INVESTMENT MANAGEMENT ASSOCIATION

ASSET MANAGEMENT SURVEY

JULY 2006

Investment Management Association

ima

CONTENTS

The IMA would like to thank all participants for their contributions.

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Investment Management Association, 2006

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1 KEY FINDINGS

This is the fourth annual IMA survey undertaken of member firms. The survey presents a snapshot of the UK asset management industry, across both the institutional and retail landscapes. Direct questionnaire responses were obtained from 53 firms, managing between them just over £2.2trn (80% of total assets managed by IMA members), and internal IMA data has also been included this year to provide analysis of trends in UK authorised funds.

The key findings are presented below, and are explored in more detail in the main body of the survey.

OVERVIEW OF THE UK ASSET MANAGEMENT INDUSTRY

- Assets managed by IMA members in the UK totalled an estimated £2.8trn as at December 2005.

- Assets managed in the UK on behalf of overseas clients represent some 20% of the total. However, given that many firms have a global footprint and will be servicing client accounts and managing assets in multiple locations, this figure understates the total importance of overseas business to the UK industry.

- Some 19% of total assets under management in the UK are domiciled overseas. These range from hedge funds to retail funds.

- The market share of the five largest firms has increased, standing at 31% (from 28% a year earlier). The share of the ten largest rose to 48% (from 46% a year earlier). This is due to the increasing share of two leading indexing firms, although the market as a whole remains relatively unconcentrated.

- Some 80% of assets managed in the UK are invested on behalf of institutional investors (primarily corporate pension funds and insurance companies). The retail market accounts for just under 20% of total assets.

- While headline figures show a sharp increase in the position of equities as a proportion of total assets under management, matched samples suggest that the overall trend away from equities and into bonds is continuing.

INSTITUTIONAL BUSINESS

- Within the institutional market, corporate pension funds and insurance companies account for some 75% of total business, with 80% of insurance mandates coming from parent companies to their asset management subsidiaries.

- Excluding in-house managed occupational pension scheme (OPS) firms, two thirds of assets managed by survey respondents are in specialist/single-asset mandates, reflecting the gradual move away from balanced/multi-asset mandates.

- A matched sample on pension fund asset allocation confirms an ongoing movement towards bonds. Data in this year's survey on corporate pension funds also supports findings elsewhere that the move has been more pronounced in this part of the market than in the local authority sector.

- With respect to investment objective, index benchmarks remain predominant. Peer group objectives are used for some 9.5% of institutional assets under management.

- Liability-led strategies currently account for a modest share of the institutional market (5% according to respondent data), although a quarter of firms expect liability-led investment to be the first or second fastest growing product area in three years' time.

- The trend in recent years towards differentiation of alpha (value added by active selection) and beta (market return) has seen the emergence of a small number of market leaders in passive management, which operate at considerable scale. While 12 of 37 respondents to a question on passive mandates identified some assets managed in this way, just three firms run 90% of the total.

RETAIL AND UK FUNDS MARKET

- Retail assets identified in the survey account for 19% of total assets - some £530bn. These include UK-managed unit trusts, OEICs, investment trusts and other retail products. We estimate that some £200bn of this total is domiciled in Luxembourg, Dublin and other overseas locations.

- As at December 2005, UK-authorised funds under management totalled £347bn, with the top ten firms accounting for 50% of the total. The £300bn mark was breached for the first time in July 2005.

- During 2005 as a whole, net retail sales of UK-authorised funds rose to levels not seen since 2001. However, although ISA funds under management grew strongly year-on-year, net sales in this area remained sluggish.

- The dominant channel in the gross sale of retail funds in 2005 was the intermediary channel. In the ISA data, where fund supermarket sales are disaggregated, the growing dominance of supermarkets is apparent, equalling the sales force/tied agent channel for the first time.

OPERATIONAL ISSUES

- Data from the survey suggests that weighted average revenue as a proportion of total assets under management was 28 basis points, equating to some £8bn.

- Total direct employment is some 22,000-25,000, but with numerous activities outsourced to third-party providers, the overall level of employment associated with the asset management industry is considerably higher.

- In terms of off-shoring, the survey findings supported the OXERA study last year, which concluded that while some middle and back office functions appeared prone to relocation outside the UK, core asset management activities appeared fairly securely located for the time being.[1]

- With respect to broker relationships, the proportion of commission subject to softing continues to fall, in line with recent trends. Looking at commission sharing arrangements (CSAs), 16 firms (out of 42 respondents to this question) have put CSAs in place for at least part of their business.

[1] See 'The Competitive Position of London as a Global Financial Centre' (OXERA report for IMA/City of London), 2005.

2 OVERVIEW OF THE UK ASSET MANAGEMENT INDUSTRY

The survey covers a representative sample of 137 IMA member firms. A total of 53 firms provided detailed questionnaire data, managing between them some £2.2trn in the UK on behalf of a range of UK and overseas clients.[2] A list of respondents and the structure of the survey are provided in Appendices One and Two respectively.

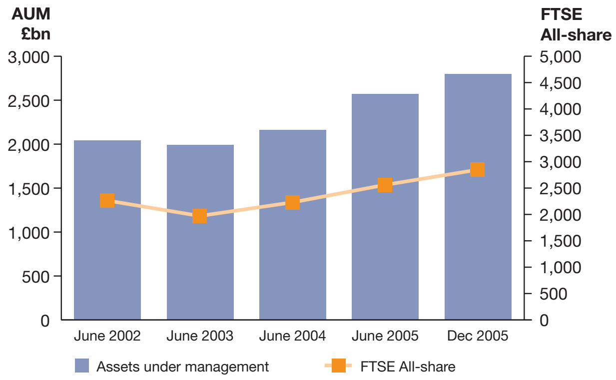
Broadly speaking, respondents fall into five general categories:

- Asset management firms with a sizeable global footprint, which undertake a wide range of asset management activities across the institutional and retail market space.
- Large and medium-size firms whose business is primarily UK/European-focused, which offer a diverse product range.
- 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.
- Mutual fund companies or firms whose business is primarily based on mutual funds, and who manage assets in-house (as opposed to the IMA firms which are fund operators and outsource their asset management functions).

INDUSTRY SIZE

In December 2005, assets managed in the UK by IMA members totalled an estimated £2.8trn.[3] Chart 1 shows the progression since 2002, with some correlation to market movements. Data from the survey suggests that about 20% of the total is managed on behalf of overseas clients. It is important to note though that many firms operate internationally, but will be servicing client accounts and managing assets in multiple locations. This figure therefore understates the total importance of overseas business to the UK-based industry.

Chart 1
Assets Managed in the UK, 2002-2005



In terms of overall investment industry size, IMA member firms operate across both the mainstream and alternative asset management spectrum. Chart 2 gives a profile of survey respondents in this respect. Almost all respondents manage equities, bonds and cash, with half having property within portfolios and some 20% running private equity and hedge funds. However, the survey is likely to under-estimate total assets under management in the UK. Including hedge funds[4] and other alternative investments[5] not managed by IMA members and not covered in this survey, we believe that the total figure for assets under management in the UK exceeds £3trn.

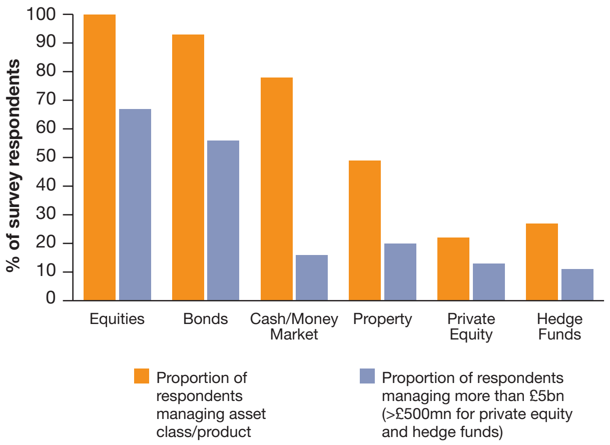
[2] Unless otherwise specified, all reference to assets under management in the UK in this survey concerns December 2005 data provided by respondent firms.

[3] This figure is calculated using a complete internal IMA data set for assets under management as at June 2005 and adjusting it based on survey questionnaire responses for December 2005.

[4] While some IMA members run hedge funds, some 80% of hedge fund assets managed in the United Kingdom are thought to be managed by firms (typically boutiques), which are outside the scope of this survey. A HedgeFund Intelligence survey, published in March 2006, found that some $255.5bn (£140bn) of assets are managed by UK-based hedge fund managers (including IMA members).

[5] IMA represents a number of firms whose activities include property funds and private equity operations, but not the totality of these markets.

Chart 2
Proportion of Survey Respondents Managing Different Asset Classes/Product Types



CONCENTRATION

Industry concentration (as measured by an internal IMA data set from June 2005) is illustrated in Chart 3. As in previous years, the chart shows a steep curve downwards from a comparatively small number of very large firms, and a long tail. While 17 IMA member firms each managed in excess of £50bn (see Table 1), 68 managed less than £16bn, about a third of whom managed less than £1bn.

