



FINANCIAL MARKETS SERIES

FUND MANAGEMENT

OCTOBER 2011



TheCityUK champions the international competitiveness of the financial and professional services industry. Created in 2010, we support the whole of the sector, promoting UK financial and professional services at home and overseas and playing an active role in the regulatory and trade policy debate.

TheCityUK has a global export focus with a commitment to help UK based firms grow their business in other parts of the world. In 2010, the financial services industry accounted for 10% of UK GDP and 11% of UK tax receipts. The sector currently employs 1 million people, more than 66% of whom work outside London, and underpins the businesses that drive jobs and growth. Added together with the further 900,000 employed in professional services, it is easy to see the importance of a sector that employs 6% of the working population.

TheCityUK provides constructive advice and is the practitioner voice on trade policy and all aspects of taxation, regulation, and other legislative matters that affect the competitiveness of the sector. We conduct extensive research and run a national and international events programme to inform the debate. Our senior team regularly engages with regulators and policymakers at home and overseas, ensuring the sector's views are represented at the highest levels. We are tasked with creating a new vision for the financial services sector. We are focused on supporting policymakers and business to deliver the new policy ideas which will help deliver growth.

FUND MANAGEMENT

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The UK is one of the largest markets in the world for fund management second only to the US. The UK fund management industry serves a large number of domestic and overseas clients and attracts significant overseas funds. London is the leading international centre for fund management.

SUMMARY

Global fund management Conventional assets under management of the global fund management industry increased by 10% in 2010, to a record \$79.3 trillion (Charts 1 and 2). This was 6% up on the peak three years earlier. Pension assets accounted for \$29.9 trillion of the total, with \$24.7 trillion invested in mutual funds and \$24.6 trillion in insurance funds. Together with alternative assets (sovereign wealth funds, hedge funds, private equity funds and exchange traded funds) and funds of wealthy individuals, assets of the global fund management industry totalled around \$117 trillion.

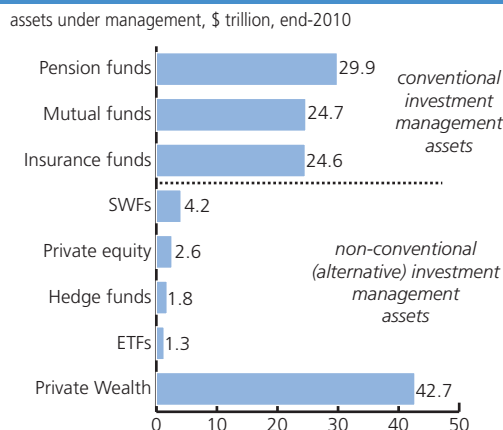
The increase in 2010 resulted from both the recovery in equity markets during the year as well as an inflow of new funds. Although some funds were exposed to instruments which suffered losses, on the whole, the fund management industry has recovered quickly from the fall in assets under management at the outset of the credit crisis. The economic slowdown may however have a longer-term effect on the sector in prompting more cautious investment strategies in the coming years, more diversification across asset classes and geographical regions, and more independence in ownership terms from banks and insurance companies.

The US remained by far the biggest source of funds in 2010, accounting for nearly a half of conventional assets under management or some \$36 trillion. The UK was the second largest centre in the world and by far the largest in Europe with around 8% of the global total (Table 1). Japan and France followed with 7.5% and 6% respectively.

UK fund management UK assets under management increased 17% in 2010 to a record £4.8 trillion. This was up around 15% on the previous high in 2007. These figures represent a conservative estimate as they do not take into account significant funds managed in the UK for which there are no available data such as funds managed on behalf of sovereign wealth funds as well as private client funds managed, for example, by family offices.

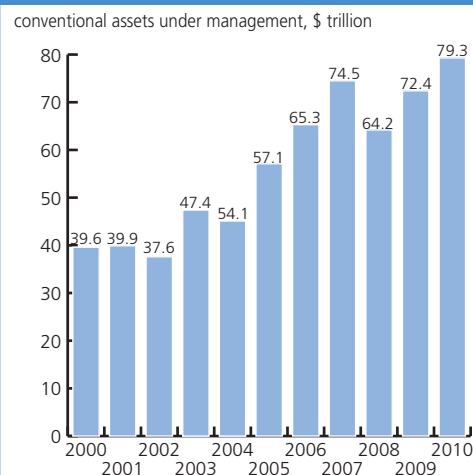
Conventional assets under management up 10% in 2010 to **\$79.3 trillion**

Chart 1
Global fund management industry



¹ Around one-third of private wealth is incorporate in conventional investment management
Source: TheCityUK estimates

Chart 2
Global conventional assets under management



Source: TheCityUK estimates

The UK fund management sector has a strong international orientation reflected in the: institutional presence of a broad mix of UK and foreign firms; investment of around a third of institutional clients' portfolios in overseas securities; and management on behalf of overseas clients of funds totalling over £1.6 trillion or a third of overall UK funds. London is central to the UK's strong international position. Other large fund management centres include Edinburgh, Liverpool, Aberdeen, Glasgow and Manchester.

Fund management accounted for 0.7% of UK GDP in 2010 and provided employment for some 50,000 people. Net exports of UK fund management totalled £2.9bn in 2009. Fund management revenue increased by around a quarter to £16.1bn in 2010.

GLOBAL FUND MANAGEMENT

According to TheCityUK estimates, assets of the global fund management industry totalled over \$117 trillion, up 10% on the previous year (Chart 1).

Assets of the global fund management industry consist of:

- **Conventional funds** (pension funds, mutual funds and insurance companies) totalling \$79.3 trillion at the end of 2010;
- **Alternative funds** (hedge funds, private equity funds, exchange traded funds and sovereign wealth funds) with nearly \$10 trillion of assets; and
- **Private wealth funds** with \$42.7 trillion in assets. About a third of this was however incorporated in other forms of investment management.

The increase in assets under management in 2010 was largely a result of a the continuation of a recovery in equity markets for the second year running as well as an inflow of new funds. Although some funds were exposed to instruments which suffered losses during the economic slowdown, on the whole, the fund management industry has recovered quickly from the fall in assets under management at the outset of the credit crisis.

Conventional funds of the global asset management industry totalled a record \$79.3 trillion. The 10% increase in 2010 followed a 13% increase in the previous year (Chart 2). Pension assets accounted for \$29.9 trillion, with a further \$24.7 trillion invested in mutual funds and \$24.6 trillion in insurance funds (Table 1).

