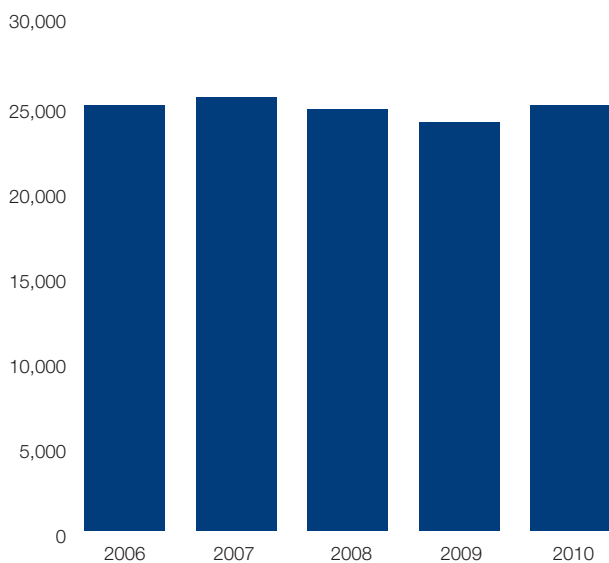
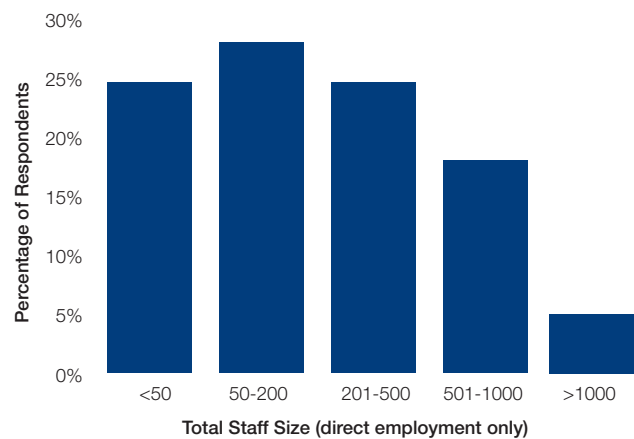


Chart 52 shows a distribution of respondents by total staff size (direct employment only) and illustrates that the majority of firms (53%) employ less than 200 staff members. Considering that the respondent sample is weighted towards larger firms, however, it is likely to understate the industry-wide proportion of small firms, and therein particularly those with less than 50 employees.

Chart 52: Percentage breakdown of respondents by total staff size (direct employment only)



The overall staff distribution is summarised in Table 9. The data shows core asset management activities (fund management, research and dealing) accounting for around 27% of total direct employment, with marketing and business development representing the second largest segment of employment (19%). Both of these figures remain unchanged from last year.

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

Activity	Survey findings
Marketing, Sales and Business Development of which	19%
Marketing, sales, business development	71%
Client management	29%
Fund Management of which	27%
Fund management (strategic and operational)	71%
Research/analysis	21%
Dealing	8%
Transaction Process of which	3%
Transaction processing, settlement	98%
Custody	2%
Fund Accounting and Administration of which	14%
Investment accounting, performance measurement and client reporting	53%
Other fund administration (including CIS administration)	47%
Compliance, Legal and Audit of which	5%
Compliance	57%
Legal	34%
Audit	9%
Corporate Finance and Corporate Administration of which	10%
Corporate finance	44%
HR and training	21%
Other administration	35%
IT Systems	11%
Other	11%
Total Industry Headcount	25,000

The personnel structure of the industry is complicated due to the outsourcing of many aspects within the asset management value chain. Around 78% of respondents outsource some of their activities (see Table 10 overleaf). 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:

- Fund accounting and administration is the most frequently outsourced area of employment, with nearly two-thirds of the responding firms outsourcing some aspect of it. Outsourcing of this area seems to take place regardless of the size of assets under management, and usually affects accounting and administration (including transfer agency). The outsourced activity 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 from the Survey).
- In common with practices in other industries, other activities – notably compliance, legal, audit and various back office functions, such as corporate finance, corporate administration and IT – are widely outsourced. Again, outsourcing of these areas is fairly evenly distributed among different firm sizes. The exception seems to be compliance, legal and audit which larger firms (with over £25bn in assets under management) do not seem to outsource at all.

As illustrated in Table 10, the use of outsourcing in recent years has been increasing from just under 74% of respondents in 2007 to 78% in 2010.

Table 10: Proportion of respondents outsourcing part of their activity (2007 – 2010)

Do you outsource any operations to external contractors?

	2007	2008	2009	2010
Yes	74%	74%	75%	78%
No	26%	26%	25%	22%

However, it is also apparent to a number of those we interviewed that the changing nature of risk management and regulatory requirements may result in firms focusing far more on their in-house capabilities in this area.

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.

The limits of outsourcing?

“The investment department staffing is finally back to where it was in 2003 and our assets have more than doubled. It’s all in monitoring, audit and risk going forward. Front office monitoring is also going to be a feature of our business. In some ways it’s not a bad thing. It should be an attitude of mind within our own business, and not just the feeling that the regulator told us to do it – because it ultimately makes for a better business.

There are now functions within asset management which I am not sure how you can outsource. The recommendation is that risk management should be embedded in the management of your business. How exactly is that going to work if that is outsourced? There are areas which you will not be able to outsource, and that is a major barrier to entry for a start-up.”

Ownership, Consolidation and Concentration

We have commented for a number of years that there are structural obstacles to wide-scale consolidation and these remain in place:

- 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, often depending upon the behaviour of intermediaries.

However, one significant driver of consolidation in 2009-2010 was restructuring in the immediate aftermath of the 2007-2008 financial crisis. Bank divestment lay primarily behind the largest deals, most notably the merger of BlackRock and Barclays Global Investors (BGI). This created particular opportunities for a number of asset management firms looking to expand via the acquisition route. As the financial services industry continued to move on from the crisis of 2007-2008, some further divestment/distressed deals took place in 2010 (see Table 11). However, the scale of these was much smaller in asset terms and there were also greater signs of strategic M&A activity as firms pursue capability expansion through acquisition.

Table 11: Major M&A deals in the UK asset management sector (2009 – 2010 vs 2010 – 2011)

2009 – 2010		2010 – 2011	
Acquirer	Purchase	Acquirer	Purchase
BlackRock	Barclays Global Investors	Royal Bank of Canada	BlueBay Asset Management
BNP Paribas	Fortis Investments	State Street Global Advisors	Bank of Ireland Asset Management
BNY Mellon	Insight Asset Management	Henderson Global Investors	Gartmore Investment Management
Invesco	Retail funds business of Morgan Stanley	Man Group	GLG Partners
Aberdeen Asset Management	Parts of Credit Suisse fund management assets and businesses	F&C Asset Management	Thames River Capital
	Parts of RBS Asset Management fund management assets	Royal London Asset Management	Royal Liver Asset Managers
Artemis/AMG	Artemis	Schroders	RWC Partners (49%)
Henderson	New Star Asset Management	Brookfield Investment Management	Pall Mall Investment Management
GLG Partners	Societe Generale Asset Management UK	Franklin Templeton	Rensburg Sheppards
		Cyrun Finance	SVM Asset Management

Emergence of standalone asset managers

The deals struck over the past couple of years have had a substantial impact upon the ownership pattern. Looking at the combination of ownership and asset changes, Chart 53 shows assets under management in the UK split by ownership of firm since the Survey began in this form in 2003. It also illustrates that in 2010 asset management companies accounted for nearly 40% of total UK assets under management. The increasing significance of asset management firms as standalone or autonomous businesses is striking:²⁹

- Looking back to 2003, the UK asset management industry (as defined by IMA firms) was still defined by very strong insurance and banking ownership patterns. Standalone asset management firms accounted for 12% of total UK assets under management. While this was comparable to the continental European experience, it stood in contrast to that of the US.
- Between 2003 and 2008, autonomous asset managers became far more prevalent at the expense of bank- and insurance-owned companies, with their share of UK assets under management reaching nearly 27% by 2006. At the same time,

the 'Other' category, which contains diversified financial groups and primarily global custodian banks, also expanded, from 6% in 2003 to nearly 9% in 2006.

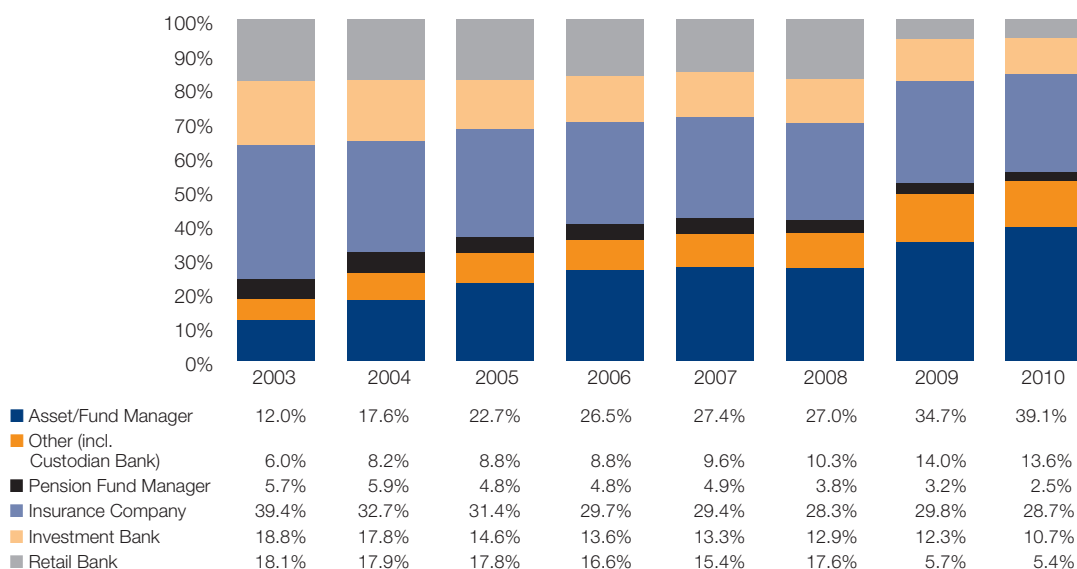
- A step change occurred in 2009. In asset terms, this is primarily because of the BGI and Insight deals.
- Grouped together, by the end of 2010 the ownership categories of traditional financial intermediaries (insurance companies, investment banks and retail banks) accounted for just 45% of the total.

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Ownership contrast with the US

“If you look at the fund industry in the US, it's big and established, but the big players are not Wall Street players. They've grown up separately because of fundamentally different cultures and geographies, and that separates them. Here everything feels like it's the City and the proportion of independent asset managers has been rising from a very low figure. In the US, the big banks aren't even known for asset management, they're known for banking.”

Chart 53: Ownership of asset management firms by UK assets under management (2003 – 2010)



²⁹ 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 business focus.

