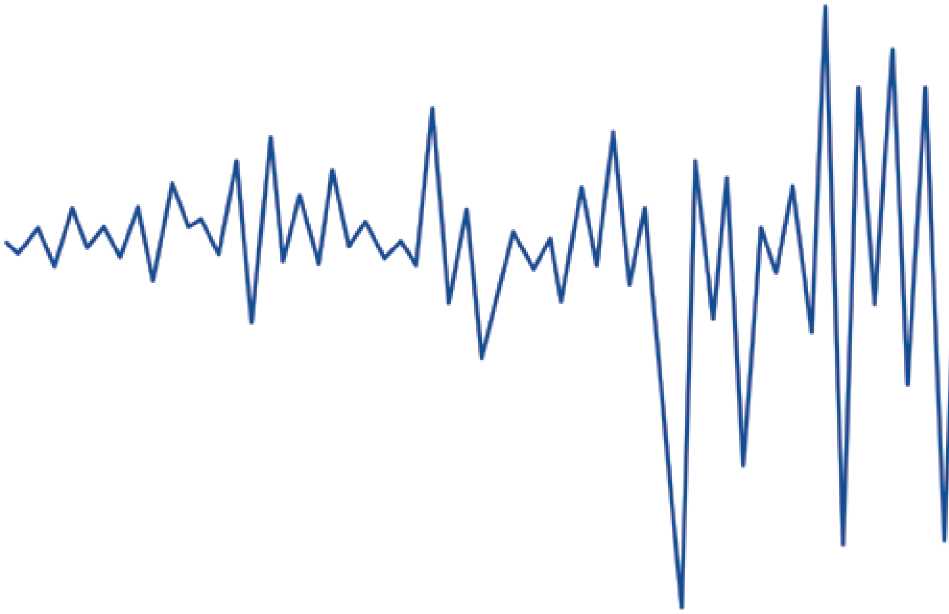

Seismic shifts in investment management
A look at the UK market

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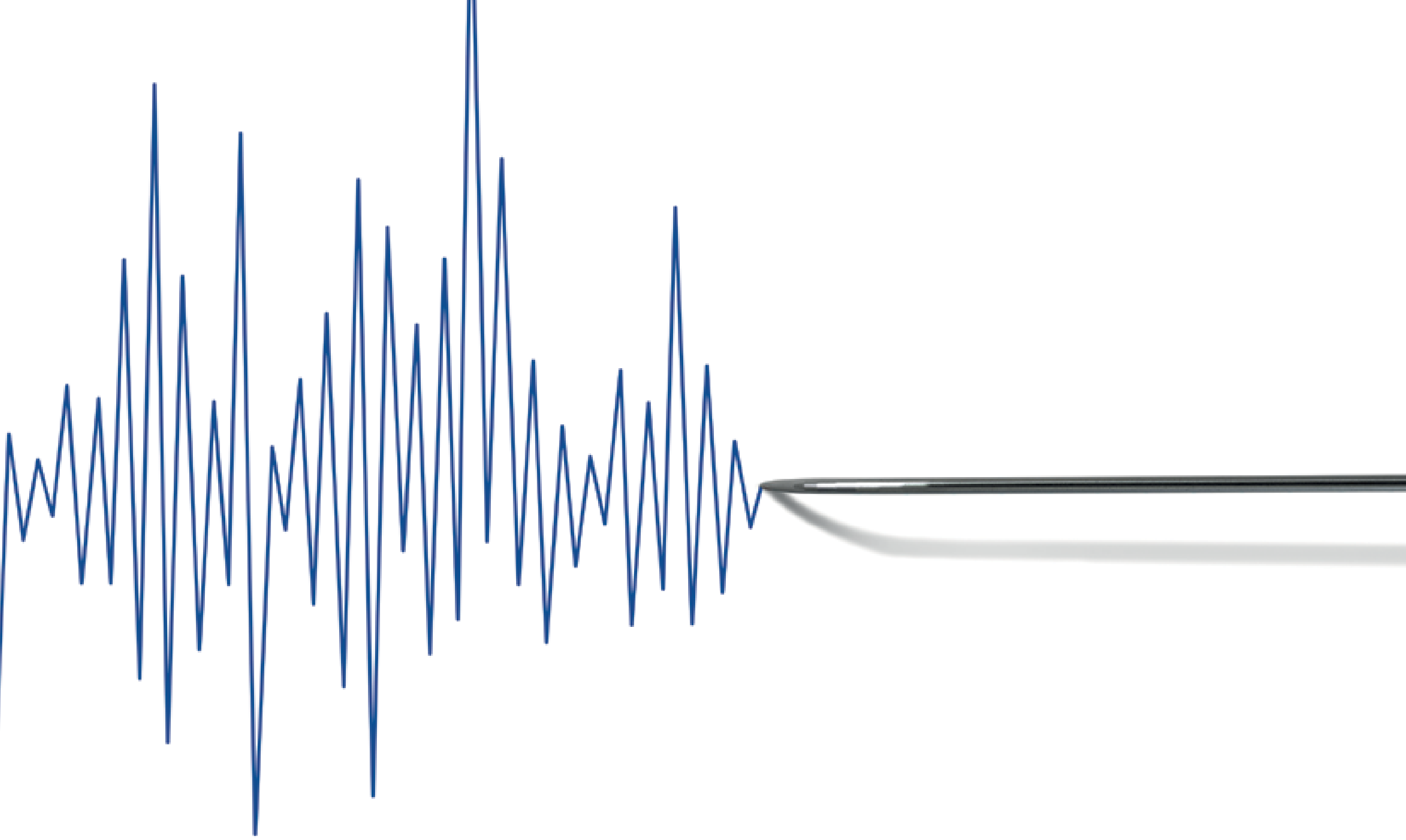
The UK investment management industry is at a turning point. Traditional active managers have already had to adapt to changes in the institutional market, but now they face a confluence of trends—from regulation to pension auto-enrolment to the growth of passive investing—that could also radically reshape the retail side of their industry.