The US was by far the largest source of conventional funds under management in 2010 with nearly a half of the world total. It was followed by the UK with 8% and Japan and France with 7.5% and 6% respectively. Rankings based on sources of assets understate the UK's position due to the substantial value of funds managed there on behalf of overseas clients. Taking these into account, funds managed in the UK are by far the largest in Europe. The Asia-Pacific region has shown the strongest growth in recent years. Many fund management firms have shown an increased interest in countries such as China and India as they offer huge potential for growth.

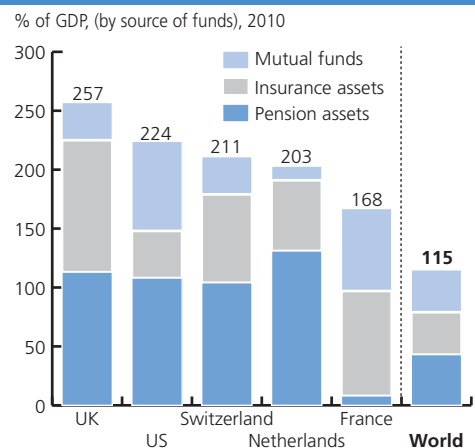
the UK is the second largest fund management centre managing **8% of global funds**

Table 1
Largest global investment management centres

\$bn, end-2010	Pension funds	Insurance assets	Mutual funds	Total conventional	% share
US	17,371	6,431	11,821	35,623	45
UK	2,926	2,736	854	6,516	8
Japan	1,388	3,958	786	6,132	8
France	232	2,509	1,617	4,358	6
Germany	171	1,384	334	1,889	2
Netherlands	1,057	508	86	1,651	2
Switzerland	551	427	262	1,240	2
Other	6,241	6,681	8,939	21,861	27
Total	29,937	24,634	24,699	79,270	100

¹ figures are for domestically sourced funds regardless where they are managed. No reliable comparisons are available for total funds under management by country
Source: TheCityUK estimates based on UBS, OECD, SwissRe, Investment Company Institute data

Chart 3
Funds as percent of GDP



Source: TheCityUK estimates based on UBS, OECD, SwissRe, Investment Company Institute data

Of the largest countries, the UK has the highest ratio of funds as a per cent of GDP (257% in 2010), followed by the US (224%), Switzerland (211%) and Netherlands (203%) as shown in Chart 3. The global average was 115%.

- **Pension fund assets** Global pension assets totalled \$29.9 trillion at the end of 2010 according to TheCityUK estimates based on OECD data. The US remains the largest single market with \$17.4 trillion in pension assets, nearly 60% of the world total. The UK was the second largest centre with 10% of the world total, followed by Japan and Netherlands with around 5% each. The large volume of pension assets in the US is mainly a reflection of its substantial domestic market. The UK pension system with assets equivalent to 113% of GDP in 2010, is more significant than most other major European economies.
- **Insurance funds** TheCityUK estimates that insurance companies held around \$24.6 trillion of funds under management at the end of 2010. Approximately four-fifths of the total was from long-term insurance policies and the remainder from general policies, such as health and property and casualty insurance. Over the past decade, insurance funds grew faster in Europe than in the US. Life companies' funds also grew faster than non-life ones. UK insurance companies' funds under management totalled around \$2.7 trillion, higher than in any other European country.
- **Mutual funds' assets** increased by 8% in 2010 to \$24.7 trillion following a 21% increase of the previous year. The bulk of the increase came in the third and fourth quarters in the year (Chart 4). Most mutual funds are managed in only a few countries. The US was by far the biggest source of funds with more than a half of the world total. UK mutual funds increased by 6% in 2010 to \$854bn. This was still below the record \$897bn held at the end of 2007. Other important centres for mutual funds include France, Luxembourg, Australia, Italy and Japan.

Institutional clients account for the majority of funds. There are substantial variations, however, between countries in the institutional to retail ratio. In France for example, the retail sector accounted for more than a half of funds. On the other hand institutional investors were the biggest source of funds in the US, UK and Japan.

Alternative funds totalled close to \$10 trillion at the end of 2010. They consist of hedge funds, private equity funds, exchange traded funds and sovereign wealth funds (these topics are covered in more detail in other TheCityUK reports):

- **Hedge funds' assets** under management increased by 13% in 2010 to \$1,920bn (Chart 5). This followed an 18% increase in the previous year. Assets under management were nevertheless still below the record \$2,150bn managed at the end of 2007. Growth in assets in 2010 was due both to high returns for the second year running, as well as a net inflow of new funds. The number of hedge funds totalled over 9,500 at the end of the year with new hedge funds launches outpacing fund liquidations for the first time since 2007. Hedge funds

Chart 4
Worldwide mutual funds assets



Chart 5
Global hedge funds

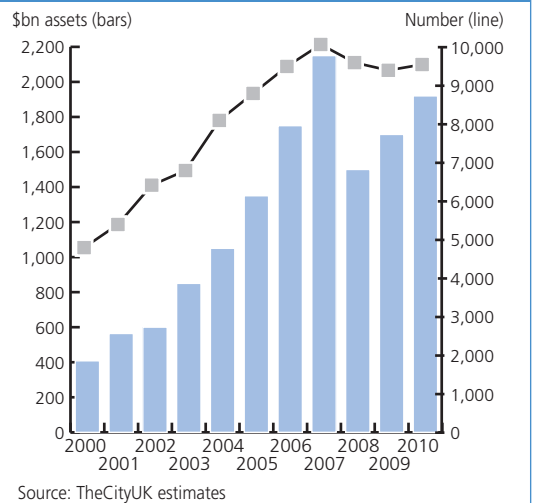


Chart 6
Top hedge funds centres



saw a \$65bn inflow of new funds during 2010, with the bulk of inflows coming in the second half of the year. Prior to this, hedge funds saw a surge in redemptions and fall in liquidity, particularly in the latter part of 2008 and first half of 2009.

London is the second largest global centre for hedge funds managers after New York. Its share of the global hedge fund industry more than doubled in the decade up to 2010 to 19% (Chart 6). The UK is much the largest European centre for the management of hedge funds. At the end of 2010, four-fifths of European hedge fund investments totalling \$423bn were managed out of the UK.