Chart 3
Firms Ranked by Assets Managed in the UK (June 2005)[6]

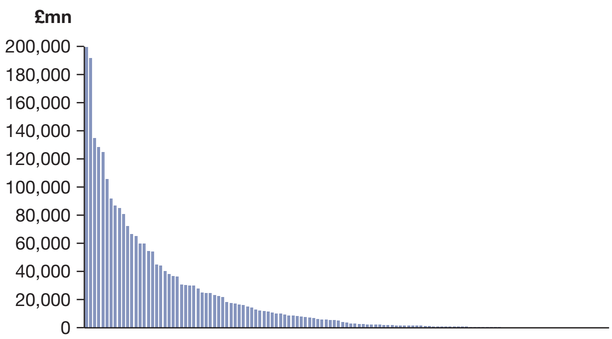


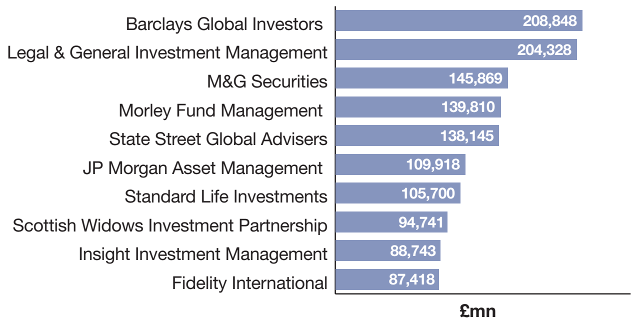
TABLE 1:
Assets Managed in the UK by Firm Size (June 2005)

Assets under management	Number of firms	Survey respondents
>£100bn	6	6
£51-100bn	11	10
£26-50bn	11	6
£16-25bn	11	6
£1-15bn	47	17
<£1bn	21	8
TOTAL	**107**	**53**

In terms of the position of the largest firms:

- The five top UK firms accounted for some 31% of assets managed in the UK by IMA members in June 2005, an increase over both 2004 (28%) and the preceding two years (28-29% in 2002-03). This was due to the expanding market share of the largest two firms, who are leading players in the indexing market.
- For the same reason, the market share of the ten largest firms had also risen modestly, to 48% in June 2005 (from 46% a year earlier), a level last seen in 2002.

Chart 4
Assets Managed in the UK - Ten Largest Firms (December 2005)[7]



[6] Internal IMA data is used for this analysis and is not available for December 2005.

[7] A chart giving a ranking of the largest managers of retail funds can be found on p.18.

By December 2005, the top two firms had each moved above £200bn under management (see Chart 4), although this has had little overall further effect on industry concentration.

The increasingly global nature of the asset management industry means that some firms that are the largest in international terms will not rank highly in the UK due to national skews in their business. For cross reference, Appendix Three (Table 14) shows data on the largest global asset managers, which includes a number of the firms listed here.

OWNERSHIP

Internationally, there has been some consolidation within the asset management industry, with a number of deals taking place over the last two years. Looking at those with an impact on the UK:

- F&C Asset Management was created after the merger of F&C Management and ISIS Asset Management.
- Aberdeen Asset Management purchased a number of investment businesses from Deutsche Asset Management.
- MassMutual bought Baring Asset Management from ING.
- AXA Investment Managers acquired Framlington.
- Legg Mason acquired Citigroup's asset management business.
- Britannic Asset Management has become Resolution Asset Management as a result of the merger of Resolution Life Group and Britannic Group.
- Black Rock and Merill Lynch Investment Managers have agreed a merger.

This activity has had little impact on the top ten asset managers. Among this group, firms owned by UK insurance companies and retail banks continue to dominate. For more detail, see Table 2.

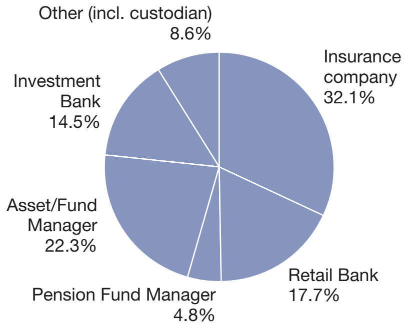
TABLE 2:
Largest UK Firms - Parent Type

Companies	Parent Group	Parent Type
Barclays Global Investors Ltd	Barclays PLC	Retail Bank
Legal and General Investment Management Ltd	Legal and General Group PLC	Insurance Company
Morley Fund Management Ltd	Aviva PLC	Insurance Company
M&G Securities Ltd	Prudential PLC	Insurance Company
State Street Global Advisers Ltd	State Street Corporation	Global Custodian/ Investment Services
JP Morgan Asset Management Ltd	JPM Chase & Co.	Investment Bank
Standard Life Investments Ltd	Standard Life Assurance Company	Insurance Company
Scottish Widows Investment Partnership	Lloyds TSB Group PLC	Retail Bank
Insight Investment Management Ltd	HBOS PLC	Retail Bank
Fidelity International Ltd	Fidelity International	Asset Manager

With respect to the wider IMA membership base, insurance-owned asset management companies are the largest single group, with 32.1% of assets under management in the UK. Retail banks account for 17.7% and investment banks for 14.5%.[8] See Chart 5 for more detail. However, these relatively narrow categories simplify a complex picture, as larger groups in particular are increasingly engaged in a diverse range of domestic and global financial services activities.

[8] Private Banks are counted in the Investment Bank category.

Chart 5
Assets Managed in the UK - Ownership of Firms



FUND DOMICILE

Some 19% of assets under management in the UK are domiciled offshore, according to responses from 45 firms managing £1.9trn in the UK. For more detail, see Table 3. This is broadly comparable with last year's response, which showed about 18% of assets under management in the UK domiciled overseas. A matched sample of 25 firms managing £1.4trn in December 2005 shows a similar picture.

There are a number of reasons for individual firms to domicile UK-managed funds overseas. Primarily, these concern tax and regulatory advantages.[9] A wide-range of product areas is affected, including Collective Investment Schemes, hedge funds, property funds and exchange-traded funds. This has a number of implications, not least for employment, with asset management usually remaining in the UK, but certain administration functions taking place overseas, often in Luxembourg or Dublin. These employment issues are explored further in Part Five of the survey.

TABLE 3:
Overseas Domicile

Overseas domiciled UK AUM (% of total)	Number of respondent firms	Total Assets Managed in the UK (£bn)	Assets domiciled overseas (£bn)
0%	15	£211	-
1-24%	16	£1,149	£108
25-50%	7	£344	£139
>50%	7	£180	£106
TOTAL	**45**	**£1,884**	**£353**

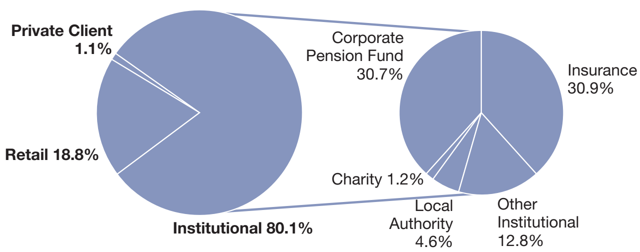
CLIENT TYPE

A general overview of assets managed in the UK by client type is given in Chart 6:

- Institutional assets under management account for almost 80% of the total, with the largest segments being corporate pension funds and insurance funds.
- After pension fund and insurance mandates, retail continues to represent the third largest client type.[10]

Both the institutional and the retail parts of the industry are analysed in more detail in Parts Three and Four of the survey.

Chart 6
Assets Managed in the UK - Client Type



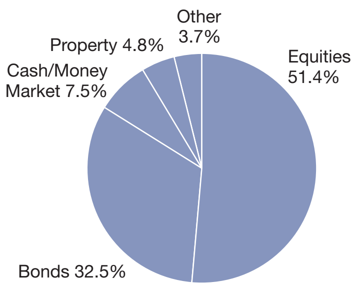
[9] For more on general issues raised here, see 'The Competitive Position of London as a Global Financial Centre' (OXERA report for IMA/City of London), 2005.

[10] 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 is domiciled (IMA monthly statistics collect data on funds domiciled in the UK only). In consequence, it picks up a wider range of retail funds, which will explain why the percentage share here is larger than implied by the IMA monthly data.

ASSET ALLOCATION

Respondents were asked to provide further mandate information based upon asset classes and geographical areas. Chart 7 shows total assets under management in the UK broken down into equities, bonds, cash/money market, property and other.

Chart 7
Assets Managed in the UK - Asset Allocation



In comparison with the June 2004 figures in the last IMA survey, the relative proportion of equities (51.4%) and bonds (32.5%) as measured as a proportion of total assets under management is substantially different (bonds 36.6% in 2004; equities 45.8%). However, this year's survey has a somewhat different sample group. Using matched samples from firms who replied on a UK basis in both 2004 and 2005 (a total of 21 firms managing £1.2trn in December 2005), the relative proportion of equities and bonds looks little changed.