At the same time, ownership categories by parent group are becoming less meaningful. First, cross-sector consolidation and expansion is creating 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 asset management subsidiaries are often quite different than their 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.
- 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. Within parts of the UK insurance industry, there is now an increasing focus on asset gathering, with platforms including products from third party managers.

These changing structures also make the relationships between firms in the asset management and distribution arena increasingly complicated. For example, an insurance-owned asset manager might be distributing through both a parent group's distribution network and third party platforms. Equally, an asset manager could be providing services to clients whose own products compete with those of that asset manager's parent group.

Views continue within the industry about the merits of different ownership and operating structures. It is by no means the case that all asset managers perceive a need to work in independently owned asset management firms. Some of those we spoke to appreciate what they perceive as the security that comes with a large financial services parent. As already reported, in an uncertain environment, there is a perceived competitive advantage potentially arising from being associated with a parent with a large balance sheet.

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Impact of different ownership structures

“Fund houses that are part of large financial groups had a balance sheet benefit going through what were particularly tough times. Particularly if you're a small equity house, and you went through the two to three years the industry's been through, and you see a massive fall in your revenue, there's a limit to what you can do to rebalance your cost. Most of our businesses don't have a massive variable cost base, people are the biggest cost.”

The negative is the reputational damage that has been done to the financial services sector as a whole. Everybody points to banks but financial services in general have been very badly tarnished over the past two years. So if you're part of the group, you suffer more from this than if you were a small boutique that clearly had nothing to do with it.”

Bank-owned firm

“You need stable ownership. Your clients will want to know that there's going to be no change to the business model and they're going to be dealing with the same institution. We need stability and secure, long-term ownership. This business has boomed under that ownership structure, and it was in part because we didn't have to expose ourselves to quarterly reporting. If you constantly have to think about what you're going to say, you just get short-term.”

Insurance-owned firm

“I think that people are beginning to rediscover the benefit of asset managers being independent of bigger financial institutions, and in particular banks who had to divest their asset management business to rebuild their balance sheets. The employees of asset management firms are also rediscovering the joys of not having multiple masters but the client being the master. Clients are beginning to realise the simplicity of it all and there is much more alignment across the industry.”

Independent firm

Overall industry concentration

The range of firms managing assets in the UK is illustrated in Chart 54.³⁰ The chart continues to show a steep curve downwards from a comparatively small number of very large firms, and a long tail:

- Average assets under management increased to £26.2bn (2009: £23.1bn) with the median at a slightly increased £7.4bn (2009: £6.2bn).
- While ten IMA member firms each managed in excess of £100bn (see Table 12), 92 managed less than £15bn, 28 of whom managed less than £1bn.

Chart 54: Firm ranking by UK assets under management (June 2010)

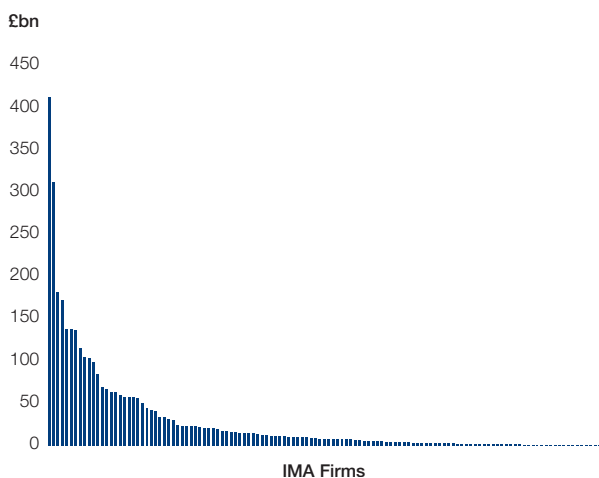


Table 12: Assets managed in the UK by IMA firm size

Assets under management	No. of firms	No. of survey respondents
>£100bn	10	10
£51-100bn	11	8
£26-50bn	8	7
£16-25bn	12	7
£1-15bn	64	33
<£1bn	28	4
TOTAL	133	69³¹

³⁰ A full internal IMA dataset 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 it does not include investment fund operators who outsource all their asset management operations.

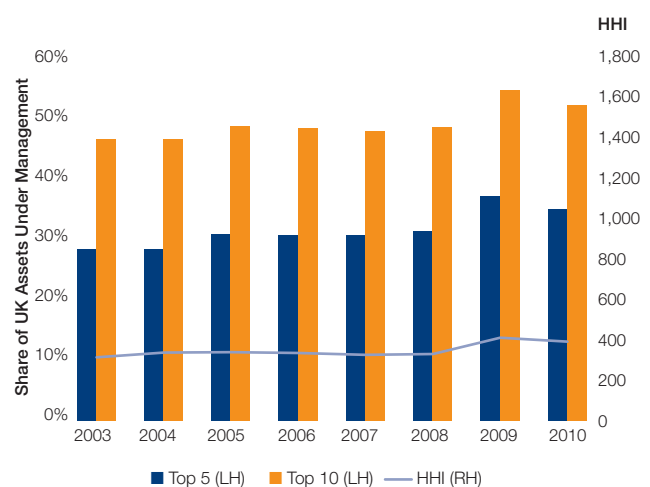
³¹ Although 76 responses were received, seven of the firms are mutual fund operators which undertake no in-house asset management in the UK.

Looking at the position of the largest firms (ranked by assets managed in the UK) as at June 2010, there are small changes to 2009:

- The top ten firms accounted for 52% of assets managed in the UK by IMA members. This is a slight decrease from a year earlier (54%) and is mainly explained by changes to the IMA membership base.
- The market share of the five largest firms also declined slightly to 35% (37% in 2009).

As illustrated in Chart 55, until 2009 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 HHI measure, the UK asset management industry has been particularly unconcentrated. This remains the case with the measure falling back to 386 from a revised 405 in 2009. Markets with an HHI between 1,000 and 1,800 are considered moderately concentrated.

Chart 55: Market share of largest firms by UK assets under management (June 2003 – June 2010)

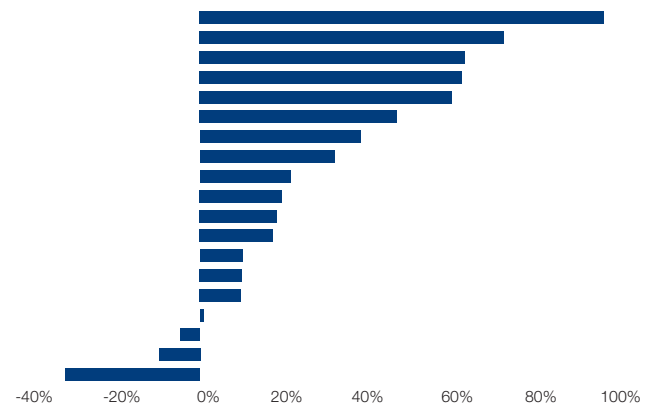


One of the themes arising from interviews over the past two years was that commercial conditions could become more difficult for boutique firms if clients gravitated towards firms perceived as better capitalised and if broader regulatory scrutiny intensified. This year, we again attempted to track the fortunes of those firms we identified as boutique asset managers. The criteria were:

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

Looking at asset growth, this (diverse) group of members has continued to display stronger performance compared to the wider IMA population, having increased their managed assets by 38% year-on-year as opposed to 14% among IMA members overall (see Chart 56). Last year, this group saw assets fall 5% compared to 12% for the wider IMA membership. As we are not able to evaluate the boutique universe outside IMA membership, it is difficult to draw precise conclusions. However, available evidence does not point to a boutique universe under significant strain.

Chart 56: Percentage change in UK-managed assets across 19 IMA boutique firms (June 2009 – June 2010)



Regulatory Environment

Regulation is an intrinsic part of the financial services industry's operating culture. At its best, regulation promotes confidence, protects consumers and allows well-run firms to distinguish themselves from their competitors. The UK investment fund industry in particular is highly regulated (both at product and management company level) and this degree of control is generally seen by IMA member firms as a positive element, providing consumers with protection in a market which offers a range of solutions to those looking to invest and save. This provides a quality mark that has both domestic and international value. At the European level, this positive element is further complemented by the international success of the UCITS brand, which is a frequently cited example of European regulation at its best.

As we reported in last year's Survey, asset managers believe that the credit crisis will require new regulation and/or legislation in a number of areas:

- The collapse of Lehman Brothers exposed a particular range of problems related to inadequate resolution mechanisms in the event of bank insolvency. While the UK has addressed some of these in recent legislation, the wider issue of cross-border resolution and crisis management is yet to be seriously tackled.
- The majority of asset managers thought that there needed to be some form of mechanism that dealt with the risks arising from the same banking institution being engaged in both principal and agency activities, particularly where trading activities might be implicitly underpinned by statutorily guaranteed deposits.

With respect to asset management specifically, there is broad acceptance that there are a number of lessons to learn. Whilst asset managers do not engage in proprietary trading and so are unlikely to be put at risk by movements in the market value of investments, they can be exposed to significant operational risks. Indeed, one of the main longer-term consequences of the 2007-2008 phase of the financial crisis has been a major focus within the industry on eliminating and mitigating operational risk. The other form of risk which has been subjected to historically high levels of scrutiny since the early phases of the financial crisis is counterparty risk (ie. the risk that the person on whom you rely to settle a trade or make payments under an investment will default in so doing).

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Greater focus on counterparty risk

“A number of illusions have been shattered. In terms of our dealings with counterparties, the discussions are on a completely different level now. You don't assume anymore that your broker won't go bust and we're doing more on counterparty risk than ever before. And I think that's healthy.”

Firms already report a significant intensification of FSA activity in risk management and this is generally seen as inevitable. While the overall impact is likely to be positive, it will drive up operating costs and the commercial consequences of this will not become clear for some time:

- Some interviewees believe it may be easier for larger firms to adapt and to bear the costs of a regulatory environment that is expected to be characterised by far greater degrees of scrutiny. This could, they believe, provide some form of competitive advantage while raising barriers to entry for the boutique end of the market. Longer term, this could alter the commercial shape of the industry.
- Others are more circumspect and believe that the industry is inherently characterised by a long tail of smaller firms and that there will be an adaptation to changed regulatory structures, particularly if different degrees of regulatory scrutiny are applied to large and small firms. However, that creates its own challenges with respect to potential firm failure.

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Impact of changing oversight

“ We always thought we were very traditional and very cautious, but the FSA is now on a mission in terms of risk management governance. What you historically thought was the regulatory dividend for being the ‘good guy’ is no longer available to you. We’ve got to invest a lot more in that area, even though we think everything is done extremely well. There is a massive upgrade in oversight to try to prevent another financial crisis. And I ask myself: ‘How can a boutique possibly survive that?’. This actually creates a competitive advantage for big fund managers because they can do it; it costs a lot of money, but they will do it and do it well. But if the FSA does it to everyone I cannot see where these boutiques are going.”