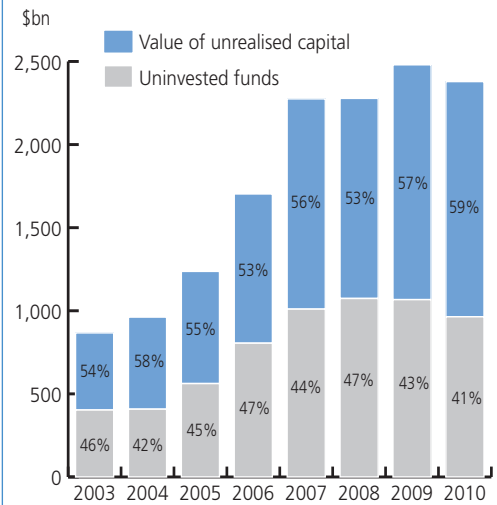
- **Private equity** According to TheCityUK estimates, private equity investments worldwide totalled nearly \$180bn in 2010, up 62% on the previous year but still down 55% on the peak in 2007. Activity in the industry looks set to build on this recovery and top \$200bn in 2011. The fund raising environment remained depressed for the third year running with around \$150bn in new funds raised in 2010, slightly up on the previous year. This was around one-third of annual funds raised in the years preceding the credit crisis. TheCityUK is forecasting a slight increase in new funds raised in 2011 to around \$180bn. The private equity industry has nearly \$2.4 trillion in funds under management (Chart 7). Funds available for investments totalled over 40% of overall assets under management or some \$1 trillion.

- **Sovereign wealth funds (SWFs)** Assets under management of SWFs increased by 11% in 2010 to a record \$4.2 trillion (Chart 8). SWFs funded by commodities exports, primarily oil exports, accounted for nearly two-thirds of assets. The remainder was funded by transfer of assets from official foreign exchange reserves, and in some cases from government budget surpluses, pension reserves and privatisation revenue. There was also an additional \$6.8 trillion held in other sovereign investment vehicles, such as pension reserve funds and development funds. TheCityUK projections are that SWFs are likely to double from their current level to around \$5.5 trillion in 2012. The UK is an important centre in the management of sovereign wealth funds assets, although lack of data means that the value of funds managed cannot be estimated.

- **Exchange traded funds (ETFs)** Assets invested in ETFs increased by 27% in 2010 to a record \$1,311bn. This follows a 45% increase in the previous year. Growth over the past two years was largely a result of an increase in the number of products offered, an increase in the range of asset classes accessible through ETFs, more active marketing, and regulatory changes in the US and Europe allowing funds to make larger allocations to ETFs. Institutional investors have been behind most of the increase in ETF industry assets since the first fund was launched in 1993 in the US and in 2000 in Europe, but retail investors are becoming more active.

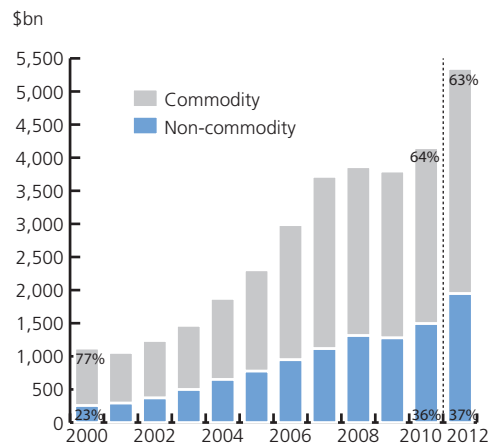
The global ETF industry had 2,459 ETFs on more than 40 exchanges around the world at the end of 2010. The number of ETFs listed in Europe reached 1,100 during the year, with the 896 in the US accounting for the bulk of the remainder. US funds on average are

Chart 7
Private equity global assets under management



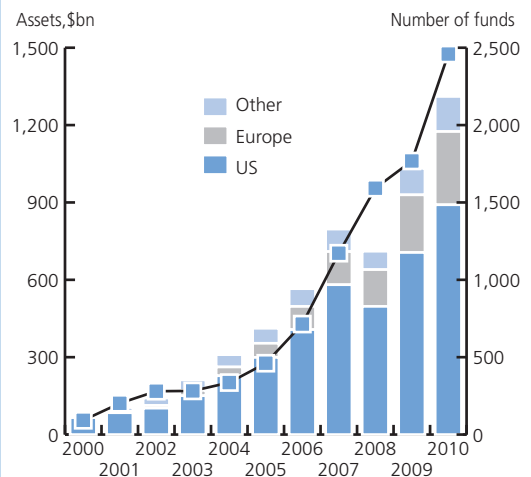
Source: Preqin; TheCityUK

Chart 8
SWFs' assets under management



Source: TheCityUK estimates

Chart 9
Exchange-traded funds



Source: Blackrock

Exchange traded funds (ETFs)

ETFs are passively managed open-ended funds that are listed and traded on exchanges. ETFs provide easy access to a broad exposure of stock market, fixed income and commodity indices. Most ETFs consist of a basket of securities that trade at approximately the same price as the net asset value of its underlying assets. They predominantly track an index, such as the S&P 500 and can be traded continuously during trading hours. More recently, ETF products are venturing into emerging markets, real estate, infrastructure, private equity and hedge funds. Because ETFs can be economically acquired, held, and disposed of, some investors invest in ETF shares as a long-term investment for asset allocation purposes, while other investors trade ETF shares frequently to implement short-term investment strategies.

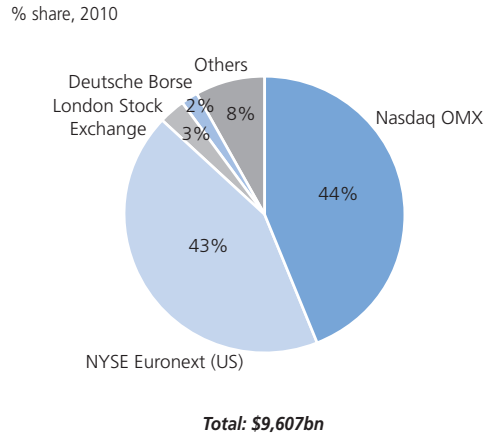
While ETFs share some basic characteristics with mutual funds, there remain key operational and structural differences. ETFs are similar to mutual funds because both instruments bundle together securities in order to offer investors diversified portfolios. ETFs trade throughout the trading day, like a stock, while mutual funds trade only at the end of the day at the net asset value price. Most ETFs track a particular index and therefore have lower operating expenses than actively invested mutual funds. Investors purchase and sell ETF shares on a stock exchange through a broker-dealer, like they would any other type of stock. In contrast, mutual fund shares are not listed on stock exchanges but are bought and sold through a variety of distribution channels.

larger, so the US accounted for 68% of global ETF assets under management in 2010 and Europe 22%. The 204 ETFs listed in the UK made up around 5% of global assets. ETFs investing in the stock markets of Brazil, China, South Korea and Taiwan have shown the fastest growth in recent years. Equity exposure accounted for 80% of global ETF assets at the end of 2010, followed by fixed income 16%, with most of the remainder invested in commodities. The NYSE and Nasdaq were dominant in the trading of ETFs with 87% of the volume of trade (Chart 10) in 2010. They were followed by the London Stock Exchange 3% and Deutsche Borse 2%.