If one takes into account asset values over this period (June 2004 - December 2005), which saw a substantial rise in the global equity markets (see Table 4), the overall erosion of the position of equities at the expense of bonds appears still to be continuing. Despite signs of decreasing investment in bonds within the retail market, the data suggests that the adjustment in pension fund asset allocation, highlighted in previous IMA surveys, is ongoing. This aspect is discussed further in both the institutional (see p.14) and retail parts (see p.19) of the current survey.

TABLE 4:
Returns on Selected Indices, June 2004 - December 2005

Equities	Capital Return	Total Return
FTSE All-Share Index	27.7%	33.9%
FTSE World (ex UK)	27.5%	31.2%
Fixed Income	**Capital Return**	**Total Return**
iBoxx Sterling Gilts Overall	5.9%	14.5%
iBoxx Sterling Non-Gilts Overall	7.6%	16.7%
Lehmann Global Aggregate Bond	1.5%	5.4%

Source: Lipper Hindsight

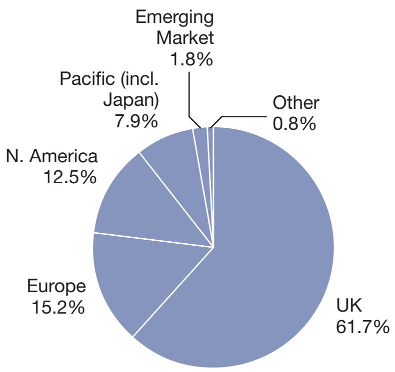
Looking in more detail at asset allocation:

- The equity split using a regional breakdown is outlined in Chart 8.[11] As in previous years, UK equities are predominant, with European and US equities the second and third largest components respectively. While this in part reflects preferences of UK-based clients, it should be noted that given the presence of large global asset management firms in the UK, this will also include overseas client money managed in the UK, while some UK client money will in turn be invested in overseas equities that are managed overseas.

- In terms of fixed income assets under management in the UK, the data suggests that some 80% of the total is invested in UK corporate, government and index-linked bonds.

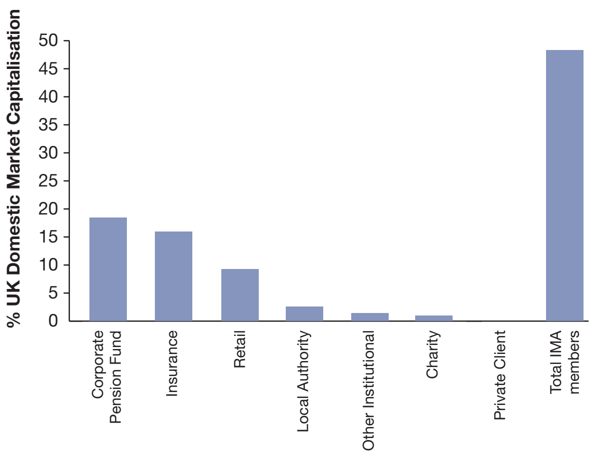
[11] This year, we asked about asset allocation using product categories (eg. global equities) rather than just regional sub-divisions. However, only 40% of respondents were able to respond in this way, and the asset allocation data in Chart 8 reflects responses giving the regional breakdown between UK and overseas stocks and securities.

Chart 8
Assets Managed in the UK - Equity Allocation by Region



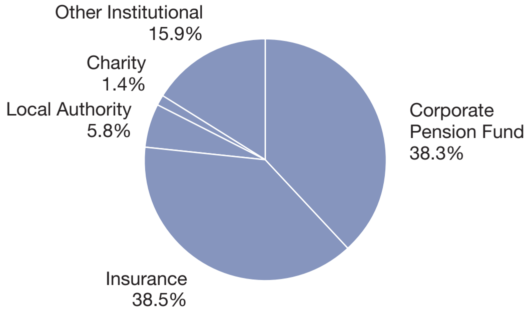
With respect to UK equity holdings as a proportion of total UK equity market capitalisation, we calculate that IMA members manage just under half of the total. Chart 9 shows the split by client type. Between them, corporate pension funds (18.0%) and insurance clients (16.0%) account for about a third of total UK shares. Including local authorities (2.5%, predominantly pension fund assets), the pension fund component rises to slightly over a fifth.

Chart 9
Investment in UK Equities by Client Type (% UK Domestic Market Capitalisation, December 2005)



3 INSTITUTIONAL MANDATES

Chart 10
Institutional Assets Managed in the UK - Client Type



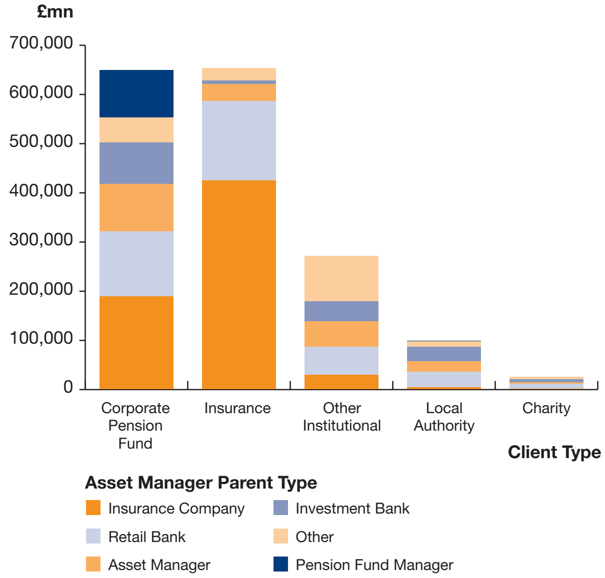
Respondents were asked to provide mandate information for institutional investment based upon assets managed in the UK. Institutional mandates split by client type are shown in Chart 10:

- Insurance companies and corporate pension funds were the largest client components in the sample, followed by local authorities.

- A large majority of insurance client assets (some 80%) are in-house funds (ie. managed by asset management subsidiaries on behalf of parent groups that are insurance companies or have a large insurance component within the group). Questionnaire responses show - unsurprisingly - that of the 20% of insurance business that is managed by third-party asset management firms, almost all is managed by non-insurer owned firms.

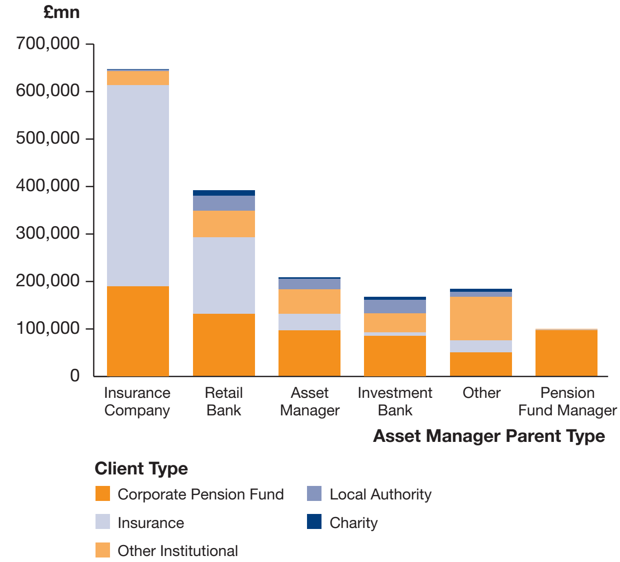
This dominance of insurance-owned firms in running insurance assets can be seen in Chart 11, which analyses client type by parent type of the asset management firm. Taken together with Chart 12, which presents the same data slightly differently (parent type by client type), the chart also shows the extent to which a number of insurance-owned asset managers are significant players in the pension fund part of the institutional market.

Chart 11
Institutional Assets Managed in the UK - Client Type by Parent Type



Sample size: 75% of total institutional assets under management

Chart 12
Institutional Assets Managed in the UK - Parent Type by Client Type



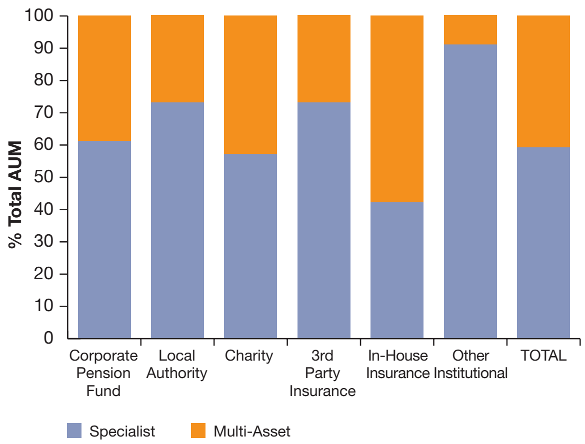
Sample size: 75% of total institutional assets under management

MULTI-ASSET VS SPECIALIST

While we have not in the past measured the balance between specialist/single asset class and multi-asset/balanced mandates, it is clear that there has been a sustained and marked move away from balanced mandates since the 1990s as pension funds adjust their strategies. Within the overall institutional space, survey responses indicate that specialist mandates account for 59% of the total.