“ The one uncertainty that I have is that there is still an appetite, certainly at the FSA, for a different level of scrutiny for small and big firms. And if one standard isn’t applied to all, in the end, you could end up with more ‘cowboy’ institutions because not much attention is paid to them.”

Four regulatory concerns

There is also unanimity that it is near impossible for regulation to prevent future financial crises and a strong majority (70%) of those we interviewed identified the current regulatory environment as one of the key areas of concern for them.

This finds expression in four ways:

1. Regulatory initiatives perceived to be disproportionate or wrongly targeted, notably:

- *The original proposals for the Alternative Investment Fund Managers Directive (AIFMD).* The range of firms and activities caught, including pooled pension vehicles, did not appear justified to firms across the industry given the root causes of the credit crisis.
- *The remuneration code.* The UK's asset managers were impacted by rules relating to remuneration disproportionately when compared to the rest of the EU (as well as the US). To a great extent, that was a reflection of a significant concentration of UK-based institutional asset managers within the EU. But it also reflected the FSA's approach of treating UCITS managers, who have permission to carry out discretionary portfolio management, as caught by the full width of the EU's Capital Requirements Directive. In the end, the proportionate approach promulgated by the European Banking Regulators and adopted by the FSA delivered an acceptable solution.

- *Changing capital requirements for asset management firms.* There continues to be a fear that the supervisory focus upon prudential weakness at banks will feed into the supervisory approach taken in relation to asset managers. The risks in relation to which capital needs to be held are of a different nature in asset management firms and demands for excessive capital will directly impact the costs borne by clients.

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Need for proper regulatory targeting

“There are certainly good elements out there that are quasi-regulatory, for example, centralised clearing of derivatives. Those make the market better. The robustness and diversity of trading platforms also makes the market better and sounder. But the reality is that most of those innovations are industry-led. Some of the compensation measures, on the other hand, look punitive in comparison.”

- 2. **Risks of unintended consequences.** Rapid regulatory change always risked unintended consequences. The example cited by several of those we interviewed was centralised clearing. While broadly supportive of the direction of travel, they feared that the way in which proposals were being implemented could result in considerable cost for end clients (see p. 92).

3 Lack of adequate international coordination.

While strong and credible regulation can be a source of comparative advantage for individual jurisdictions, in an international environment characterised by different political pressures and economic competition between financial centres, any lack of coordination, whether on substance or timing, can result in regulatory arbitrage and poor outcomes.

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Coordination internationally

“You’ve still got regulatory arbitrage. The industry has internationalised. Regulation has not. Regulators are unable to present a single coherent international proposition and they still engage in regulatory comparative advantage. This is one of the biggest things that has not changed.”

“We’ve got to harmonise across Europe, we’re a European business. So the idea that they can run UK consumer-centric initiatives independently is just completely flawed. Let’s go slower, let’s harmonise with Europe and let’s roll out a coherent pan-European policy. Let’s stop thinking the UK is an island that does everything separately and independently. Because that’s what’s driving up our costs.”

However, where European harmonisation is taking place, interviewees strongly felt that legislation should be carefully considered and driven not by politics but by single market considerations that will ultimately benefit industry and consumer.

4. The way in which regulatory oversight is exercised.

The UK retail fund industry has been hit heavily by compensation levies as a result of the default of Keydata Investment Services Ltd.³² This followed earlier compensation payouts to investors relating to the defaults of Pacific Continental Securities and Square Mile Securities. The retail firms we interviewed cited Keydata as a source of major irritation with

respect to the quality of regulatory oversight. Equally, there is some recognition of the fine balance between the kind of scrutiny that can avoid such failures and what might be perceived as a regulatory ‘heavy hand’.

There is also a broader desire to be able to work more effectively with regulators. For several years in the Survey, respondents have expressed frustration with the difficulty in establishing consistent relationships with supervisory teams, due in particular to the perceived high turnover of staff at the FSA.

In addition to the immediate financial implication of Keydata, broader points were raised by interviewees with respect to product regulation and how a focus on more sophisticated products, such as absolute return funds, might be detrimental to the further development of more outcome-oriented products. However, this concern about product regulation sits alongside a widely perceived need to ensure that such products do not over-promise or mislead consumers with respect to what the investment strategies aim to achieve.

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A need for care over product regulation

“Absolute return strategies and other products with an element of guarantee associated with them are very complex instruments. You don’t want to know much about them, you just want them to work. The regulators, as a result of the crisis, are suspicious that we are introducing this complexity to generate more fees whereas I genuinely believe that there is value for our clients in these sophisticated tools. And we have a big communication task to explain this.”

“I am concerned that people are going to end up with very low-risk products as perceived by the FSA, when in fact they could be catastrophically high-risk when you’re thinking about inflation or government debt. People have these low-risk products but I’m actually not sure they know what it means.”

³² Keydata is an investment firm that had sold life insurance-linked investment products from Luxembourg companies SLS and Lifemark. It was declared insolvent and closed down by the FSA in 2009. Owing to the structure of the UK Financial Services Compensation Scheme, UK retail fund managers were required on short notice to contribute £233m to subsidise the obligation of another class of firms to finance compensation payments to investors.

One specific product area of concern were ETFs, particularly in the context of their very strong recent asset growth. Four interviewees identified some types of ETFs as a potential threat, both systemically and to the broader reputation of the industry.

industryview

Risks posed by ETFs

“There’s a bomb going to go off with ETFs. There are synthetic ETFs out there and I don’t think we’re giving them a close enough look. You’re buying a piece of paper.”

“The ETF market concerns me in terms of how much volume it’s getting. I just hope we don’t get into a situation like the one we had with the collateralised debt obligation markets where a lot of people don’t know where the credit risk lies.”

“ETFs are another issue because something’s going to happen with one of the fringe players, which you worry about if you’re an indexer.”

“The Financial Stability Board’s report on ETFs was very interesting because, clearly, they are now being perceived as potentially systemically at a point of vulnerability, particularly those that are not invested in physicals but in swaps.”

industryview

Reputational dependence on distribution

“You have to wipe out mis-selling scandals to the extent that these exist. These are the most corrosive things you can imagine. And now that the investment management industry has become detached from distribution almost entirely, you’ve got what I would call a separate industry eroding the trust of our industry. Nobody notices that. Everybody thinks that a mutual fund is an entire package from manufacturing through delivery to reporting, but asset managers only do so much before they hand over to distributors. And they’re the ones who mis-sell. Keydata is a case in point where none of us had anything whatsoever to do with it and we’re now suffering from the erosion of trust. So if you don’t address the mis-selling issue, you won’t address the trust issue.”

As we have reported in previous surveys, there is support for the broad aims of the Retail Distribution Review (RDR), even as the details of its implementation remain the subject of disagreement with the regulator. However, while the adviser-charging model will give consumers and their advisers greater control over commission payments from providers, interviewees also expressed concern about its limitations. Many within the fund industry believe that there are market distortions to the advantage of the insurance industry that will continue to have a detrimental impact on consumer outcomes.

Given the current uncertainty over the final outcome, our questions on RDR this year were of a more general nature:

- The prevailing industry view is that access to advice may become more difficult for middle to low income groups. Where it is available, it may look very different, with a focus on a smaller range of options.
- Some of those we interviewed believe this will lead to an increasing focus on packaged products which will embed certain decisions that may otherwise be an area where advice might have been sought. Asset managers can play a wide variety of roles in the manufacture of such products (eg. multi-manager, multi-asset, solution-based).
- Within such an environment, there is no real consensus on what combination of advice or guidance may be needed, and how that can be delivered effectively. Clearly, however, the way in which it is delivered will have significant implications both for asset manager relationships with distributors and the ability of consumers effectively to access the full range of financial services products.

industryview

A need for regulated advice or guidance?

“ We see a separation of a market for the sophisticated client who still wants pure products. It is more and more obvious that this space is limited to high net worth individuals whilst in the mass market people have limited resources and there may not be advice available at a reasonable price. In such an environment, I believe that we should have more portfolios where advice is in-built, and where the portfolio is managed not because of its content but for the outcome. And this I think is going to be the direction of travel for the mass market. ”

“ I think the majority of people actually don't need advice. If your finances are complex, for example when you're a high earner, you need all kinds of advice about that. But if you're investing money over the long-term as an ordinary person I think you need guidance and that can be provided off the internet and in many cases is done so very effectively now. ”

“ We'll find a lot of the smaller IFAs either disappearing or merging, and a lot of them not offering true advice. It will be guided advice, it will be mechanical. You go onto a platform, you put your profiles in, and you'll be pushed in certain directions. It's simpler for the investor but it also raises the question of how much knowledge you have before you invest. Or are you going to get a very vanilla offering, so choice is removed from the industry? People will have much less choice and they'll have very simple offerings. And that's good and bad. It's good because it's simpler to understand but you also want choice and diversity, you want people to be able to build different portfolios and have control over their future. ”

5. The International Dimension

Key Findings

Four international dimensions

- The total share of assets managed in the UK on behalf of overseas clients has grown to 33%, up from 31% in 2009. The industry's increasing internationalisation is also evidenced by a growing proportion of firms with primarily overseas clients.
- Overseas-owned firms now account for 52% in UK assets under management, a small decrease compared to the year before (53%).
- The size of overseas-domiciled funds managed in the UK has increased 20% year-on-year to £617bn, of which the largest part (75-80%) is domiciled in Dublin and Luxembourg.
- In total, IMA members including their parent groups are estimated to have over £19.9trn in assets under management globally (£17.3trn in 2009).

UK in comparative context

- With 31% of total European assets under management, the UK continues to be the largest single asset management centre in Europe and the second largest in the world. While growing very fast, competing centres in the Far East are starting from a far lower base in asset terms.
- Strong growth in the UK domestic market notwithstanding, the UK's position as a fund domicile continues to be far less favourable, accounting for only 10% of the European fund industry.

Current outlook for location decisions

- While the UK continues to rate highly as a financial services centre, concerns remain on all three levels of domicile choice – corporate, personal and fund. Only 14% of respondents noted an improvement in the business climate over the past year.
- In addition to policy shifts perceived as negative, there is a sense that the UK's traditional locational advantages are being challenged through greater technological and communication sophistication as well as economic and labour market shifts.
- The danger focuses as much on future location choice for new capacity as relocation of existing capacity.
- This increases the need for a stable and predictable fiscal environment and a regulatory regime that maintains high standards while not falling foul of regulatory arbitrage. Overall, the UK industry would like an unequivocal message that the UK is 'open for business'.