Private wealth funds The annual World Wealth Report 2011 published by Merrill Lynch Capgemini estimated that in 2010, the value of funds managed on behalf of 11 million high net worth individuals (HNWIs) with over \$1m of investable worldwide assets increased 10% to \$42.7 trillion surpassing the 2007 pre-crisis peak (Chart 11). The value of ultra-HNWIs' assets under management (investable assets of US\$30 million or more), rose by 12% in 2010 following 22% growth in the previous year. The US, Japan and Germany accounted for 53% of the world's HNWI population at the end of 2010, down slightly from the previous year. The population of HNWIs in Asia-Pacific, at 3.3 million individuals, was the second largest in the world behind North America at the end of the year, and ahead of Europe for the first time.

The HNWI population increased their holdings of equities in 2010 to 33% from 29% a year earlier, while slowly reducing their holdings of fixed-income instruments and cash. These moves reflected a continued but gradual easing of crisis-related concerns. At the height of the credit crisis HNWIs had reduced their holdings of equities in favour of fixed income instruments and markets outside their home regions. Boston Consulting Group, in its annual report Global Wealth 2011, estimated that the total value of assets managed on behalf of all investors increased by 8% in 2010

Chart 10
Trading of ETFs



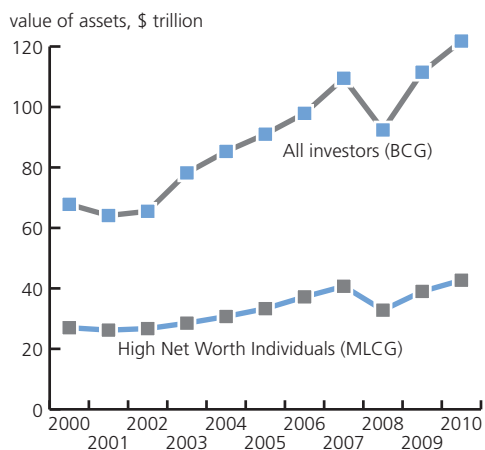
Source: World Federation of Exchanges

Table 2
ETFs by country

	2008	2009	----- 2010 -----	
	assets \$bn	assets \$bn	assets \$bn	Number listed
US	497	665	891	896
Germany	63	96	111	387
UK	25	47	67	204
France	39	54	60	257
Canada	13	29	38	157
Switzerland	11	18	38	108
Japan	27	25	32	80
Hong Kong	14	21	26	40
Others	22	77	48	330
Total	711	1,032	1,311	2,459

Source: BlackRock

Chart 11
Private wealth



Source: Boston Consulting Group (BCG), Merrill Lynch Capgemini (MLCG)

to \$121.8 trillion. Wealth grew fastest in Asia-Pacific at a 17% rate.

Managers of funds The latest available data shows that assets under management of the world's largest 500 fund managers increased 16% in 2009 to \$62 trillion (Chart 12) following a 23% decline in the previous year. Funds under management of the top 500 are likely to have continued their recovery in 2010 in parallel with the increase in global assets under management of the fund management industry. US owned firms held the bulk of the total in 2009 with 46%, followed by French firms with 9% and UK firms 8%. The proportion of assets managed by managers in developing countries totalled around 4%.

Independent managers account for around a half of total assets of the largest 500 fund managers, with the remainder split equally between insurance companies and banks. The concentration of the industry has grown over the past decade. The largest 20 fund managers' share of top 500 assets increased to 40% in 2009 from 38% in 2008 and 30% a decade earlier.

There has been a rise in M&A activity in the fund management industry since the start of the economic slowdown. Asset management firms have reduced the number of mutual funds and products they offer in a bid to reduce costs and many funds have been merged or liquidated. A major trend has been one of bank divestment of asset management subsidiaries. This is partly due to regulation changes which affect banks by setting restrictions on owning or investing in hedge funds and private equity funds. In June 2009 Barclays Global Investors accepted BlackRock's \$13.5bn offer, making this the second largest asset management deal ever and creating the world's largest fund manager, 75% larger than Allianz Group, the next largest manager. State Street Global followed in third place. Large M&A deals involving UK firms during 2010 include the acquisition of BlueBay Asset Management by the Royal Bank of Canada, the purchase of Bank of Ireland Asset Management by State Street Global Advisors, the purchase of Gartmore Investment Management by Henderson Global Investors and the acquisition of GLG Partners by Man Group.

Asset allocation varies considerably around the world. In the UK, US and Australia (Chart 13), the proportion of funds invested in equities has generally been higher than in other countries although exposure to equities has gradually been declining over the medium-term in favour of more diversification. More risk appetite in 2009 and 2010 encouraged investors to invest more in equity markets, emerging markets and alternative investments reversing the medium-term trend. UK based investors on average held 46% of their portfolios in equities in 2010 (Table 6), with 37% in fixed income, and 4% in cash. Property investments accounted for most of the remainder.

Institutional investors are likely to remain more cautious in the next couple of years focusing on diversifying their portfolios both in terms of assets and geographical regions. There has been a shift in 2010 from actively managed funds to passive investing due to high manager fees and poor performance. This is likely to continue as investors search for better returns in relation to costs. The use of low-cost passively managed products such as ETFs is likely to continue growing.

Table 3
Largest global investment managers

assets under management, end-2009, \$bn	Market	Assets (\$bn)
1 BlackRock	US	3,346
2 State Street Global	US	1,911
3 Allianz Group	Germany	1,859
4 Fidelity Investments	US	1,699
5 Vanguard Group	US	1,509
6 AXA Group	France	1,453
7 BNP Paribas	France	1,326
8 Deutsche Bank	Germany	1,261
9 JP Morgan Chase	US	1,253
10 Capital Group	US	1,180
11 Bank of New York Mellon	US	1,115
12 Credit Agricole	France	918
13 UBS	Switzerland	876
14 Goldman Sachs Group	US	871
15 HSBC Holdings	UK	857