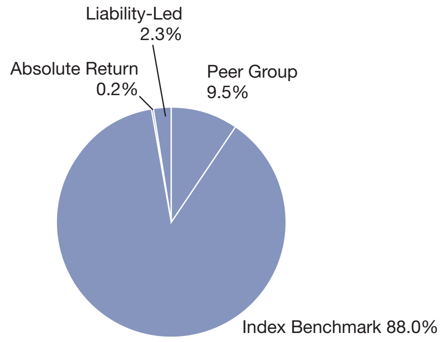
The responses are analysed across client type in Chart 13. This chart reflects the presence of a number of large in-house OPS schemes in the sample (which by definition will be multi-asset). Removing these from the sample sees the proportion of assets under management for corporate pension funds subject to specialist mandates rise to 72%, more comparable with the higher levels seen in the local authority figures (73%). It also increases the overall share of specialist mandates from 59% to 64%.

Chart 13
Use of Specialist and Multi-Asset Mandates (Institutional Clients)



OVERALL INVESTMENT OBJECTIVES

Chart 14
Investment Objectives of Institutional Assets under Management



This year's survey splits investment objectives into peer group, index benchmark (including customised benchmark), absolute return, liability-led and other. Chart 14 illustrates the overall balance within institutional mandates. The index benchmark is the predominant measure.

Given the rising prominence of liability-led investment (LLI) products, we tried to measure the extent of usage by institutional clients.[12] As several leading providers were able to give us data on LLI products, but not as part of an overall distribution of institutional mandate objectives, the 2.3% shown in Chart 14 is a considerable understatement, with our estimate being some 5.3% of total institutional assets under management.[13]

We also asked about LLI products within a ranking of product areas currently growing fastest: 20% of respondents to this question ranked LLI first or second in terms of current importance. This figure rises to just under a third for expectations in three years' time.

[12] Defined as approaches where investment objectives and risks are calculated explicitly with respect to client liabilities. We would differentiate these from absolute return funds in the sense that the latter are designed to generate positive returns regardless of market conditions, but may not necessarily be specifically tailored to client liabilities.

[13] To measure the true extent of LLI usage, it would also be necessary to survey investment banks, which provide competition for the asset management industry in this area.

Chart 15
Pension Fund Investment Objectives

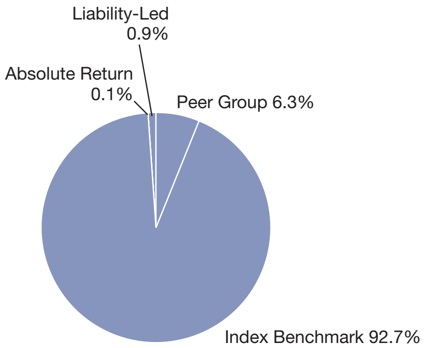
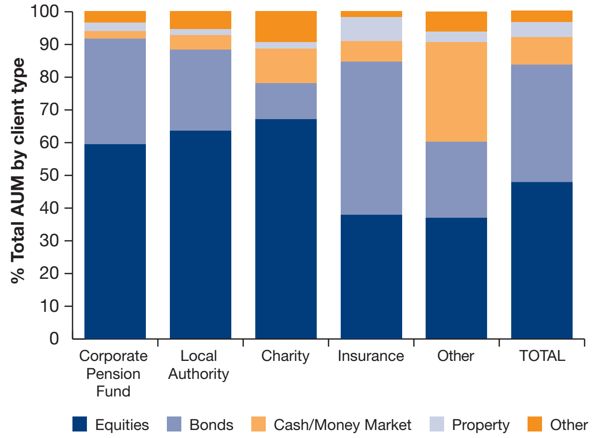


Chart 16
Asset Allocation by Institutional Client Type



With respect to pension funds,[14] peer group mandates account for some 6.3% of mandates as measured by assets under management by the respondent group. Data on UK pension funds has shown a steady decline from as high as a quarter at the end of the 1990s.[15] Chart 15 shows the position in more detail. Once again, the liability-led component is under-stated in the aggregate data.

ASSET ALLOCATION

In looking at overall institutional asset allocation (see Chart 16), the traditional contrast between insurance and pension funds is still clearly evident in that fixed income continues to account for around 50% of total insurance investment. Nonetheless, over the last few years the bond exposure of pension funds has significantly increased at the expense of equities, and last year's survey identified the further development of this trend.

The headline figures from the overall sample this year show public and private sector pension funds holding 31% of their assets in bonds and some 60% in equities (compared to 35% bonds/56% equities last year). However, just as we saw with respect to the overall allocation of UK-managed assets, matched samples from 2005 and 2004 suggests that there is little substantial change in the relative proportions of equities and bonds in pension funds. Given changing asset values, this implies that the move away from equities is continuing. Data from this year's survey, which splits local authorities from corporate pension funds, confirms findings elsewhere that the general move away from equities has been more pronounced among the latter (see Chart 16).[16]

USE OF ALTERNATIVES

The survey included questions on the use of property, private equity and hedge funds. As Chart 17 shows, these accounted for some 5.4% of total institutional assets under management in the UK, with hedge funds and private equity together accounting for less than 1% of total assets under management by IMA members.[17] There is also growing evidence of the use of other forms of 'Alternatives', for example, commodities and currency overlay.[18]

[14] Pension fund mandates are measured by combining corporate pension fund and local authority mandates, which captures most of the UK pension fund universe.

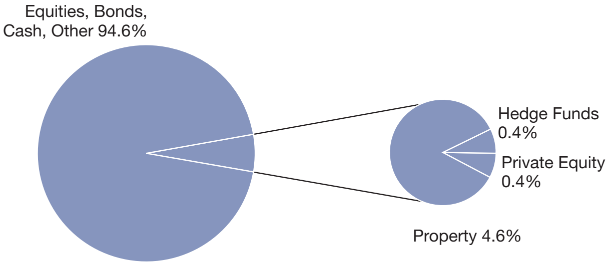
[15] See SSGA, 'The Changing Face of UK Pension Fund Asset Allocation,' December 2005.

[16] See WM Company, 'WM Annual Review: UK Pension Funds 2005'.

[17] Due to the coverage issues outlined earlier in the first part of the survey, the data shown in Chart 17 will not reflect the full extent of the use of alternative investment types by institutional funds.

[18] See, for example, JP Morgan Fleming Asset Management, 'Alternative Investment Strategies', March 2005.

Chart 17
Property, Private Equity and Hedge Funds (% total institutional AUM)



SEGREGATED AND POOLED FUNDS

The use of pooled funds may be considered by institutional investors for a number of reasons, for example, where small portfolios make segregated management an unviable option; where specialised pooled funds (eg. pensions) are convenient for those with similar investment goals; where market exposure through index tracking is desired; or where pooled funds offer accessible sources of geographical diversification. Pooled funds may be unauthorised vehicles open only to institutional investors, or authorised funds with institutional share classes.

The headline data suggests that in terms of total third party business (ie. excluding in-house assets and those run by OPS firms), the proportion of assets in segregated funds is some 60% compared to 40% in pooled funds. As a number of large firms did not fully respond, we believe that this figure overstates the importance of pooled funds. These sampling issues nothwithstanding, survey responses do allow a number of general observations about patterns of third party segregated and pooled business:

- Of 28 respondents managing total pooled funds of some £352bn, only seven firms manage more than £5bn each, but account for 91% of the total (see Table 5). While some are active houses, the impact of the indexing players is considerable in this area. This aspect is also examined in the next section on usage of active and passive management techniques.

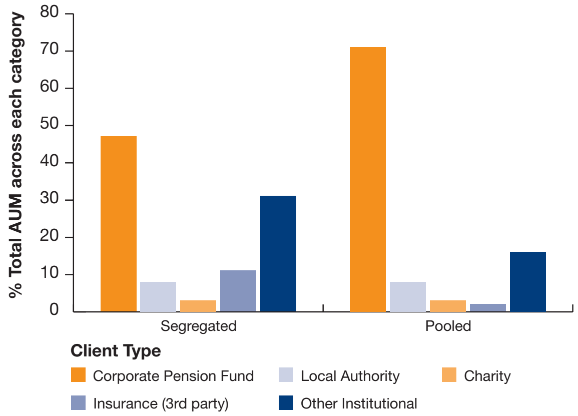
TABLE 5:
Distribution of Third Party Segregated and Pooled Mandates

	Number of firms managing more than £5,000mn	% of total third party institutional AUM by these firms
Segregated	18	95%
Pooled	7	91%

- The shape of the segregated market is rather different. Out of a total of 38 respondents managing some £531bn, the number of firms managing more than £5bn rises to 18 (of which all feature among the largest managers of pooled funds).

- Looking at the composition by client type of segregated and pooled third party business identified in the survey, pension funds have a particularly strong position among pooled funds (see Chart 18).

Chart 18
Client Composition of Segregated and Pooled Third Party Institutional Business



Asked about the broad outlook for business development, 14 respondents (of a total of 30 on this question) saw segregated institutional business as most important in terms of current growth. Four ranked it equally with pooled institutional, and a further five saw pooled institutional as most important. On a three-year outlook, this position is broadly unchanged.