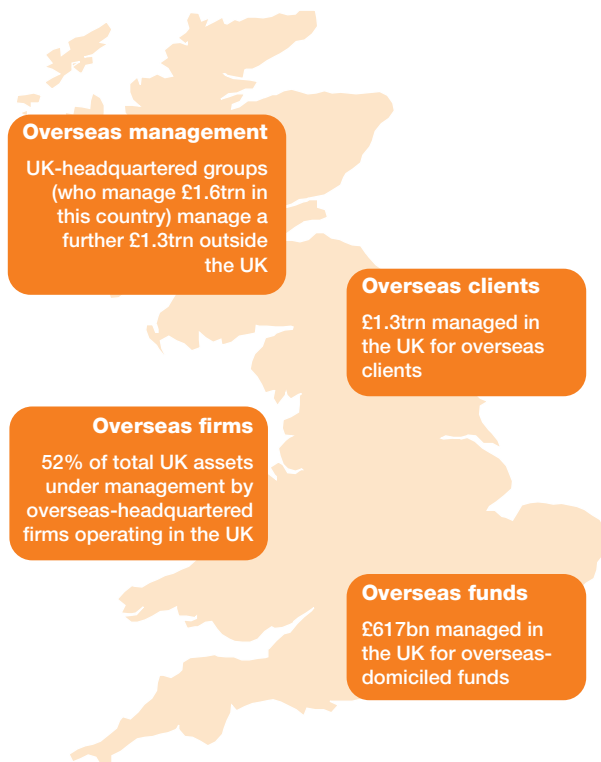
5. The International Dimension

Four Dimensions

This chapter focuses on the international nature of the UK asset management industry. As Figure 5 shows, this can be seen in four main ways:

- Overseas clients.
- Overseas-headquartered firms.
- Overseas domicile of funds.
- Overseas management of assets.

Figure 5: International dimensions of the UK asset management industry

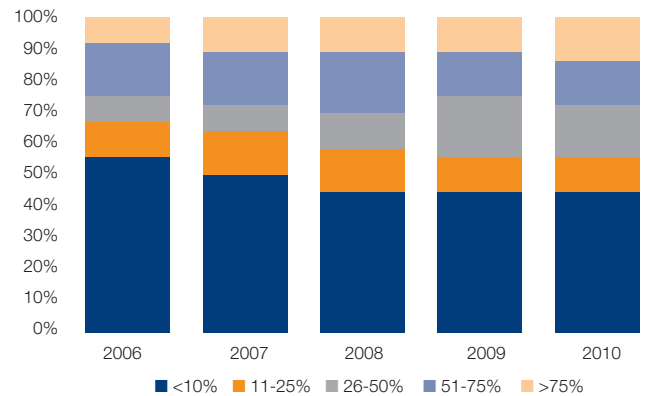


Overseas clients

The £3.9trn figure for total assets under management includes an estimated £1.3trn managed on behalf of overseas clients. This is 33% of total UK assets under management and has increased by around two percentage points since last year. Of the overseas client base, 44% is accounted for by European clients and 56% by clients from the rest of the world.

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 over 50% of their client base as overseas (in UK assets under management terms) has risen from 25% to 28% since 2006 (see Chart 57).

Chart 57: Overseas client assets as percentage of firm assets under management in the UK (2006 – 2010)



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. As we have noted in previous surveys, there continues to be concern about the speed of change in the European distribution landscape and a recognition that it will take many years to achieve the kind of opening to third party fund competition that a number of UK exporting firms are seeking to achieve.

industryview

Ensuring a more transparent European distribution environment

“First, there is a need to remove the opacity in European charging structures. In the UK, you have a clear understanding of what you’re paying for. If you go to Europe, that is not the case. Second, professional, independent advice needs to be able to flourish in the region. Having to invest savings in the stranglehold of a single dominant channel or sector isn’t good. PRIPs³³ will move it in some way, but we should transport some UK standards into Europe.”

“I would like to see a distribution environment where choice is a basic consumer right, where every distributor has to offer a reasonable range of choice, where any perception that the consumer might have about a potential conflict of interest is openly disclosed and managed, either through regulation or through industry self-policing and best behaviour. I’d like to see a world where the whole of the industry is aligned to make sure that the consumer does get the bulk of the return of the capital they provide, and we figure out how we split the rest.”

industryview

Europe as an attractive market for UK firms

“The pool of assets is much bigger in Europe than it is in Asia. Many get caught up in growth as the main driver, whereas I think the asset management industry lends itself to servicing a pool of assets, and the European pool of assets is very deep and available. We are getting good flows in Europe relative to the size of our operations, which makes us think that there is an increasing openness to cross-border players. The tide is swinging towards a more transparent sales process, which is allowing a decent number of external alternatives into the mix.”

³³The Packaged Retail Investment Products (PRIPs) initiative aims to align disclosure requirements as well as the regulation on the selling and marketing of different types of competing financial products across the EU.

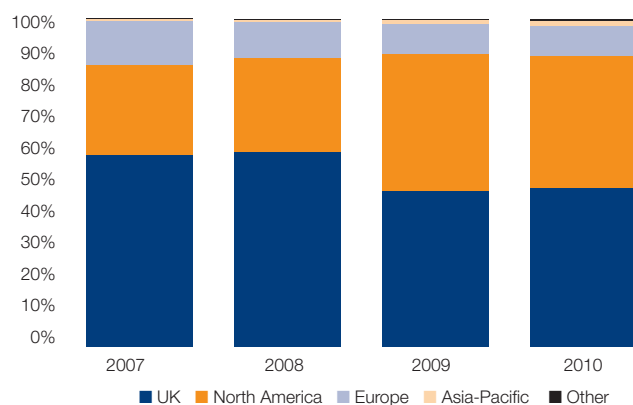
Overseas-headquartered firms

There are a number of overseas-headquartered firms with a sizeable global footprint operating in the UK.

Chart 58 breaks down total assets under management in the UK by the region of group (or parent group where relevant) headquarters and shows the evolution since 2007. This year sees little significant change after a large shift in 2009 caused mainly by the merger between BlackRock and BGI.

From accounting for almost 60% of total assets under management in 2008, UK-owned asset management firms now account for 48%, which serves to underline the international nature of the industry. The direction of travel is not one-way, however. The falling share of European parent groups from 13% in 2007 to 9% in 2010 in part reflects M&A activity by UK firms as a result of a number of banks divesting parts of or their entire asset management arms following the 2007-2008 crisis. In this respect, 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 58: UK assets under management by region of parent group headquarters (2007 – 2010)



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 £617bn of assets (16% of total assets) are managed in the UK by IMA members for overseas-domiciled funds. This is a 20% increase year-on-year.
- Luxembourg and Dublin are key locations for overseas-domiciled assets. Responses to Survey questions both this year and last indicate that 75-80% of UK-managed overseas-domiciled fund assets are in Luxembourg and Dublin.
- In terms of the composition of overseas-domiciled funds, institutional money market funds are the largest single component, accounting for around 27% (£167bn from a revised £158bn in 2009). Almost all institutional money market funds whose assets are managed in the UK are domiciled in Dublin and Luxembourg. Other overseas-domiciled vehicles comprise a range of institutional and retail products, including hedge funds and ETFs.

The £617bn would rise by a further £155bn for those hedge funds not covered by IMA membership. There are also other fund types not fully covered by IMA members, including institutional money market funds.

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 p. 55).

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:

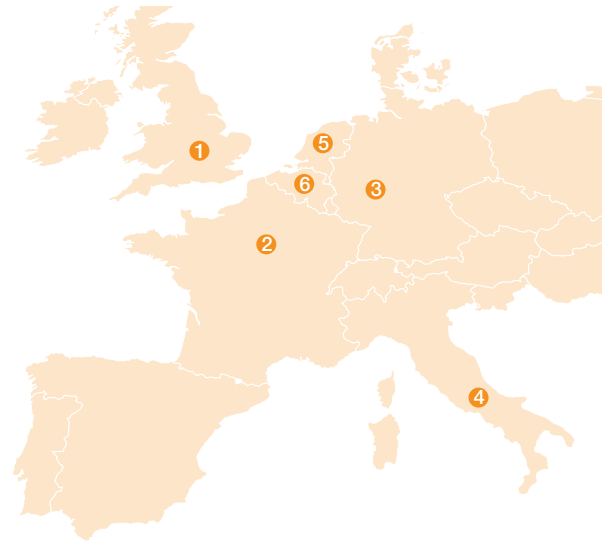
- UK-headquartered firms which responded to the Survey manage £1.6trn in the UK. Globally, these firms manage a further £632bn. The groups of which they are a part have an even wider reach, managing a total of £3trn internationally.
- In total, we estimate that IMA members, or the groups of which they are a part, managed over £19.9trn globally at the end of December 2010 (from £17.3trn a year earlier).

Year-on-year comparisons in both cases are affected by changes in the IMA membership and in corporate activity at parent group level.

The UK in a Comparative Context

The UK continues to be the largest single asset management centre in Europe. Figure 6 shows that, as at December 2009 (the most recent year for which comparative data is available), the UK share of total European assets under management had risen slightly to 31% (from 30% in 2008). Sterling weakness saw this share shrink in euro terms from 34% in 2006 – 2007.

Figure 6: Assets under management in Europe (December 2009)



Country	Net assets (€bn)	Market share
1 UK	3,783	30.6%
2 France	2,816	22.8%
3 Germany	1,460	11.8%
4 Italy	658	5.3%
5 Netherlands	474	3.8%
6 Belgium	393	3.2%
7 Other	2,782	22.5%

Source: EFAMA

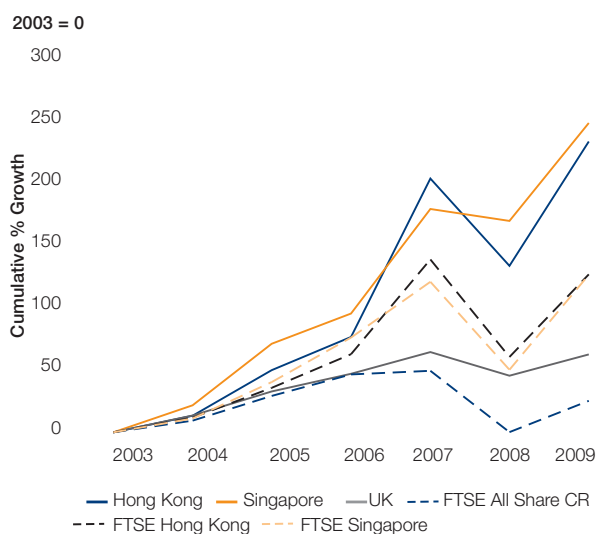
Accurate wider comparative data on a management location basis is difficult, tending to be based on individual market sizes. However, all available data point to the UK being the second largest asset management centre in the world, after the US.³⁴

³⁴ Discretionary asset management undertaken by SEC registered firms is estimated by the Investment Adviser Association (IAA) at \$35.2trn (£23.1trn) as at April 2010. However, this includes assets managed overseas, so will inevitably be an overstatement of management activity actually undertaken in the US. Data from the Boston Consulting Group puts the size of the US market (measured in terms of professionally managed assets) at \$26.1trn (£16.4trn) at the end of 2009.