Source: Pension & Investments / Towers Watson

Chart 12
Assets of 500 global managers

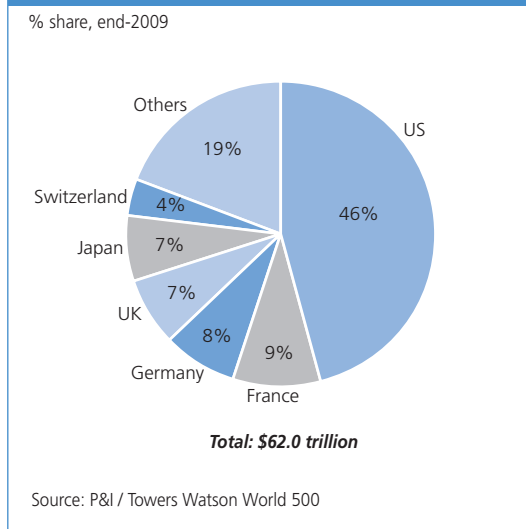
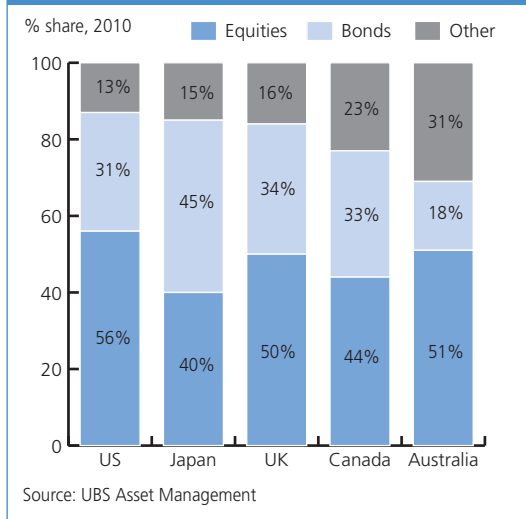


Chart 13
Asset allocation in major pension markets



UK FUND MANAGEMENT

UK fund management overview The UK fund management industry was responsible for a record £4.8 trillion of funds at the end of 2010 (Table 4, Charts 14 and 15), up 17% during the year. This increase was primarily a result of the equity markets recovery and an increase in retail inflows. It follows growth of 13% in the previous year.

The international orientation of the UK fund management industry is reflected in the presence of a broad range of UK and foreign-owned firms, in significant investment in overseas securities, and in the management of overseas clients' assets. Over 30% of funds under management in the UK, or nearly £1.6 trillion, are from overseas (Charts 16 and 17). London is central to the UK's strong international position. Other large fund management centres in the UK include Edinburgh, Liverpool, Aberdeen, Glasgow and Manchester.

The UK has been a beneficiary of the globalisation of the fund management industry. Foreign firms operating in the UK manage more than a half of UK funds under management. The UK has however lost market share as a domicile for funds over the past decade. Over £600bn in overseas domiciled funds were managed in the UK in 2010. Around three-quarters of this was for funds domiciled in Luxembourg and Dublin, and most of the remainder in the Channel Islands and Cayman Islands.

Regulatory changes resulting from the economic downturn are likely to influence the fund management industry in the coming years. In Europe, the Alternative Investment Fund Managers Directive (AIFMD) will bring a number of changes for hedge funds and private equity firms including new disclosure requirements, harmonised governance standards and limits on leverage. In the UK the Financial Services Authority's Retail Distribution Review, due to be implemented at end-2012, aims to establish a more transparent and consumer-friendly retail investment market in the coming years.

The figure of £4.8bn for assets under management in the UK represents a conservative estimate. It does not take into account significant funds managed in the UK for which there are no available estimates such as funds managed on behalf of sovereign wealth funds as well as private client funds managed, for example, by family offices.

Client type Institutional clients account for the bulk of funds under management in the UK. The UK's strong international position as a fund management location means that significant institutional funds from overseas are managed there. Retail and private clients generate the remaining funds.

Institutional clients in the UK accounted for around two-thirds of funds under management in 2010. Institutional clients include insurance funds, pension funds, local authority and charity funds:

- *Insurance funds* UK insurance funds totalled £934bn in 2010, up

Table 4
Funds under management in the UK

£bn	2009	2010
Managed by IMA ¹ member firms ²	3,308	3,878
Institutional clients	2,591	3,067
- insurance companies	766	934
- corporate pension funds	1,132	1,354
- other (local authorities, charities, etc.)	693	779
Retail clients	717	811
Other funds ³	400	486
- Hedge funds	190	234
- Property funds	130	140
- Private equity funds	108	112
Private client funds	402	475
Total funds under management in the UK	4,140	4,839

¹ Investment Management Association; ² Excluding private clients; ³ Figures have been adjusted to take account of double-counting
Source: IMA, ComPeer, Eurohedge, BVCA, IPD, TheCityUK estimates

Chart 14
Growth of funds under management in the UK

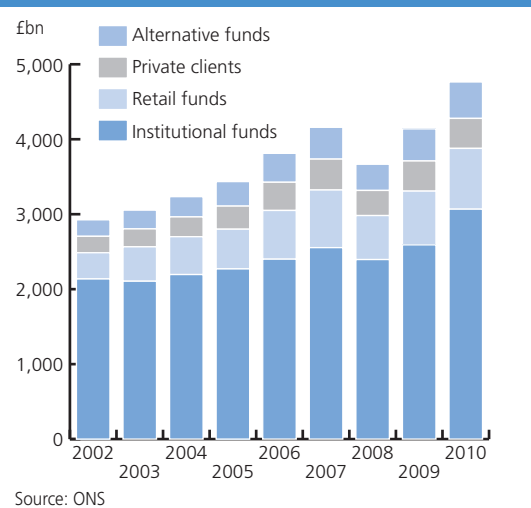
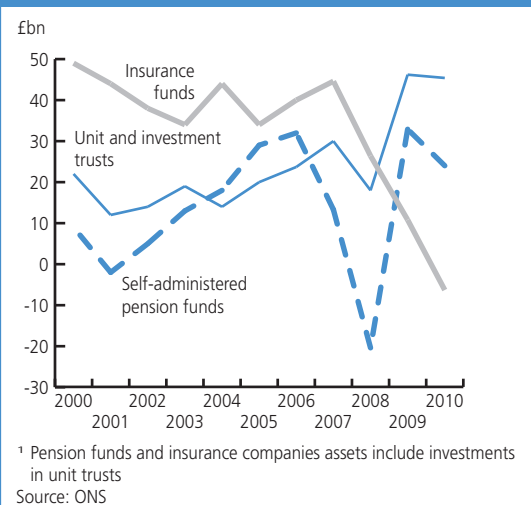


Chart 15
Annual net investment by UK institutional groups



Funds under management in Scotland

According to the Scottish Financial Enterprise, funds managed by the Scottish investment management industry total around £650bn. A third of the funds invested by Scottish managers are long term life assurance funds with a further third in pension assets. Mutual funds and private and charitable funds make up most of the remainder. Scotland has a traditional strength in pensions and the management of long-term savings, including open and closed-end mutual funds.