ACTIVE VS PASSIVE MANAGEMENT

Indexing products have enjoyed increasing importance over the past few years as investors make a clearer differentiation between alpha (value-added by active management) and beta (market return). There have also been a number of innovations in this area, such as exchange-traded funds and enhanced index products (which attempt to bridge the gap between active and passive).

We asked this year about the use of passive management,[19] across both segregated and pooled mandates. Responses suggest that some 20-25% of total institutional assets may be managed passively,[20] and the data supports a number of further observations:

- The majority of passively-run third-party institutional assets (60%) are in pooled funds, but this clearly also leaves a sizeable proportion of assets run on a segregated basis.

- The passive space continues to be dominated by a small number of firms. While 12 respondent firms (managing total assets of £1.1trn) had some institutional assets under passive management, three firms run over 90% of all the passive assets (by total institutional assets under management) we have been able to identify.

With respect to active strategies, some 24 firms (of a total of 37 responding to this question), managing total assets of £880bn, see active equity as the first or second most important product area for their business in terms of current growth, and almost all expect it to remain so over the next three years. These 24 firms vary considerably in size, from some of the largest scale firms to smaller operators.

[19] Defined as non-discretionary stock and securities selection (excluding enhanced index products).

[20] As with the segregated/pooled split, we believe that partial responses to this question from some firms have resulted in a headline figure – 35% of total institutional assets under management are in passive funds - that overstates the actual position. On the basis that responses were received from the largest passive management firms, we estimate the figure to be closer to 20-25%.

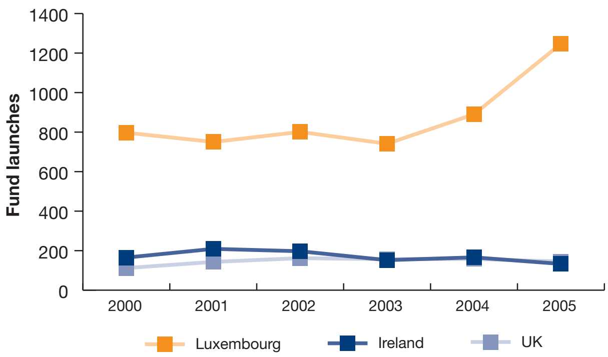
4 RETAIL AND UK FUNDS MARKET

As we showed in Part One, retail clients account for some 19% of total assets under management in the UK, equating to some £530bn. This figure comprises a range of retail investment vehicles, primarily:

- UK-managed authorised funds (unit trusts, OEICs);
- UK-managed funds domiciled outside the UK (eg. UCITS, ETFs) marketed to retail investors in the UK and elsewhere; and
- Investment trusts.

Looking more closely at non-UK domiciled funds, a number of respondents have significant retail operations elsewhere in Europe where the assets are largely managed in the UK, but with domicile outside. We estimate that some £200bn of UK-managed retail assets were domiciled outside the UK as at December 2005. One illustration of the general dynamism of other European centres is the number of fund launches - Chart 19 shows the relative position of the UK, Luxembourg and Ireland (see also earlier discussion on domicile, p.9).

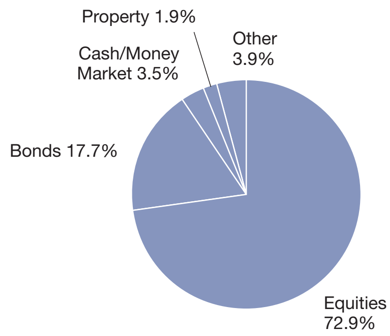
Chart 19
Fund Launches in Ireland, Luxembourg and the UK (2000-2005)



Source: FERI and IMA

In terms of asset allocation, a striking feature of the retail market, in contrast to trends seen in the institutional market in recent years, is the far higher apparent level of exposure to equities (see Chart 20). However, retail fund holdings are an imperfect illustration of individual portfolios. Firstly, retail investors may directly own equities and bonds. More importantly, they will often be directly holding other assets, notably cash and property.

Chart 20
Retail Assets Managed in the UK - Asset Allocation



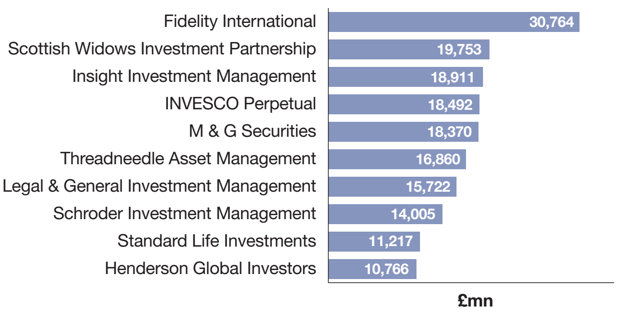
UK-AUTHORISED UNIT TRUST AND OEIC MARKET

IMA also collects detailed monthly sales statistics on the UK-authorised fund sector (unit trusts and OEICs), referred to as 'funds' in this section. In contrast to the retail numbers given in the previous section, this data includes both retail and institutional investment in collective investment schemes. We estimate that the balance between these two sets of clients as at December 2005 was some 90% (retail investors) to 10% (institutional investors). This section analyses developments over the past year in this part of the industry, with a focus on the retail side.

SIZE AND STRUCTURE

In December 2005, there were 118 companies providing a total of 2,007 funds with £347bn under management. The top ten firms, as measured by asset management firm, accounted for £175bn or 50% of the total (see Chart 21). The concentration of funds managed by the top ten firms has been trending up since 2000 as the number of firms has consolidated.

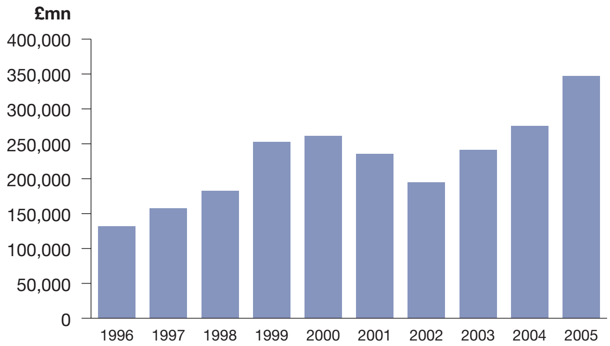
Chart 21
Top Ten UK Unit Trust and OEIC Managers (December 2005)[21]



FUNDS UNDER MANAGEMENT

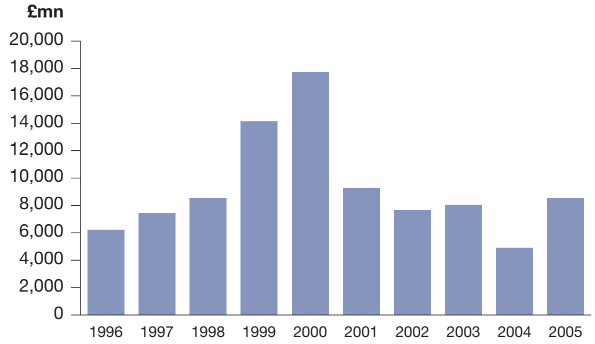
Funds under management have made a good recovery over the last three years, correlated with the UK equity market which bottomed in the first quarter of 2003 and has been in an uptrend since. UK assets have averaged about 45% of the total over the ten year period.

Chart 22
Funds under Management (1996-2005)



With strong investment markets in both equities and bonds continuing in 2005, funds under management breached the £300bn mark for the first time in July 2005, helped by both the strong markets and strong net retail sales. By December, the total had reached £347bn, a 26% increase from the previous year (see Chart 22). As Chart 23 illustrates, net retail sales of £8.5bn returned to levels not seen since 2001 (net retail sales reached their highest levels in 2000 at £17.7bn).

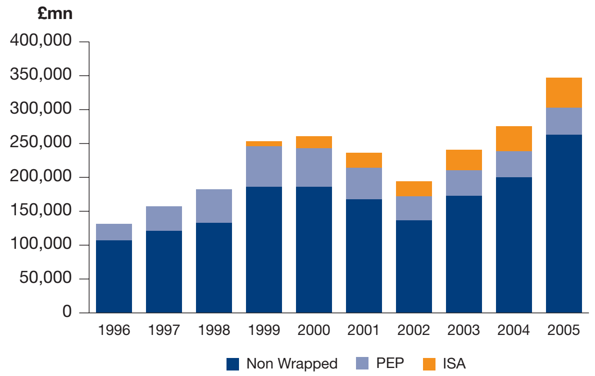
Chart 23
Net Retail Sales (1996-2005)



ISA funds under management, although increasing 20% year-on-year to £45bn in 2005, peaked in 2004 in terms of their contribution to funds under management, at 13.6% of the total:

- In December 2005, of the total funds under management, 12.9% were from the ISA tax wrapper with 11.6% in PEPs. Tax wrappers at their peak contributed 28.8% (see Chart 24).
- Although ISA sales started to improve towards the end of the year, net ISA sales fell 10% in 2005 to £1.8bn, the lowest level since ISAs were introduced in 1999. As Chart 25 illustrates, total tax wrapped business saw a net outflow of £1.3bn in 2005 for the second year as redemption of PEPs outstripped net ISA sales. (Reregistrations, where an investor reregisters their holding from a firm to a fund supermarket, may cause distortions in the data as some of the data capture may be lost).