Outside Europe and the US, the closest rival in size to the UK is Japan (£2.7trn as at March 2011).³⁵ The Hong Kong and Singapore industries remain comparatively small with assets under management of £286bn and £290bn, respectively, at the end of 2009. Both of these centres experienced very strong expansion in recent years, which appears to have been driven both by market movements and substantial new asset flows (see Chart 59).

If recent growth rates were to be sustained, Hong Kong and Singapore combined would have total assets under management of over £3.8trn by 2020, still less than half those of the UK.³⁶

Chart 59: Comparative asset growth, Hong Kong, Singapore, UK (2003 – 2009)



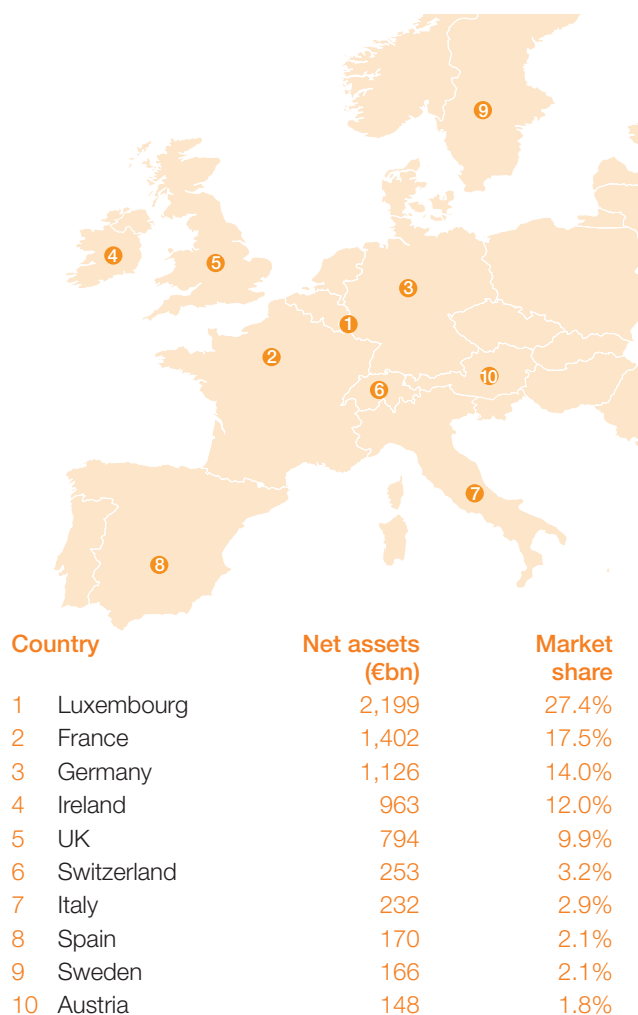
Source: IMA, Lipper, MAS, SFC

External projections of market growth for Asia excluding Japan also show that while this part of the global market is set to become increasingly important, it will be some time before the investment markets mature to a level that will compare to European and US domestic savings pools.³⁷

Fund management

The combined net assets of the investment fund market in Europe (ie. the market for UCITS and non-UCITS funds) stood at €8.0trn at the end of 2010, an increase of 14% year-on-year.³⁸ The UK as a fund domicile accounts for 10% of the total (see Figure 7). Including overseas-domiciled funds whose assets are actually managed in the UK, that figure would double.

Figure 7: European investment funds by country of domicile



Source: EFAMA

³⁵ Source: Nomura Research Institute. This does not include all in-house insurance assets.

³⁶ The data for Singapore has estimates for discretionary management from 2004. The compound growth rates used for the projection are 20% for Hong Kong, 17% for Singapore and 8% for the UK.

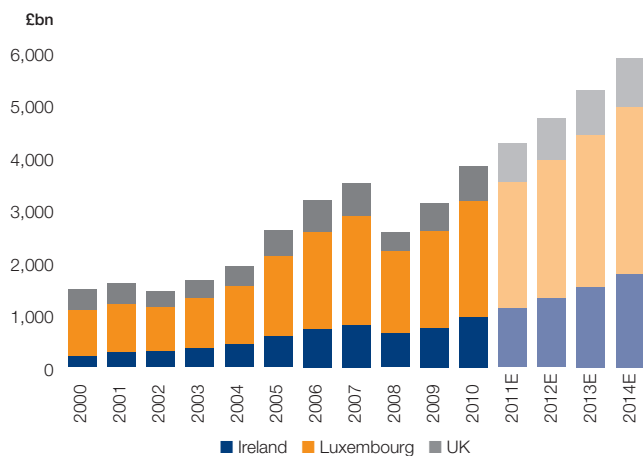
³⁷ See, for example, Nomura Research Institute, Growth of the asset management business in Asia, 2010.

³⁸ Data sourced from EFAMA.

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. In making a historical comparison between the UK and euro-zone fund centres, the data of the past decade shows very clearly the rise of other European fund domicile centres:

- Total fund assets domiciled in Ireland have grown at an average annual rate of 17% since 2000, compared to 10% in Luxembourg and 8% in the UK (in sterling terms).
- As Chart 60 illustrates, were growth rates to continue at similar rates, Luxembourg and Dublin will between them account for almost €5trn in domiciled funds by 2014.

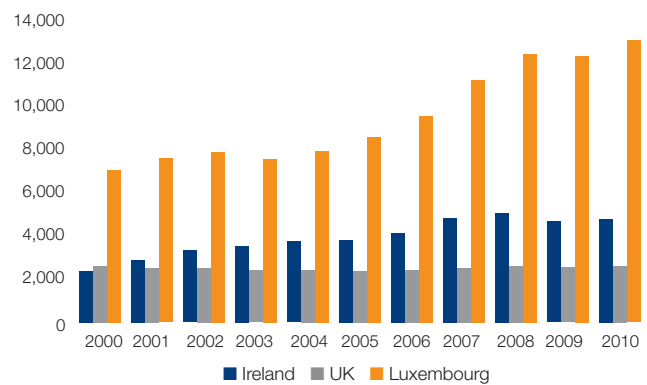
Chart 60: Fund assets by domicile, Ireland, Luxembourg, UK (2000 – 2010, projected to 2014)



Source: IMA calculations, EFAMA

- The contrast between the UK and these two fund centres is also well-illustrated by the number of funds domiciled (see Chart 61). Over the past ten years, this has increased by an average of 7% a year in Ireland and 6% in Luxembourg. In contrast, the UK remains virtually static.

Chart 61: Total number of funds by domicile, Ireland, Luxembourg, UK (2000 – 2010)



Source: IMA, EFAMA

Current Outlook for Location Decisions

The UK is still rated as the leading global centre for asset management in the most recent GFCI report, and is comfortably ahead of other European centres as a financial hub.³⁹ However, while several interviewees commented on how resilient the UK – and London in particular – has been, the mood among those we interviewed was generally fairly downbeat:

- Only three interviewees (14%) noted an improvement in the UK as an operating environment during 2010. A slightly higher proportion (22%) expressed positive sentiment about the outlook for the next five years.
- This broadly repeats our findings last year and stands in marked contrast to the kinds of comments that we reported when we first started asking about this issue in the 2006 Survey (see Figure 8 overleaf).

Concerns cover all three areas of domicile choice (corporate, personal and fund) and are broadly familiar from earlier surveys:

- With respect to personal and corporate domicile, the predictability of fiscal measures has been a growing concern in recent years, as has been a perceived negative shift in the immigration climate.
- Although the industry and Treasury continue to work to improve the competitiveness of the tax regime for investment funds, the momentum that has built particularly in Dublin and Luxembourg is thought difficult to reverse, certainly in the foreseeable future. Firms we spoke to gave a view that points to a considerable and ongoing ‘perception gap’ between the degree of change in the UK funds regime and the reality as investors see it.

industryview

Loss of position as a fund domicile of choice

“Our problem is that perception of the UK is still not good. There are people in the offshore market that just won’t touch a product domiciled in the UK. Whereas there’s a perception that you can invest in a product domiciled in Luxembourg and you’ll be taxed at your local level, there’s a concern that UK authorities constantly change their tax policy so people just don’t trust them.

I would like a clear policy statement from the UK Government that this is a suitable domicile for global funds distribution and that the UK will ensure that all global investors are treated fairly, their rights of access to that product are unlimited and there will be no tax recoverability at the UK level other than for UK investors.”

³⁹ See Z/Yen, The Global Financial Centres Index 9, March 2011.

Figure 8: Five views from across the industry (2006 – 2011)

2006 – 2007 IMA Survey	2010 – 2011 IMA Survey
<p>General degree of satisfaction, but worries about rising costs</p>	<p>Rising unease, diminished confidence about long-term outlook</p>
<p>“ We like London. It’s almost our head office. We see an amazing pool of resources in the UK. It’s deeper and broader than in other places. London is still the natural place. We do have increasing costs and retention issues, but that has more to do with the direction of the industry than London per se.”</p> <p>Major international firm (overseas HQ)</p>	<p>“ It has got worse at three levels: regulation, political attitudes and tax. The UK is now less attractive and less competitive in consequence. This is an international business that now has to deal with domestic issues. Ten years ago, London was setting the pace in the internationalisation of workforce. Hong Kong and Singapore say ‘we’re open for business’. The UK says ‘we’re open for businesses’, but it’s not a welcoming climate.”</p>
<p>“ London really is the financial capital of the world. It’s a very natural place to run global equities products, emerging markets products. I really cannot see any weakening of the presence here from the fund management perspective.”</p> <p>Major international firm (overseas HQ)</p>	<p>“ I think you’ll lose the new investment. And it’s not about the high-paid fund managers. There are thousands of people in this building and down the road in support functions; that’s a lot of jobs that aren’t going to be in London or even in the UK.”</p>
<p>“ We’re entirely happy about London at the moment. There’s no reason for us to leave.”</p> <p>Major international firm (UK HQ)</p>	<p>“ If the 50% tax is temporary, then fine. If it stays, then anyone opening an asset management business today would be unlikely to choose London, and memories can be quite long in this regard. Furthermore, with so much of the world’s growth and savings being in Asia, and an increasing share of our revenue being from outside the UK, we could see ourselves eventually relocating to Asia.”</p>
<p>“ London is winning as a financial centre, so there’s major pressure on costs and infrastructure. You can go and work at a boutique tomorrow at significantly more than you can earn here. There’s a huge demand for talent.”</p> <p>Major UK firm</p>	<p>“ From an investment management perspective, the outlook is positive. But as a domicile, we’re not getting any clear indication from the UK government that keeping UK or global funds domiciled here is a priority for them. I still feel that, at the moment, the Government still hasn’t quite decided to support our industry; they feel it’s sort of a dirty word. But we’re a UK-based organisation, and we’d probably withstand a lot of pressure before we moved.”</p>
<p>“ I have no hesitation in saying that London will continue to be the global financial centre, and I think New York will fade.”</p> <p>Major UK firm</p>	<p>“ The business climate has improved a little in that the City is no longer seen as the enemy. I am optimistic about the long-term future of the UK as an asset management centre.”</p>

Erosion of traditional advantages

One theme that has received greater attention in interviews this year has been the extent to which external factors are also having an impact. Several interviewees have suggested that some of the relative advantages of London and the UK, notably scale, language and time zone, are starting to decline.