22% on the previous year. This represented close to a fifth of funds under management in the UK. Around 90% of insurance investment funds are from long-term insurance policies in which premiums paid over many years are invested by insurance institutions in order to meet the liability at maturity. The remainder are from general insurance policies which have a shorter timescale. Around 80% of insurance clients' assets are managed by in-house asset management subsidiaries, although third-party insurance asset management is on the increase.

- Pension funds' assets increased by a fifth in 2010 to £1,354bn. The UK pension fund industry has been affected in recent years by various factors such as changes in regulation and accounting standards and the continuing shift from defined benefit to defined contribution schemes. The increasing cost of operating DB schemes in the private sector has resulted in closure of many such schemes to new members. As a result the number of active members in private sector DB schemes dropped from a peak of 5.7m in the early 1990s to 2.6m in 2008 and 2.4m in 2010. Contributions to DC schemes that have replaced them have increased during this period.
- 'Other institutional' category includes a wide range of clients such as corporations, local authority, sovereign wealth funds, charity, etc. They accounted for £779bn in 2010, up 12% from £693bn in the previous year.

Retail clients held some £81bn in investment funds managed in the UK in 2010, up 13% on the previous year largely due to healthy returns on investments and a record inflow of new funds. The overall figure for investment funds managed in the UK is around £1.2 trillion as some products are sold to a range of institutional clients. UK based investment funds consist of:

- UK domiciled funds including unit trusts and open ended investment companies (OEICs), investment trusts and other retail products. Funds under management of UK authorised retail funds increased by a fifth in 2010 to £579bn (Chart 18). Total net sales of UK authorised funds increased to a record £49.8bn in 2010 from £34.4bn in the previous year. Early indicators for 2011 show that despite a steady inflow of new funds, the value of UK domiciled retail funds under management declined 3% in the first 8 months of the year due to volatile market conditions (Chart 19).
- UK managed funds domiciled outside the UK totalled over £600bn at the end of 2010, including funds such as UCITS and ETFs marketed to

Chart 16
Assets managed in the UK by domicile

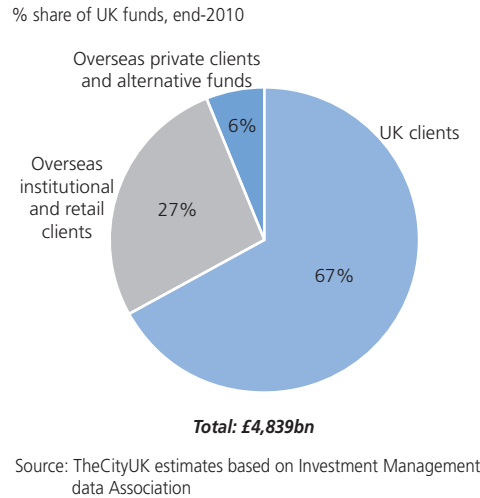


Chart 17
Assets managed in the UK by region

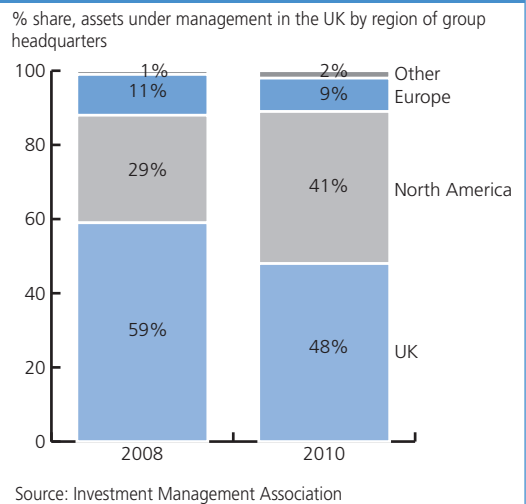
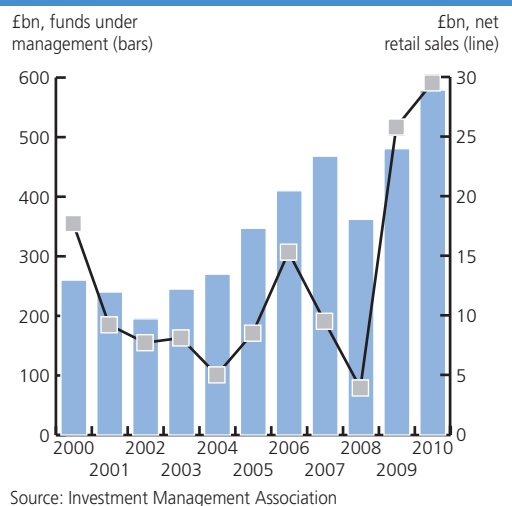


Chart 18
UK domiciled retail funds under management



retail investors. A number of firms have significant retail operations where the assets are largely managed in the UK but with domicile in Luxembourg, Dublin and other overseas locations.

Private clients are a significant part of the UK market, with assets of around £475bn at the end of 2010. This figure includes assets managed by private client firms such as stockbrokers and private client departments of banks and fund managers. Latest available data shows that individual ownership of UK shares accounted for around 10% of total share ownership in 2009, down from 16% in 2000 and 21% in 1990. Although the proportion of equity held by individuals is lower than in some other countries, the greater UK market capitalisation implies a more significant penetration of individual share ownership.

Alternative funds include hedge funds, property funds and private equity funds. Both institutional clients and private clients invest in such funds. Adjusting for double-counting, alternative funds were the source of close to £500bn in 2010 or over 10% of UK funds under management. The UK accounts for around a third of the European property funds market. The UK is also Europe's leading centre for managers of hedge funds. In 2010, close to 70% of European-based hedge funds' assets were managed in the UK. Including US hedge funds with an office in Europe, the UK probably accounted for 90% of European hedge fund assets. The UK is Europe's leading centre for managers of private equity funds with more than a half of European assets managed in London.

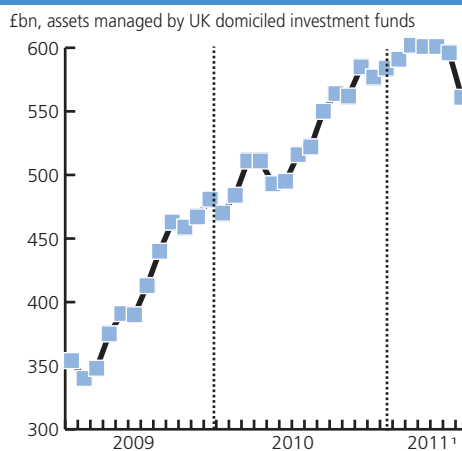
Overseas clients and firms In recent years, the UK has consolidated its position as one of the most important centres for the management of funds on behalf of foreign clients. Funds in the UK managed on behalf of overseas clients totalled around £1.6 trillion in 2010 or a third of the UK total (Chart 16). This was twice the total a decade earlier due to growth in the client base and consolidation which has been reflected in some large acquisitions. Institutional and retail clients were the source of around 80% of overseas clients' funds, while the remainder came from private clients and alternative funds.