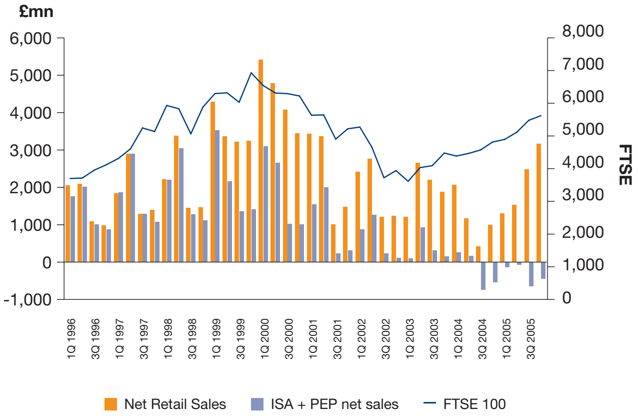
Chart 24
Funds under Management by Product (1996-2005)



[21] The ranking here is calculated on the basis of asset management firms managing assets for funds branded under their own name or that of other parts of the same parent group: eg. Insight Investment Management includes Insight Investment Fund Management, Halifax Investment Fund Managers Ltd and Clerical Medical.

Chart 25

Quarterly Net Retail Sales and ISA/PEP Net Sales vs FTSE 100 (1996-2005)



The reason for sluggish sales of tax wrapped products is unclear. Possible explanations are:

- Money flowing into cash ISAs and therefore not captured in IMA data;
- Tax wrapped products becoming mature; a 7 year holding period of funds is typical; and
- Abolition of the 10% tax credit on dividends from equity investments.

ASSET ALLOCATION[22]

As Chart 26 illustrates, the asset mix in UK funds remains dominated by equities, accounting for 74.6% of the total funds under management as at December 2005, although not gaining any ground over the last three years. The majority of equity assets are in UK equities, accounting for 41.7% of the total at year-end. Global equities accounted for 32.9%. Europe remained the favoured region with the three pure European sectors making up 30.2% of global assets.

Bonds reached their highest percentage weight in 2003 at 15.8%, benefiting from both the bear market in equities and flows into bond funds. The weighting in bonds declined to 15.1% during 2005. The Balanced and Other categories make up the majority of the remaining assets.

Chart 26

Funds under Management by Asset Type

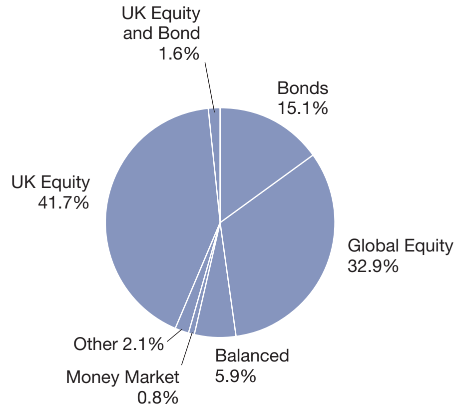
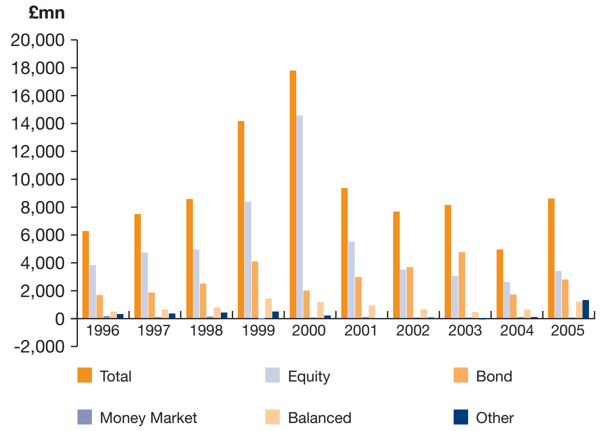


Chart 27

Net Retail Sales by Asset Category (1996-2005)

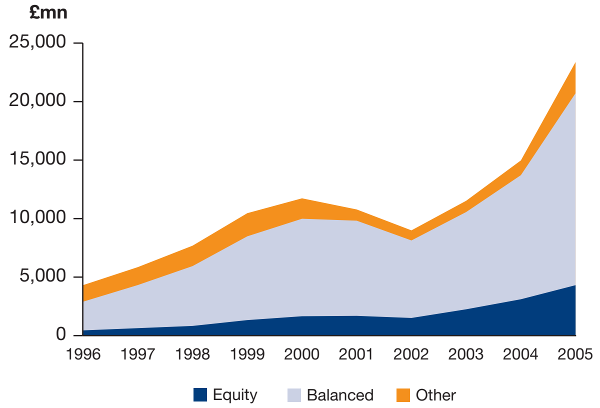


In terms of retail asset flows (see Chart 27), the retail investor continued to favour equity funds over bonds in 2005 for the second consecutive year, investing £3.3bn or 39%. This was a reversion to their asset preferences prior to the equity bear markets which put bonds as the asset category of choice for the two year period of 2002-2003. The best selling sectors in terms of net retail sales were UK Equity Income at £1.5bn and Cautious Managed at £1.4bn. The worst selling sector was Europe ex UK at £10.7mn.

[22] IMA monthly statistics on UK authorised funds are collected on a different basis in terms of asset allocation to the annual survey questionnaire.

FUNDS OF FUNDS

Chart 28
Funds under Management for Funds of Funds (1996-2005)



Funds of funds asset growth also continued strongly in 2005 reaching £23bn, an increase of 56% year-on-year (see Chart 28):

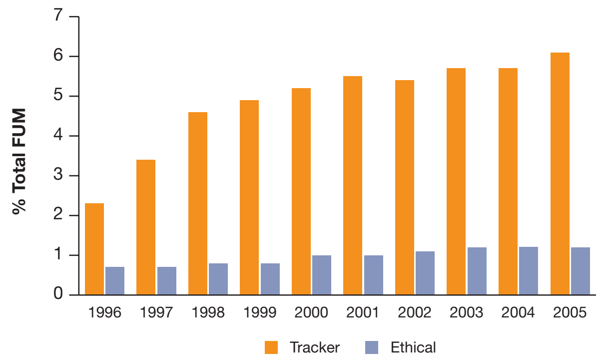
- Balanced managed funds accounted for the majority of funds under management, representing 70% of assets followed by equities at 18%. At December 2005, the split of funds between fettered and unfettered fund of funds was 56% to 44%.

- Funds of funds net retail sales at £2.3bn increased 67% over the prior year with the second quarter recording a record all time level of business at £752mn. Their increasing popularity saw them deliver about 27% of all retail fund sales, a major increase from the 4% in 2003 and double their market share of ten years ago. The Cautious Managed sector accounted for £846mn of net retail business and was the most popular sector, followed by Active Managed.

TRACKER AND ETHICAL FUNDS

Tracker and ethical funds remained in a fairly static trend making up 6% and 1% of the total funds under management in 2005. There were 67 tracker funds and 44 ethical funds at year-end. During the year, tracker funds saw a net outflow of retail money of £91mn whilst ethical received an almost equal inflow of £88mn.

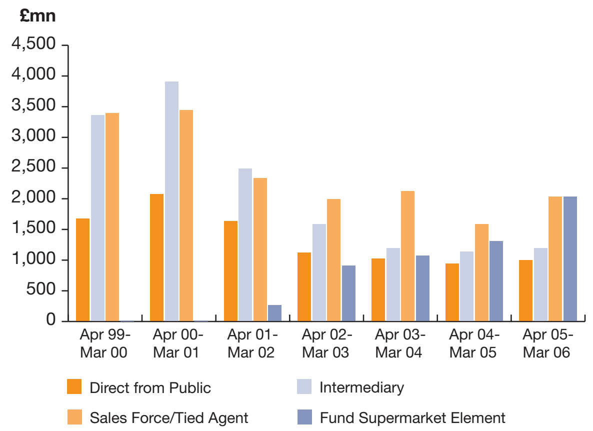
Chart 29
Tracker and Ethical Funds under Management (% total FUM, 1996-2005)



SALES CHANNELS

The dominant channel in the gross sale of retail funds in 2005 was the intermediary channel, taking 77% of the total. Sales force/tied agents distributed 10.5 %, while 9% went direct. Recent years have seen the growing influence of fund supermarkets, which are reported within the intermediary channel above. In the ISA data, where the fund supermarkets are disaggregated, their growing dominance is more apparent. In the latest tax year, the sales force/tied agent channel and the fund supermarkets were responsible for equal amounts of gross ISA sales for the first time (see Chart 30).