A number of reasons are provided for this:

- Greater inter connection as a result of technological advances, which are diminishing the ‘cluster’ advantages available to UK financial services.
- Actual – and anticipated – shifts in the patterns of economic and market growth in different global regions, particularly Asia but also Latin America and the Middle East/Gulf.
- The ongoing dominance of English as the global business language facilitating mobility in the international financial services industry.
- Labour market flexibility internationally, allowing firms to operate across time zones with greater ease than having to depend upon the straddling effect provided in the UK (and continental European) time zones.

Combined with concerns about predictability and the need for policy change that is seen as durable rather than arbitrary, all of this is leading firms to emphasise the importance of an ongoing proactive effort by the UK authorities. This would involve an unequivocal signal that the UK is ‘open for business’ and will fight to retain its pre-eminence as an international financial centre.

industryview

The erosion of cluster advantages

“The cluster argument is weakening and technology has a lot to do with that. You have a more multi-polar world. Although you still have a cluster benefit in the case of an equity or a bond fund manager, why can’t you sit somewhere else with broadband? Competitive firms can emerge in other countries as long as the savings pool is big enough.”

“It’s easier for us now to place people wherever we feel like placing them. You don’t really need people sitting together in ways you did in the past. That’s the reason why the UK needs to be more assertive about creating a good environment.”

“Without question, the effects of having the buy-side and sell-side close together are less significant than they were ten years ago. The advance in communication and technology has been enormous. The benefits of co-location are more in doubt now. And so is the time zone benefit, particularly when you consider the cost of living in London. People are working 24/7 so they may just as well be doing that in Singapore, India or elsewhere. But these are longer-term factors.”

Risks to new investment

While the actual number of asset management staff relocating from the UK in recent years due to policy shifts has been comparatively small, it has been a reality. International firms also stress that the problem is less visible when measured in these terms. More significant will therefore be decisions on the future location of new capacity, notably:

- Whether corporate decisions favour overseas financial centres.
- Whether individual employees prefer not to relocate to the UK from overseas.

industryview

New capacity and potential recruits to go elsewhere?

“Not that many people have voted with their feet yet but it's not about that; you haven't seen new people come in either. The UK is a less attractive place from the tax, regulatory and other perspectives. There is a definitive risk that over time, you'll see attrition here but no replacement. But this doesn't seem to be seen as a real problem on a political level.”

“We've lost more than a couple of people overseas. As successful as we are, we have to work incredibly hard to get people from overseas to work in the UK. It is not the posting that it was five years ago. It used to be top of everybody's list. We don't have issues with visa yet, but half of the battle is creating your shortlist to choose from and that's getting more and more difficult for non-Brits.”

“If we are trying to compete with the best firms all over the world, then we have to recruit the best people and this year a number of our recruits had a hard time getting their visas. So from that point of view things are looking less good, although not to the extent of making us want to relocate elsewhere.”

“There isn't an understanding that there's a war for talent and you need to be competitive. It just doesn't seem to have got through to people. I am very worried about a 'one-size-fits-all' pay structure or remuneration code which means that we will no longer be competitive with jurisdictions that don't require that.”

industryview

Broader support for capital markets

“We've lost our focus not in terms of the asset management industry but in terms of capital markets. We need to continue to make sure that entrepreneurs will be here and companies are listed here because that's where business will be built.”

“A lot more thinking needs to be done about the structure of capital markets and I'm afraid to say that, having tried to generate some of those conversations, I don't think this will become a live debate until the point at which the recovery gets going and they're going to find there's a demand for capital in one place, and the supply in another. In terms of London and its position, we also need to be thoughtful about the power shifts around the world. London has been pre-eminent in this space because historically it's been the place that finance has been processed through. Actually there's a dominant new financial power rising in the world: China. What are we going to do to make sure that when all that R&D finance is made available, that it's processed through London?”

In this respect, shifts of perception by both large firms and more mobile, smaller investment firms and boutiques will be extremely important.

A final point made by several respondents revolved around the need to ensure that the UK capital markets themselves operate in a competitive and healthy way in future years. The unifying theme here is the ability to maintain a world-leading status as a 'turntable' for capital, ensuring that companies regard the UK as a pre-eminent location for the raising of finance.

6. Market Interaction and the Impact of MiFID

Key Findings

Market interaction

- Firms are increasingly adapting to the post 2007-2008 crisis market conditions, although uncertainties remain around bank capital levels and resolution regimes.
- Concerns exist about the effectiveness and appropriateness of regulatory measures aiming to improve and internationally harmonise the market infrastructure. In particular, firms are worried about the approach to the central clearing of derivatives.

Equity trading

- We included a new question about the use of single equity contracts for difference (CFDs) to gain a better understanding about the use of derivatives for synthetic equity exposure. Overall usage as a proportion of single-issuer equity exposure remains low, with most respondents (89%) indicating well below 10%.

Corporate bond trades

- While dependence on banks remains high, their ability to provide adequate liquidity is not universally acknowledged. Almost 30% of respondents are not satisfied in this respect.

Derivative trades

- For the first time, we asked about the exchange of 'independent amounts' between counterparties in derivative trades. While this kind of capital set-aside has not typically featured for over-the-counter (OTC) trades, 35% of respondents now appear to use it.

Impact of MiFID

- Consistent with 2009, respondents do not see an improvement in post-trade transparency resulting from the Markets in Financial Instruments Directive (MiFID). We also asked a question about the impact of MiFID on the cost of trading. Contrary to expectations and the reform objectives, the majority of respondents (59%) do not see a decrease in trading costs.

6. Market Interaction and the Impact of MiFID

In capital markets, asset management firms comprise a significant portion of the investor group, which invests on behalf of underlying clients. These firms operate on an agency basis which acts effectively to remove potential conflicts between the business of the manager and that of their client. This in turn puts considerable emphasis on the need for managers to be able to trade in an efficient and transparent manner.

Last year we drew attention to many firms' pre-occupation with difficult market conditions and their concern that the infrastructure underpinning market access was strained. This year we have seen two broad themes emerge from these preoccupations:

- Firms have further adjusted to continuing problematic market conditions. Although trading in some markets has settled down on the face of it, this is somewhat belied by the continuing lower (pre-crisis) levels of liquidity provision and shallower level of trading across the board. There is also uncertainty about future bank capital levels and about the practical operation of bank resolution regimes. But undoubtedly, firms are better accustomed now to dealing with these realities and this is reflected in their responses.
- While firms remain concerned about the quality of market infrastructure, they are considerably more concerned about the quality of some of the regulatory responses to improving that infrastructure. Both the US and the EU have expressed a desire to ensure that their regulatory regimes for OTC derivatives in particular are dovetailed. In the EU, the legislation is known as EMIR (see text box). The reality is that there are still many differences between the regimes and huge

uncertainties about both. For example, the US legislation (Dodd Frank) appears to have introduced many extra-territorial provisions, justified primarily on the basis that the banks and service providers may be US-domiciled or part of a US group. For a UK-based asset manager, however, these provisions introduce the possibility that trades may have to be registered and reported in two places; the definitive answer remains elusive.

What is EMIR?

EMIR (European Markets Infrastructure Regulation) is Europe's legislative response to the G20 commitments on derivatives. It is designed to bring in several new and separate areas of regulation: common supervision of all clearing houses in Europe; central clearing of contracts for much of the enormous OTC derivatives market, and a significant degree of transparency for derivatives trades, both for regulators and for market participants. It is a complex and highly technical area. In due course, the provisions in EMIR will be augmented by capital rules for derivatives (through the Capital Requirements Directive) and by rules relating to trading platforms (through MiFID). Market participants are also substantially impacted by the overlaps – and underlaps – between EMIR and the US equivalent regulation, known as Dodd Frank.

In the EU, firms continue to question the wisdom of some aspects of the Commission's approach both to central clearing of derivatives and the introduction of new trading concepts across all asset classes in MiFID. They have been alarmed that such important developments appear to be considered within very narrow time windows and without clear guiding principles in terms of improved market resilience. It was also notable in the legislative proposal for OTC derivatives that many investor-specific issues had been missed because of the rush to legislate.

industryview

Risks for centralised clearing

“Centralised clearing is an area where I worry about unintended consequences at the market structure level. If everybody has to clear and you don't recognise the different riskiness of different types of participants, you may end up making certain risk-reducing activities, such as LDI hedging, so expensive that in fact it's no longer viable to do. And as a result you don't manage your risk as well as you could and risks within important pools of capital such as pension funds end up rising not falling.”

“The regulatory challenge worries me a lot. There is a danger that instead of penalising those that have created problems, you end up penalising everybody. Some of what is currently on the agenda has not been thought through enough and it's very difficult to make headway. If centralisation of derivatives clearing were to be implemented in the way that it had originally been proposed, it would be a disaster for asset managers and pension funds. We are not saying that you don't need to improve things, but to ask for greater consideration of the implications. Will there be more liquidity? I'm not so sure. There is a real risk of forcing things into a monopolistic structure.”

As part of the Survey, we asked firms detailed questions about their interaction with capital markets. Compared with previous years, more questions were asked, which reflects our expectation that the next three years will see significant changes in most markets. This includes changes in the OTC derivatives market owing to the introduction of central clearing and the standardisation of many contracts in Europe and the US, and gradually in Asia and other parts of the world. The review of MiFID has discussed potentially far-reaching changes in the equity and fixed income markets with regard to publication of data on completed trades and, more unexpectedly, considerable prescription in markets pre-trade.

Equity Trading

Over the last decade, there has been a shift at almost every level of firm size to dedicated dealing staff and greater reliance on technology. The latter trend has become more marked in recent years, as investment in technology improves the opportunities to secure good quality execution of trades. Commonly this equates to a search for liquidity in sufficiently large volume to allow purchases and sales to occur without undue change in the dealt price.

Many firms have stepped up their equity trading technology to a higher level even compared with a few years ago. Given the huge increase in reliance on algorithms for optimising trade flow and the banks' simultaneous introduction of many trade-crossing networks (so-called “dark pools”), there is now likely to be pressure to consolidate trading mechanisms.