A significant number of overseas headquartered firms are operating in the UK. They accounted for over a half of UK funds under management in 2010. Most of these funds are managed by firms with North American headquarters (around three-quarters of the overseas total), with Europe accounting for the bulk of the remainder (Chart 17). The large increase in overseas companies' share of UK funds under management in 2009 and 2010 was largely a result of a number of divestments by UK retail banks and the BlackRock Barclays-Global Investors deal.

Manager type UK fund management organisations can be classified by manager type into (Chart 20):

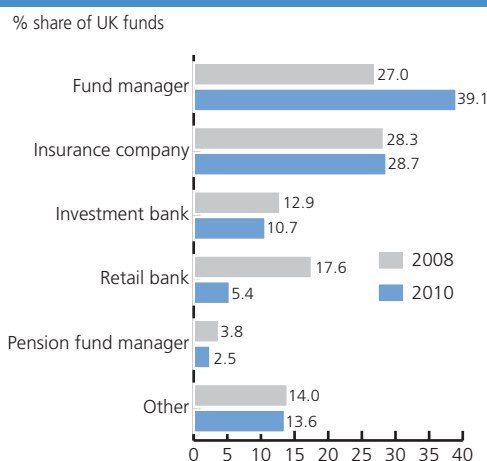
- *Fund managers* include independent investment managers that are not linked to any UK-based banking, securities or insurance groups. They managed 39% of UK funds, mainly pensions, at end-2010, up from 27% two years earlier;
- *Insurance companies* Insurance companies managed 29% of total

Chart 19
UK investment funds assets under management



¹ First 8 months of 2011
Source: Investment Management Association

Chart 20
Assets managed in the UK by manager type



Source: Investment Management Association

Table 5
Largest firms by UK funds under management

UK assets under management, end-2010, £bn	Assets under management
1 BlackRock Investment Management	530
2 Legal & General Investment Management	342
3 State Street Global Advisors	193
4 M&G Investments	188
5 JP Morgan Asset Management	161
6 Aviva Investors	142
7 Scottish Widows Investment Partnership	141
8 Standard Life Investments	132
9 Schroder Investment Management	128
10 Insight Investment	108

Source: Investment Management Association

funds in the UK at the end of 2010. Two-thirds of funds originated from their clients and most of the remainder from pension funds. Around four-fifths of insurance companies' funds are either managed by their internal investment department or by a separate subsidiary which might manage funds of external clients as well as those of its parent company. The remaining funds are outsourced to third-party asset management firms;

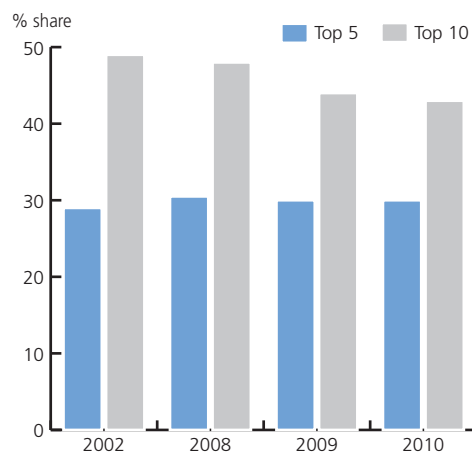
- *Retail and investment banks* represent banking and securities groups some of which combine securities and fund management operations. Retail and investment banks accounted for 5% and 11% respectively of UK funds at the end of 2010. Investment banks' funds predominantly came from pension assets while retail banks' funds originated from both insurance and pension assets equally. Retail banks saw their share decline from 17% to 5% over the past two years largely due to the acquisition of Barclays Global Investors by Blackrock in December 2009;
- *Self-managed pension funds* represent separate legal entities set up to manage a company's pension fund assets. Their share has fallen in recent years as companies' pension funds are increasingly managed by third-party fund managers. In 2010, UK self-managed pension funds held around 3% of assets under management.

Largest UK fund management organisations The UK market is relatively concentrated with the largest five fund managers accounting for 30% of total funds under management in 2010 (unchanged from the previous year), and the top ten managers for 43% (down from 44%) (Chart 21). BlackRock Investment Management was the largest firm with £530bn of funds under management in the UK at the end of 2010. It was followed by Legal & General and State Street Global Advisors (Table 5). Amongst the largest 10 firms, only BlackRock and Schroders are fully independent asset managers. The others are part of insurance companies or banks.

Asset allocation Some 46% of UK managed funds were invested in equities at the end of 2010 (Table 6, Chart 22). This was up from 42% in the previous year with emerging markets capturing a growing share of investments. Allocation to fixed income accounted for 36% of assets in 2010, down from 39% in the previous year. The previous ten years have however seen a gradual reduction in portfolio allocation to equities and an increase in investments in bonds. The shares of cash and property investments fell slightly during 2010 to 9% and 4% respectively. The use of derivatives as a means of facilitating the transfer of risk and implementing tactical asset allocation decisions has become a common feature of many fund managers.

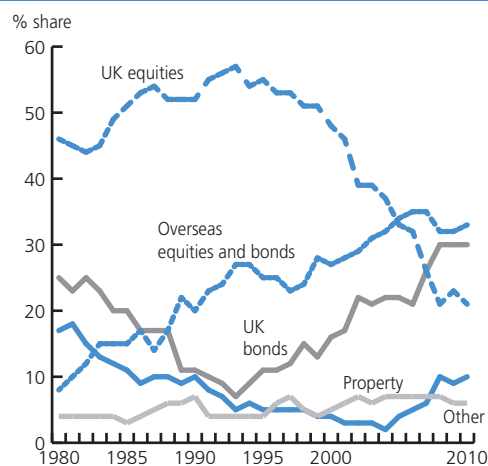
Around 63% of UK institutional assets were managed actively at the end of 2010. The public sector, corporate, non-profit and third-party insurance had the largest proportion of active management (over 80%) while pension funds (around 60%) had the smallest proportion (Chart 23).