Chart 30
Tax Year Gross ISA Sales by Distribution Channel (1999-2005)



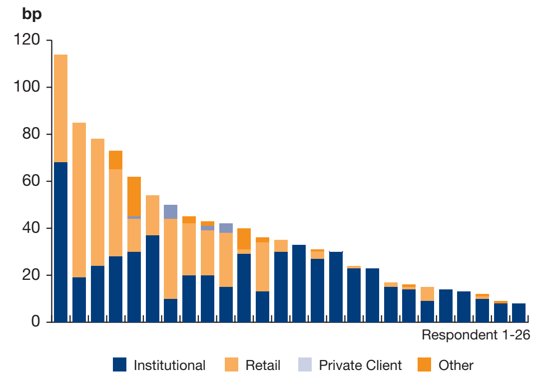
5 OPERATIONAL ISSUES

REVENUE AND FEE STRUCTURES

Twenty-six firms managing £1.6trn of assets in the UK reported revenue as a proportion of UK assets under management. Data from the survey suggests that weighted average revenue as a proportion of total assets under management was 28 basis points in 2005, equating to some £8bn.

Chart 31 shows revenue split by client type. The central observation is that most of the higher revenue firms have a large proportion of retail business. This is as would be expected given the higher cost base associated with retail activity (ie. administration overheads and extensive use of intermediaries for distribution).

Chart 31
Revenue by Firm as a Proportion of Assets Managed in the UK - Split by Client Type



With charging structures within the industry continuing to evolve, we also asked firms about the extent of the use of performance-related fees, and also about current trends in their usage:

- A total of 39 firms, managing £1.7trn, responded to the question, with 30 saying that they did use performance-related fees. At this point in time, usage seems more prevalent in the institutional than the retail market.
- Among those respondents who do use performance fees, the weighted average proportion of total assets under management subject to performance-related fees was 27%. All but five of these respondents indicated that the use of performance-related fees was increasing.
- A more detailed distribution is shown in Table 6.

TABLE 6:
Use of Performance-Related Fees

Proportion of assets under management subject to performance fees (%)	Number of firms	Total AUM by these firms (£bn)
0%	9	£25
1-25%	16	£1,053
26-50%	7	£204
51-75%	5	£359
76-100%	2	£53
TOTAL	**39**	**£1,694**

COST BASE

TABLE 7:
Costs by Activity (Range and Median)

	Range	Median	Median largest ten
Marketing, distribution, client services	0-54%	15.5%	21.0%
Asset Management and research	14-75%	33.9%	32.3%
Transaction process, fund accounting and administration	3-39%	16.5%	17.6%
Compliance, Legal, Audit	1-8%	3.0%	3.0%
Corporate Finance and Admin	2-15%	6.9%	13.4%
IT	2-27%	8.3%	12.5%
Premises	0-13%	6.0%	4.5%
Other	0-17%	2.0%	0.0%

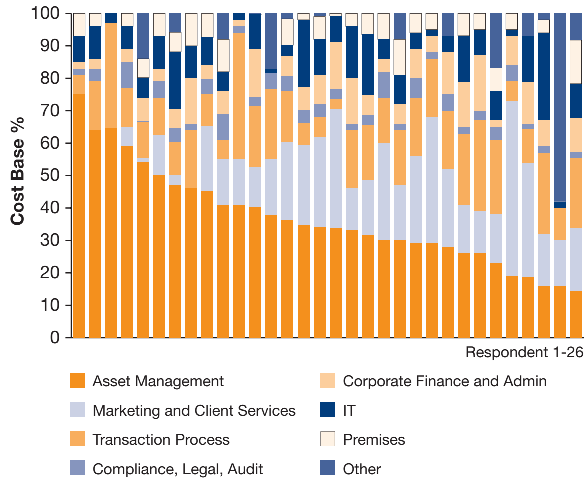
Respondents were asked to provide a breakdown of their cost base, split by front, middle and back office activities. Responses received from 32 firms, with £1.6trn of assets under management, illustrate very clearly the diversity of business models within the industry:

- Looking firstly at asset management and research, the proportion of the cost base devoted to these activities varies considerably: from some 14% to 75%. See Chart 32. The largest single group above the third quartile (>45%) is OPS firms, who by definition will not have the kind of marketing, distribution and administration costs seen in other parts of the industry. As Table 7 shows, the median for all 31 respondents is 34%, with 17 firms in the range 25%-45%. For the largest ten firms responding to this question (each with over £60bn of assets under management in the UK), the median is 32.3%.

- With respect to marketing and distribution costs, where the median is 15.5%, there is a clear connection, as would be expected, between retail funds under management and a higher proportion of cost in this area. For the largest ten firms ranked by retail funds under management in the UK, the median is 21%.

- Certain cost categories - for example, IT and premises - can be affected by one-off changes that will drop out over a longer time sequence. However, once again, the proportion of the cost occupied by IT and premises will in considerable part be determined by the nature of the firm.

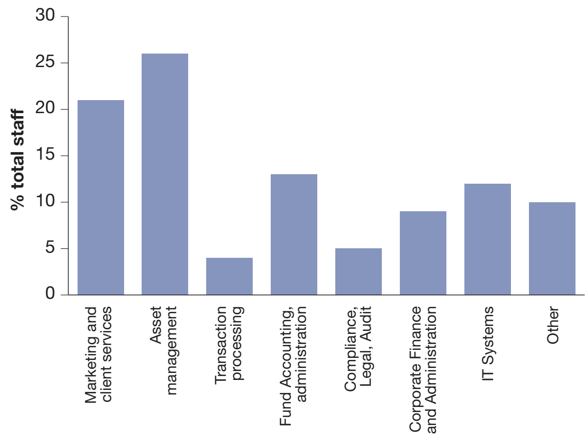
Chart 32
Costs by Activity (% of Total by Respondent Firm)



HEADCOUNT, OUTSOURCING AND OFF-SHORING

Staff numbers were gathered from 35 respondents representing 58% of UK assets under management or £1.6trn. These firms employ some 12,730 people. Based on these returns and data from last year's survey, we estimate direct employment numbers for UK-based asset management activity at 22,000-25,000. The overall distribution is summarised in Chart 33, with more detail provided in Table 8.

Chart 33
Distribution of Staff by Activity



The data shows core asset management activities (fund management, research and dealing) accounting for just over a quarter of total direct employment, with marketing and client services representing the second largest segment of employment (21%). Comparing this to the cost base data, it is clear, as would be expected, that the higher proportion of costs generally associated with asset management functions reflects the importance of this area of the business.

TABLE 8:
Sub-Division of Employment in Main Activities

Marketing and Client Services	**21%**
Marketing, sales, business development	62%
Client services	38%
Asset Management	**26%**
Fund Management (strategic and operational)	76%
Research/Analysis *	16%
Dealing	7%
Transaction Processing	**4%**
Transaction processing, settlement	97%
Custody	3%
Fund Accounting and Administration	**13%**
Investment accounting, performance measurement and reporting	51%
Other fund administration (including CIS administration)	49%
Compliance, Legal and Audit	**5%**
Compliance	50%
Legal	38%
Audit	12%
Corporate Finance and Corporate Administration	**9%**
Corporate Finance	32%
HR and training	32%
Other Administration	36%

* In some firms, the fund management and research roles are combined.

However, the personnel structure of the industry is increasingly complicated due to outsourcing of many aspects within the asset management value chain. These staff numbers therefore significantly understate total employment generated by the sector in the UK:

- Many mutual fund firms outsource a substantial amount of their activities, notably fund administration and accounting. However, such outsourcing extends to larger firms (particularly for the retail aspects of their operations). Outsourced administration is often undertaken by specialist third party administration firms. It may also be undertaken by other asset management firms, who offer such services (staff numbers for the latter were excluded in this survey).

- In common with practices in other industries, other activities - notably IT - are widely outsourced. Eight of 35 firms who responded to the staff question outsource at least 50% of their IT functions.

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. Data provided by one leading firm showed that while almost 90% of its European-based asset management and research staff were in the UK, this figure fell to less than a half for staff involved in the transaction process and fund accounting/administration.

The extent to which actual off-shoring is taking place (ie. existing UK-based jobs being relocated outside the country for tax, regulatory, cost or service quality reasons) has been a source of considerable discussion over the past few years. A major study by OXERA, commissioned by the IMA and the City of London, examined the question in some detail.[23] It concluded that while some middle and back office functions appeared prone to relocation outside the UK, core asset management activities and marketing/distribution appeared fairly securely located for the time being. Our survey this year asked a number of questions about off-shoring and will monitor the issue in coming years. The findings broadly confirmed the OXERA study, with only two respondents indicating that off-shoring was likely to increase over the next three years.

BROKER RELATIONSHIPS

The survey includes a number of questions on broker relationships, reflecting issues of ongoing regulatory interest. This year, we cover four areas:

- Extent of execution-only trades.
- Extent of soft commission remaining and the introduction of commission sharing arrangements.
- Number of brokers used to complete UK and international trades.
- Transaction costs analysis.

Execution-Only Trades

Respondents were asked what proportion of trading by value was completed on an execution-only basis (including through execution-only brokers, crossing networks and by direct market access (DMA)):

- Of 38 respondents, 11 managing £599bn (35% of total assets under management in the sample) do 100% of their business on an execution-only basis. See Table 9.
- In part this reflects the continuing major presence of indexed funds, but also increasing usage by active asset managers' dealing desks of alternative execution venues to access liquidity and preserve anonymity. An emerging trend would appear to be the recognition by some specialist active managers who have in-house research analysts that brokerage commission pays purely for access to liquidity.