Execution-only trades

As in previous years, we asked firms what proportion of equity trades through brokers, crossing networks and direct market access were directed on an execution-only basis. Originally introduced to track changes in broker commission arrangements, the question also provides an indication of the extent to which firms are taking control of their equity trading.

Respondents were asked what proportion of equity trading by value was completed on an execution-only basis. This refers to trade execution where the commission was paid for pure execution and did not include payment for other services. Trades may be conducted through many different routes – such as execution-only brokers, broker crossing networks and through direct market access (DMA) which managers access through a broker. What they have in common is that the firm is taking charge of carrying out its client trades, accessing the various services only for liquidity.

As shown in Table 13, almost one-quarter of respondents conducted all their business on an execution-only basis, although these accounted for less than 5% of the value of their equity holdings. Most firms (60%) did less than one-half of their business this way and accounted for 51% of the value of equity holdings. Looking at a matched sample, the responses show little overall change since last year.

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

Range	Percentage of respondents	Equity holdings (£bn)
<1%	0%	0
1-25%	40%	335
26-50%	20%	291
51-75%	6%	282
76-99%	10%	275
100%	24%	54
TOTAL	100%	1,237

Use of brokers

Respondents were asked how many brokers they used for the majority of their equity trades by value. This year's Survey has broken the results down into three geographic areas – UK, Europe ex UK and the rest of the world (see Table 14):

- Across all three areas, over 60% of firms use 5-15 brokers.
- For the UK and the rest of the world, around 18% of respondents use 16-25 brokers, while for Europe that category falls to 7%.

The results were similar to those of the 2009 Survey, which observed that firms had reviewed their broker relationships after MiFID implementation and the subsequent increase in trading venues, and had reached the optimum number of brokers in terms of their choice of trading strategies.

On a matched basis, however, there has been an increase in the number of brokers used for trading in the rest of the world. In 2009, just over 60% of respondents used 5-15 brokers. One year later, the results show only one-quarter of firms in this category, with 70% using more than 15, and 10% using over 50. What we have observed about increasing allocations to emerging markets (see p. 21-22) may explain the increase.

Table 14: Number of brokers used for the majority of trades

Number of brokers	UK	Europe (ex UK)	Rest of world
<5	10%	16%	16%
5-15	63%	67%	61%
16-25	18%	7%	18%
26-35	2%	5%	0%
36-45	4%	5%	2%
46-50	2%	0%	2%
TOTAL	100%	100%	100%

Use of equity CFDs

This question was new in 2010 and was brought in to see if we could, over time, chart a trend from investment in cash equities to synthetic equity exposure via derivatives. The question attracted a high level of responses and clearly indicates that at present the use of single equity CFDs remains relatively low as a proportion of overall single-issuer equity exposure (see Table 15). Almost 60% of respondents reported less than 1% usage and a further 37% of respondents reported below 25%.

Table 15: Proportion of overall single-issuer equity exposure coming through the use of single equity CFDs

Proportion of exposure	Percentage of respondents
<1%	59%
1-10%	30%
11-25%	7%
26-99%	2%
100%	2%

Corporate Bond Trading

Use of agency broking

Agency brokers were not a major feature of the corporate bond market prior to the credit crisis. Indeed, most asset managers were reasonably content with how the market performed at that time and had little need to use a broker. However, discontent with the market makers rose sharply in 2007-2008 as most of them withdrew liquidity for their clients following the onset of the crisis and this was slow to return. The lack of liquidity also brought home forcefully the difficulties of demonstrating that “best” execution had been obtained for clients. Firms therefore looked at alternative ways to get their business done.

In 2009, we found that overall usage of agency brokers remained low compared to direct access to traditional market makers. In 2010, the proportion was similar (see Table 16). Nearly 80% of respondents (with £860bn in

fixed income holdings) used agency brokers for less than 10% of bond trading. However, although most firms remain heavily dependent on banks for liquidity provision, some appear to have taken steps to ensure that their trades are intermediated by agency brokers. Five firms seek to have all their trades intermediated in this way but are not major players in the fixed income market, accounting for only £473m.

Table 16: Proportion of bond trading conducted with agency brokers

Range	Percentage of respondents	Bond holdings (£bn)
<1%	7%	5
1-10%	71%	854
11-20%	10%	26
21-99%	0%	0
100%	12%	0.5
TOTAL	100%	885

It is interesting to note that although 71% of firms believe they can now access sufficient liquidity, 29% remain sceptical (see Table 17). Again, the range of firms within the latter group is wide and also includes a number of the largest asset managers, some of whom do not use agency brokers at all.

Table 17: Liquidity provision by market makers

Do you think these market makers are providing adequate liquidity?	Percentage of respondents	Bond Holdings (£bn)
Yes	71%	627
No	29%	281
TOTAL	100%	908

Derivative Trades

We introduced questions about derivative trades for the first time in the 2009 Survey. The intention was to be able to track changes in market usage during the period in which many new regulatory requirements will be introduced, principally central clearing for many derivative trades that are currently dealt and settled bilaterally with a single bank counterparty.

Collateral

A hallmark of the credit crisis was the lack of information about many aspects of derivative trades, including importantly the extent to which trades were appropriately collateralised and margined. It is clear that margining of trades – using collateral or otherwise – is now well embedded in the process.

Table 18: Collateral demands on firms

Compared to 2009, how much collateral are you being asked to post?	Percentage of respondents
More	37%
Less	9%
About the same	54%
TOTAL	100%

Our question about changes in collateral produced a variety of responses, with the headline findings indicating that collateral requirements are rising for a significant proportion of firms (see Table 18).

It should be noted that collateral has always been exchanged to cover some degree of mark-to-market risk for OTC derivative contracts. However, the market has seen changes bringing in increased margin requirements, notably with respect to ‘independent amounts’. Independent amounts mimic requirements for on-exchange trading, where a fixed amount has to be set aside against the possibility of default by one of the parties to a trade. The amount is set by reference to the perceived risk of the instrument traded (therefore in addition to the daily mark-to-market movement in value). Typically, this type of buffer capital had not been a feature of the bilateral OTC markets, at least not one involving investment managers, but this has changed and independent amounts are now often exchanged.

Out of 37 respondents, 35% reported that they post independent amounts for bilateral derivatives (this is the first time we have asked about this aspect specifically). Of those posting independent amounts, over 70% of respondents do so to all their counterparties, and typically in amounts equivalent to up to 5% of the contract size (see Table 19).

Table 19: Exchange of independent amounts

Do you post independent amounts for bilateral derivatives?	Percentage of respondents
Yes	35%
No	65%
TOTAL	100%

Of those who answered Yes, to what proportion of your counterparties approximately?

Percentage of respondents	Percentage of respondents
0-10%	18%
11-99%	9%
100%	73%
TOTAL	100%

Of those who answered Yes, in what amount approximately, as a proportion of contract size?

Percentage of respondents	Percentage of respondents
<1%	36%
1-5%	36%
6-20%	27%
>20%	0%
TOTAL	100%

Central clearing of OTC derivatives

The results of the Survey show that it is still rare for investors to clear any OTC derivatives trades centrally, regardless of the underlying asset. Over 90% of respondents report proportions of less than 1% cleared centrally (see Table 20). We expect this to change from 2012 once the US and EU legislation is brought into effect. However, it is notable that there has been very little client movement. We believe it stems from the as yet poorly developed initiatives for clearing client trades as much of the focus has continued to be on clearing dealer trades.

Table 20: Central clearing of OTC derivatives

Proportion of OTC derivative trades cleared centrally	CDS/Credit derivatives	Equity derivatives	Other
<1%	100%	93%	100%
1-99%	0%	3%	0%
100%	0%	3%	0%
TOTAL	100%	100%	100%

Documentation published and maintained by the International Swaps and Derivatives Association (ISDA) is used by most market participants. The documentation is complex and requires considerable resource to maintain. It did, however, provide protection for firms' clients during the bankruptcy of Lehman Brothers. The Survey shows continuing difficulty in agreeing contractual terms with the banks for derivative trades – 54% of firms report this – although we believe the situation has improved slightly from 2009 (see Table 21).

Table 21: Negotiation of ISDA terms

Have you found it more difficult to negotiate ISDAs for your derivative trades since 2009?	Percentage of respondents
Yes	54%
No	46%
TOTAL	100%

Impact of MiFID

We continue to ask a series of questions in the area of market or market-related regulation. These cover areas of regulation that apply to firms in their dealings in the market and with clients. They also cover regulation of other service providers on which our firms may be relying. Questions were introduced several years back to gauge the impact of MiFID. As the MiFID Review progresses we are likely to ask additional questions in this area.

Table 22: Transaction cost analysis

	Is transaction cost analysis used as part of your internal assessment of achieving best execution?	Do you provide transaction cost analysis on a regular basis to institutional clients?
Yes	80%	42%
No	20%	58%
TOTAL	100%	100%

As shown in Table 22, some 80% of respondents (45 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, a direct regulatory requirement was imposed on managers to act in the best interests of their clients when placing orders that result in decisions to deal. Indeed, 42% of respondents (22 out of 52) provide transaction cost analysis on a regular basis to clients, which on a matched basis is slightly down on 2009.

Execution policies

As in previous years, we asked about the provision of information to and requests from clients (see Table 23). This year we also asked about the provision of information from brokers to asset managers.

MiFID states that asset managers are required to provide appropriate information on their execution policy to clients on request. We asked whether institutional clients did actually request copies of firms' full execution policies, rather than accepting a summary. The results show that, similar to 2009, a significant portion of clients did not ask to see firms' execution policy.

MiFID also requires that investment firms have to provide clients with a demonstration of their best execution policy upon request. Again there appears to be little appetite amongst institutional clients to request such evidence. The vast majority of firms (89%) had been asked by less than one-quarter of their clients, though 9% of firms had been asked by all.

Table 23: Clients asking for detail of execution policy and compliance demonstration

Proportion of clients	What proportion requested a copy of your execution policy?
<1%	52%
1-25%	18%
26-50%	2%
51-75%	5%
76-99%	2%
100%	20%
TOTAL	100%

Proportion of clients	What proportion requested a demonstration of compliance with your best execution policy?
<1%	60%
1-25%	29%
26-50%	0%
51-75%	2%
76-99%	0%
100%	9%
TOTAL	100%

As Table 24 illustrates, 76% of respondents had asked every broker for a copy of their execution policies. There were very few responses this year that suggested that brokers' policies were not forthcoming one way or another.

Table 24: Brokers asked for execution policies

Proportion of brokers	From what proportion of your brokers have you asked for their execution policies?	What proportion of those brokers responded?
<1%	13%	N/A
1-25%	2%	3%
26-50%	2%	0%
51-75%	2%	5%
76-99%	4%	15%
100%	76%	78%
TOTAL	100%	100%

Publication of equity trade data

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 time at which the transactions were concluded. This information is to be made public as close to real-time as possible in a manner that facilitates consolidation of post-trade data, and 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.