Chart 21
Market share of largest asset management firms



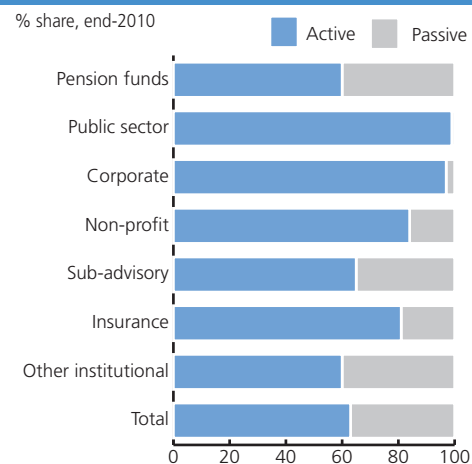
Source: TheCityUK estimates based on Investment Management data Association

Chart 22
Asset allocation of UK pension funds



Source: UBS Asset Management

Chart 23
Active versus passive management



Source: Investment Management Association

CONTRIBUTION TO THE UK ECONOMY

Value added While there is no official figure for the contribution of fund management to UK GDP, TheCityUK has made an estimate by applying cost margin indicators to total funds under management in the UK (Charts 24 and 25). According to this measure, fund management generated around 0.7% of GDP in 2010. The industry was therefore an important component of the financial sector's overall contribution of around 10% in that year. Fund management's wider contribution to the economy stems from its promotion of the UK's capital market and from the links fund managers have with other financial services providers, such as banks, securities dealers and information providers.

Revenue Combining the Investment Management Association's estimates on revenue margins with data on revenue for private clients separately estimated by ComPeer, TheCityUK estimates that the total revenue of fund management activities totalled around £16.1bn in 2010, up around a quarter on the previous year.

Profits and costs Fund management margins (profit/revenue) increased to 34% in 2010, the first annual increase following two years of decline. This was still however below the 2007 levels. The recovery in 2010 was largely due to revenue growing more quickly than costs (Chart 25). Profitability is likely to remain at lower levels in the coming years with wide variations across institutions depending on which asset classes they offer. Equity specialists may see a fall in business whereas fixed income specialists should continue to benefit from an increase in fixed income investments seen in recent years.

Many fund managers have been reducing costs since the start of 2008. Some firms have consolidated fragmented back-office operations into centralised infrastructures while others have outsourced back-office processes such as investment operations and fund administration. Fund managers are also looking at other approaches to reduce cost bases such as trimming sales and client services and reducing the product range on offer. Offshoring services such as transactions processing, IT services and call centres to offshore locations has been a trend for a number of years. Offshoring has been more common amongst firms based in the US, UK and Asia, while firms in France, Italy and Germany have been more reluctant, partly due to the language barrier.

Employment The IMA estimated that fund management firms in the UK directly employed around 25,000 at the end of 2010, up from 24,000 in the previous year, a reflection of the recovery in the industry seen during the past two years. Of this, around a quarter were employed in asset management, a fifth in marketing and client services, and most of the remainder in fund accounting and administration, corporate finance and administration, compliance, legal and audit and transaction processing. These figures largely exclude private client investment managers and stockbrokers who are thought to employ an additional 25,000 people. It should be noted that due to outsourcing of many operations by fund management firms within the UK, these figures significantly understate total employment generated by the fund

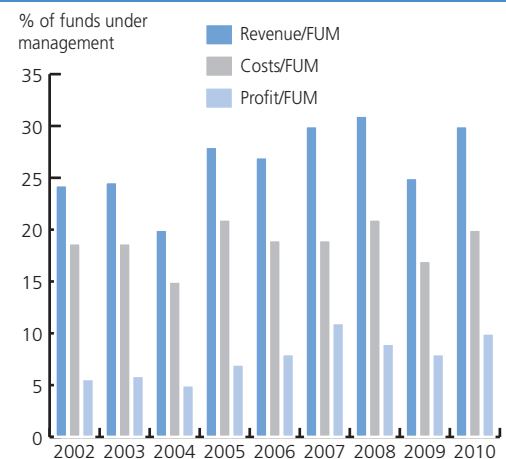
Around 50,000 employed in the UK fund management sector

Table 6
Asset allocation in the UK by client type

	-----UK institutional client mandates-----				Total assets managed in the UK
	Pension funds	Public sector	Corporate	Third-party insurance	
Equities	37.9	34.6	28.9	14.4	45.7
Bonds	40.5	11.2	12.6	54.2	36.1
Cash	1.1	22.8	33.2	3.8	8.6
Property	2.0	1.0	21.7	4.2	4.0
Other	18.5	30.4	3.6	23.4	5.6

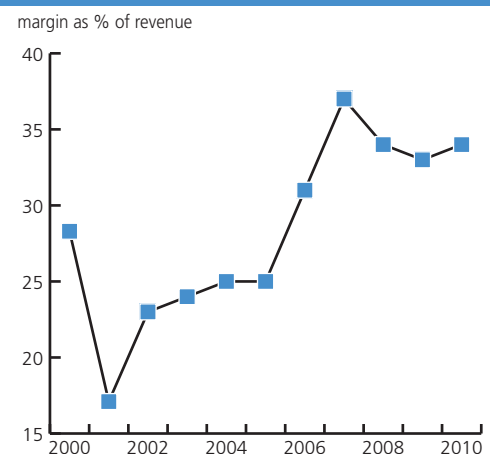
Source: Investment Management Association

Chart 24
Fund management industry profitability



Source: IMA, TheCityUK estimates

Chart 25
Fund management margins

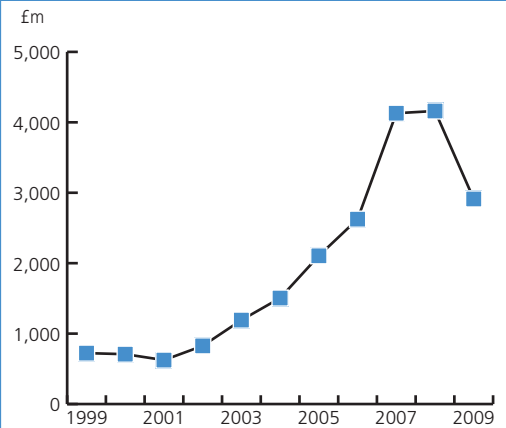


Source: IMA, TheCityUK estimates

management industry.

Net exports of fund managers totalled £2.9bn in 2009, down over 40% on the previous two years' record levels (Chart 26). The balance of payments inflow from portfolio investment by financial institutions, which will have owed much to the activities of UK fund managers, totalled £54.5bn in 2009, more than double the level a decade earlier.

Chart 26
Net exports of UK fund managers



¹ Data since 2003 is not entirely comparable with prior years due to wider sample selection
Source: ONS

OTHER SOURCES OF INFORMATION

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www.bcg.com

ComPeer Limited: In Depth Review of Wealth Managers
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www.institutionalinvestor.com
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