TABLE 9:
Proportion of Business Directed on an Execution Only Basis

Proportion of trade through brokers on execution only basis (%)	Number of firms	Total AUM (£bn)
<1%	7	£151
1-25%	15	£831
26-50%	3	£141
51-75%	0	
76-99%	3	£77
100%	11	£599
	39	**£1,799**

Soft Commission

Respondents were also asked to provide the proportion of commissions subject to soft commission arrangements. The number of firms who do not have soft commission arrangements represented some two thirds of the sample by assets under management (see Table 10). In a matched sample, a quarter of firms who indicated last year that they did use soft commissions have now ceased the practice. In line with recent trends, the matched sample shows that the proportion of commission subject to softing has fallen to 2.6% in 2005 from 4.4% in 2004 on an AUM-weighted basis.

[23] See 'The Competitive Position of London as a Global Financial Centre' (OXERA report for IMA/City of London), 2005.

TABLE 10:
Proportion of Total Commmission Paid Subject to Soft Commission Arrangements

Proportion of total commission paid subject to soft commission (%)	Number of firms	Total AUM (£bn)
0%	31	£1,272
1-10%	7	£502
11-20%	3	£76
Total	**41**	**£1,850**

The new FSA rules on Softing and Bundling came into effect on 1 January 2006, restricting the use of client commissions to the purchase of research and execution services, with an explicit list of non-permitted services. The IMA's Pension Fund Disclosure Code was endorsed by the FSA as a suitable standard for disclosure of the split of commission between research and execution. As a result of these disclosure requirements, investment managers have conducted reviews of their broker relationships in order to establish what is being paid for execution services and for research services. The rules also allow for the purchase of third party research and execution services from bundled commission.

Commission Sharing Arrangements

A new question was included regarding commission sharing arrangements (CSAs), which facilitate the purchase of third party services from bundled commission arrangements. As of the date of the survey, 26 firms had no commission sharing arrangements in place. However, 16 firms, managing some £230bn of UK equities, have put CSAs in place for at least part of their business. For more details, see Table 11.

TABLE 11:
Proportion of Trade through Brokers Subject to Commission Sharing

Proportion of trades through brokers subject to commission sharing (%)	Number of firms	Total AUM by respondent firms (£bn)
0%	26	£919
1-5%	4	£236
6-15%	4	£316
>15%	8	£279
	42	**£1,750**

Number of Brokers

Going forward, the IMA will monitor changing trends in broker usage which may occur as a result of the new FSA rules on Softing and Bundling as well as of increased usage of CSAs. A new question in the survey has been introduced and respondents were asked how many brokers were used for the majority (80%+) of trades:

- As Table 12 shows, some 45% of respondent firms use 5-10 brokers for UK equities while a similar number use 11-20. Only one firm uses less than five, while three use over 20.
- Just under a third of respondents use 5-10 brokers for overseas execution and a similar proportion use 10-20. Eight respondents use over 20. Broker usage is clearly also dependent on the typical mandate of an individual manager e.g. global vs UK.

TABLE 12: Number of Brokers Used for the Majority of Trades

Number of firms	Region	
	UK	Rest of World
<5	1	6
5-10	17	11
11-20	18	12
>20	3	8
Respondents	**39**	**37**

Transaction Costs Analysis

Some two thirds of respondents, 27 firms (out of a total of 41 responses), undertake transaction costs analysis as part of the firm's internal assessment of performance. This is broadly unchanged from last year. Table 13 details the responses of 39 firms, showing the number of clients requesting transaction costs analysis. Twenty-eight replied that less than 25% of clients required such analysis. Over 20% of respondents, however, said that more than 75% of their clients did require such feedback. As pension fund trustees begin to engage with the disclosure requirements under the new FSA rules, transaction costs analysis may be expected to play a bigger role in these discussions.

TABLE 13: Proportion of Clients Requiring Transaction Costs Analysis

Proportion of clients requiring feedback (%)	<25%	25% -50%	50% -75%	>75%
Number of respondents	28	3	0	8

6 APPENDIX ONE: QUESTIONNAIRE RESPONDENTS

Aberdeen Asset Management plc

Aberforth Partners LLP

ABN AMRO Asset Management Ltd

AEGON Asset Management Ltd

Aerion Fund Management Ltd

Artemis Investment Management Ltd

AXA Investment Managers Ltd

Baillie Gifford & Co. Ltd

Barclays Global Investors Ltd

Baring Asset Management Ltd

BP Investment Management Ltd

Britannic Asset Management Ltd
(now Resolution Asset Management)

British Airways Pension Investment Management Ltd

Canada Life Asset Management Ltd

Capital International Limited

Cazenove Capital Management Ltd

CCLA Investment Management Ltd

Fidelity International Ltd

First State Investments Ltd

Gartmore Investment Management plc

Henderson Global Investors Ltd

Hermes Pensions Management Ltd

Insight Investment Management Ltd

INVESCO Asset Management Ltd

Investec Asset Management Ltd

JP Morgan Asset Management Ltd

Jupiter Asset Management Ltd

Kvaerner Pensions Investment Management Ltd

Lazard Asset Management Ltd

Legal & General Investment Management Ltd

Liontrust Investment Funds Ltd

Liverpool Victoria Asset Management Ltd

M&G Securities Ltd

Majedie Asset Management Ltd

Marlborough Fund Managers Ltd

Mellon Fund Managers Ltd

Merrill Lynch Investment Managers Ltd

Morley Fund Management Ltd

Odey Asset Management LLP

Pimco Europe Ltd

Rathbone Unit Trust Management Ltd

Rio Tinto Pension Investments Ltd

Rothschild Private Fund Management Ltd

Royal London Asset Management Ltd

Schroder Investment Management Ltd

Scottish Friendly Asset Managers Ltd

Scottish Widows Investment Partnership

Standard Life Investments Ltd

State Street Global Advisers Ltd

Threadneedle Asset Management Ltd

UBS Global Asset Management Ltd

Virgin Money Unit Trust Managers Ltd

Wesleyan Unit Trust Managers Ltd

APPENDIX TWO: STRUCTURE OF SURVEY

This year, the survey has been conducted in a two part questionnaire: the first part asks a number of questions about assets managed in the UK; the second looks at a range of operational issues. We also use a range of data available in-house within the IMA on industry size and the structure of the retail funds market.

QUESTIONNAIRE PART ONE

The initial focus of the questionnaire was the value of total assets managed within the UK regardless of fund or client domicile.

In terms of the general structure of mandates and funds, we asked firms to supply:

- Assets under management split by client type across segregated and collective institutional portfolios.
- Assets under management split by active and passive management (where passive management is defined as non-discretionary stock and securities selection).

We next asked about Investment Objectives and Asset Allocation. Investment Objectives were divided as follows:

- Peer Group
- Index Benchmark (including Customised Benchmark)
- Absolute Return
- Liability-Led
- Other

We also asked for asset allocation across a range of mandate categories:

- Equities
- Bonds
- Cash/Money Market
- Main Alternatives (Property, Private Equity, Hedge Funds)
- Other

QUESTIONNAIRE PART TWO

Part Two of the questionnaire looks at a range of operational areas, including:

Business structures

- A general division of the cost base, looking at front, middle and back office functions.
- An overview of staffing levels based on front, middle and back office functions.
- The extent of off-shoring and future expectations in this regard.

Business development

- Geographical areas of business focus, and likely changes over the next three years.
- Product areas of most importance, and likely changes over the next three years.

Market interaction

- Extent of execution-only trades.
- Extent of soft commission remaining and commission sharing arrangements.
- Number of brokers used to complete UK and international trades.

GENERAL POINTS

A number of general points should be noted:

- Unless otherwise specified, all references to ‘Assets under Management in the UK’ refer to assets under management by IMA members as at December 2005.
- Not all respondents have been able to provide information for all questions, and not all questions have been answered on the same basis. Response rates have therefore differed across questions.

As in the past, 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.

APPENDIX THREE: TOP TWENTY GLOBAL MANAGERS

Table 14: Top 20 Global Managers (as at December 2004)

Organisation	Country	Total assets (US $mn)
UBS	Switzerland	$1,975,000
Allianz Group	Germany	$1,459,323
Barclays Global Investors	UK	$1,361,949
State Street Global Advisers	US	$1,354,330
Fidelity Investments	US	$1,286,107
AXA Group	France	$1,185,316
Credit Suisse	Switzerland	$1,078,815
Capital Group	US	$1,020,952
Vanguard Group	US	$848,397
JP Morgan Chase	US	$791,558
Deutsche Asset Management	Germany	$730,534
Mellon Financial	US	$707,078
ING Investment Management	Netherlands	$671,088
Northern Trust Global	US	$571,883
Morgan Stanley	US	$563,208
Aviva	UK	$525,853
AIG Global Investment	US	$524,677
IXIS Asset Management	France	$505,987
Prudential Financial	US	$499,577
Merill Lynch	US	$496,171

Source: Pensions and Investment/Watson Wyatt Global 500 (2005).

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