Table 25: Post-trade transparency after MiFID implementation

How has post-trade transparency in equity markets developed since MiFID implementation?	UK equities	European (ex UK) equities
Increased	9%	11%
Decreased	64%	53%
Same	28%	36%
TOTAL	100%	100%

Similar to the 2009 Survey findings, almost two-thirds of respondents report a deterioration of post-trade transparency for UK equities since MiFID implementation, while just over a quarter report that it had remained the same. Just over one-half said that transparency had deteriorated for European equities in that time, a slight improvement on 2009 (62%).

Cost of trading

This year, we also asked whether the MiFID reforms had brought about a reduction in the cost of trading. One of the main changes brought about by MiFID was the abolition of the “concentration rule”, which allowed individual member states to require that all secondary market equity trading be carried out on their national stock exchange. This abolition was to allow for more competition in the trading of European equities and it has resulted in a proliferation of alternative trading venues over the last three years. The consequent benefit should be a reduction in the cost of trading. Disappointingly, 59% of respondents reported that they had not seen a reduction in the cost of trading (see Table 26).

Table 26: Impact of MiFID on the cost of trading

Do you think the reforms under MiFID brought about a reduction in the cost of trading?	Percentage of respondents
Yes	41%
No	59%
TOTAL	100%

Compliance with GIPS

Out of 57 respondents, three-quarters claimed compliance with Global Investment Performance Standards (GIPS), a similar proportion to last year (see Table 27). It would appear that some firms choose not to become GIPS-compliant, but the Survey does include a number of firms which do not have the same commercial requirement, since they have mainly retail clients.

Of those claiming compliance, almost 90% are independently verified. The 2010 GIPS revisions were adopted at the beginning of 2011 and they do not include a requirement to be independently verified, encouraging firms to do so and to disclose if they are not.

Table 27: Compliance with GIPS

Is your firm GIPS compliant?	Percentage of respondents
Yes	75%
No	25%
TOTAL	100%

Of those who answered Yes, is the process externally verified?

Of those who answered Yes, is the process externally verified?	Percentage of respondents
Yes	88%
No	12%
TOTAL	100%

Appendix One: Summary of Main Responses – Assets under Management in the UK¹

Sample sizes vary between questions

CLIENT TYPE	TOTAL
Assets Under Management in the UK (£m)	3,939,104
Segregated (directly invested) or Pooled Institutional Assets (%)	
Assets directly invested on a segregated basis	54.8%
Managed on a pooled basis	45.2%
Active or Passive (%)	
Actively managed	79.3%
Passively managed <i>of which</i>	20.7%
Equities	61.8%
Other asset classes	38.2%
Asset Allocation (%)	
Equities <i>of which:</i>	45.7%
UK	42.6%
Europe ex UK	19.9%
North America	15.1%
Pacific ex-Japan	7.3%
Japan	4.3%
Emerging Market	9.7%
Other	1.1%
Fixed Income ² <i>of which:</i>	36.1%
UK Government	21.3%
UK Corporate	37.4%
UK Index-Linked	15.5%
Other UK	1.8%
Overseas	24.0%
Cash/Money Market	8.6%
Property	4.0%
Other	5.6%

¹ This includes all assets under management in this country, regardless of where clients or funds are domiciled. Caution should be used in undertaking direct year-on-year comparisons with previous surveys.

Where relevant or possible, we have used matched results in the Survey analysis to validate observations of change.

² With holdings of UK Government and corporate debt quite concentrated among IMA members, direct extrapolations from the Survey headline findings are likely to overstate the value of these securities held.

INSTITUTIONAL								ALL INSTITUTIONAL	RETAIL	PRIVATE CLIENT
Pension Fund	Public Sector	Corporate	Non-Profit	Sub- Advisory	In-House Insurance	Third Party Insurance	Other Institutional			
1,354,210	180,267	123,295	42,929	146,140	781,937	152,067	286,306	3,067,151	810,666	61,287
34.4%	4.6%	3.1%	1.1%	3.7%	19.9%	3.9%	7.3%	77.9%	20.6%	1.6%

Appendix Two: Summary of Main Responses – UK Institutional Market¹

Sample sizes vary between questions

CLIENT TYPE	TOTAL
Total Institutional Market (£m)	2,247,909
Third Party Institutional Market (£m)²	1,473,259
Segregated or Pooled Institutional Assets (%)	
Assets directly invested on a segregated basis	57.7%
Managed on a pooled basis	42.3%
Active or Passive (%)	
Actively managed	62.4%
Passively managed	37.6%
Multi-Asset or Specialist (%)	
Multi-Asset	10.5%
Single-asset/specialist of which:	89.5%
Equities of which:	38.2%
UK	35.7%
Europe ex UK	12.5%
North American	12.3%
Pacific ex Japan	7.4%
Japan	4.6%
Emerging Market	3.3%
Other	1.4%
Global	22.9%
Fixed Income of which:	36.7%
UK	84.0%
Overseas	5.9%
Global	10.1%
Cash/Money Market	4.2%
Property	2.8%
Other	7.7%

¹ This includes UK institutional client mandates, regardless of where assets are managed.

² Third party institutional business is defined here as total UK institutional business minus in-house insurance and in-house managed OPS assets.

Pension Funds			Public Sector	Corporate	Non-Profit	Sub-Advisory	In-House Insurance	Third Party Insurance	Other Institutional
Corporate	Local Government	Other							
935,405 41.6%	150,148 6.7%	29,870 1.3%	16,778 0.7%	30,365 1.4%	26,610 1.2%	87,808 3.9%	676,500 30.1%	91,680 4.1%	202,745 9.0%
837,255 56.8%	150,148 10.2%	29,870 2.0%	16,778 1.1%	30,365 2.1%	26,610 1.8%	87,808 6.0%		91,680 6.2%	202,745 13.8%
59.1% 40.9%	69.5% 30.5%	51.6% 48.4%	94.8% 5.2%	68.5% 31.5%	67.9% 32.1%	95.6% 4.4%		93.4% 6.6%	11.7% 88.3%
54.7% 45.3%	77.5% 22.5%	82.5% 17.5%	100.0% 0.0%	98.6% 1.4%	84.5% 15.5%	63.3% 36.7%		79.2% 20.8%	60.1% 39.9%
8.1% 91.9% 35.0%	13.4% 86.6% 52.1%	18.0% 82.0% 57.5%	30.3% 69.7% 34.6%	3.1% 96.9% 28.9%	35.2% 64.8% 31.8%	21.7% 78.3% 55.9%		16.4% 83.6% 14.4%	8.1% 91.9% 44.8%
38.0%	32.6%	18.0%	5.1%	47.7%	46.6%	47.9%		28.1%	23.4%
15.0%	7.0%	3.9%	42.6%	6.2%	5.4%	11.1%		21.1%	9.4%
16.5%	8.0%	0.9%	0.0%	0.2%	8.0%	1.4%		14.0%	8.7%
6.8%	3.4%	2.0%	19.3%	0.0%	0.9%	11.7%		20.1%	23.5%
5.8%	2.8%	2.1%	0.0%	8.2%	1.6%	1.5%		5.8%	2.6%
1.5%	3.9%	1.0%	31.2%	2.5%	11.1%	2.2%		6.7%	13.0%
1.4%	1.7%	3.3%	0.2%	0.4%	0.2%	1.0%		0.0%	0.8%
14.9%	40.6%	68.9%	1.6%	34.7%	26.1%	23.3%		4.2%	18.7%
44.7%	18.6%	18.6%	11.2%	12.6%	13.3%	17.0%		54.2%	26.5%
88.3%	77.1%	69.2%	100.0%	43.2%	69.3%	74.9%		78.3%	17.0%
4.0%	1.2%	15.7%	0.0%	31.7%	4.6%	10.7%		16.1%	39.0%
7.7%	21.8%	15.5%	0.0%	25.1%	26.2%	14.4%		5.6%	43.9%
1.2%	0.2%	2.9%	22.8%	33.2%	17.1%	1.1%		3.8%	14.0%
1.7%	4.1%	1.8%	1.0%	21.7%	2.3%	3.6%		4.2%	3.0%
9.3%	11.6%	1.2%	0.0%	0.4%	0.2%	0.6%		7.0%	3.7%

Appendix Three: Survey Respondents

Aberdeen Asset Management	Investec Asset Management
Aberforth Partners	Invista Real Estate Investment Management
AEGON Asset Management	JO Hambro Capital Management
Aerion Fund Management	JP Morgan Asset Management
Alliance Trust Asset Management	Jupiter Asset Management
AllianceBernstein	Kotak Mahindra
Allianz Global Investors	Lazard Asset Management
Ashmore Investment Management	Legal & General Investment Management
Aviva Investors	Liontrust Investment Funds
BAE Systems Pension Funds Investment Management	Liverpool Victoria Asset Management
Baillie Gifford & Co	M&G Investments
Baring Asset Management	Manek Investment Management
BlackRock Investment Management	Martin Currie
Brewin Dolphin	Morgan Stanley Investment Management
British Airways Pension Investment Management	Newton Investment Management
Canada Life Asset Management	Nikko Asset Management
Capital International	Nomura Asset Management
Cazenove Capital Management	Octopus Investments
CCLA Investment Management	Odey Asset Management
Edinburgh Partners	Old Mutual Fund Managers
Family Investment Management	Origin Asset Management
Fidelity International	Pictet Asset Management
First State Investments	Premier Portfolio Managers
Franklin Templeton Investment Management	Principal Global Investors
GLG Partners	Pyrford International
Henderson Global Investors	Rathbone Unit Trust Management
Hermes Fund Managers	Record Currency Management
HSBC Global Asset Management	Royal London Asset Management
Ignis Asset Management	Santander Asset Management
Insight Investment Management	Schroder Investment Management
Invesco Perpetual	Scottish Friendly Asset Managers

SEI Investments
Sharefunds
SMARTfund Administration
St James's Place Unit Trust
Standard Life Investments
State Street Global Advisors
Scottish Widows Investment Partnership
T. Bailey Asset Management
T. Rowe Price International
The Co-operative Asset Management
Threadneedle Asset Management
UBS Global Asset Management
Vanguard Asset Management
Veritas Asset Management

Appendix Four: 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.

AllianceBernstein

Allianz Global Investors

Aviva Investors

Baillie Gifford & Co

Barclays Wealth

BlackRock Investment Management

Capital International

F&C Asset Management

Fidelity International

Insight Investment Management

Invesco Perpetual

Investec Asset Management

Invista Real Estate Investment Management

JP Morgan Asset Management

Lazard Asset Management

M&G Investments

Newton Investment Management

Odey Asset Management

Schroder Investment Management

Standard Life Investments

Scottish Widows Investment Partnership

Threadneedle Asset Management

Vanguard Asset Management