As the industry experiences these seismic shifts, several key trends emerge.

- **Retail-isation:** with pension liabilities around the world moving from the state and employers to the individual via defined contribution schemes, retail investors are becoming increasingly important. As retail investors are generally poorly engaged with investment decision-making and often use the default funds offered by their pension provider, becoming the default fund is an extremely attractive prospect—regular, large fund flows that are likely to remain in place for decades are an asset manager's ideal. But the market requires scale to penetrate.
- **New intermediation models:** asset managers who have historically controlled a significant part of the value chain are in danger of losing out as platforms, wealth managers, insurance companies and other parts of the chain all aim to control a larger slice of the cake. These intermediaries—made up of around 150 decision makers—are acting as 'gatekeepers' by standardising the criteria for fund selection and launching their own funds, sub-advised by asset managers. This is significantly concentrating fund flows and putting pressure on fund charges, with many asset managers struggling to differentiate themselves and justify their fees in the eyes of these powerful new intermediaries.
- **Internationalisation:** asset managers are adapting to demands from UK investors for increasingly global products. At the same time, wealth in emerging markets is growing, creating new client bases for asset managers in these local markets.
- **Pricing and cost pressures:** pricing pressures are coming from several sources. Platforms that directly compare funds can force down fund management charges. In addition, the continued growth of low-cost passive funds can directly challenge those active funds that only achieve 'marginal alpha'. Regulatory costs add to this pressure.

Research, including interviews with a number of senior executives at asset management companies operating from the UK, suggests that the key industry responses to these trends are as follows:

- **Distribution:** asset managers are faced with a choice between building direct retail businesses and strengthening intermediated approaches. The majority of asset managers interviewed stress the importance of building deeper partnerships with their intermediaries as their primary route to market.
- **Products:** asset managers targeting foreign markets are using two approaches—either taking out UK-manufactured products via global distribution networks or building a domestic presence in a smaller number of regions using specifically targeted products. Active managers are also repositioning alpha products in light of the growth of hedge funds and pricing pressures from lower-cost passives, with many choosing to offer either higher, more differentiated alpha performance or lower-cost, semi-active funds with reduced costs.
- **Pricing:** interviewees accept that there is significant pricing pressure on UK-focused asset managers and there is evidence of fees being reduced in places. However, most are seeking ways to reduce prices only selectively by moving to variable pricing models, such as pricing by type of product (actives establishing higher prices for complex products and lower prices where automated processes can be introduced), by style of fund and by type of distributor (discounting only for the largest independent financial advisers but sustaining price differentials with smaller intermediaries). Avoiding wholesale reductions in pricing is the name of the game.
- **Costs:** to date, many firms have introduced cost-cutting and more disciplined spending regimes. Although interviewees display an appetite for more radical cost savings through outsourcing, they are struggling to understand which functions are key. Outsourcing data to cap escalating data costs raises concerns about cyber risk and regulatory requirements.

The UK investment management industry is undergoing extensive and continued structural change that will create a 'winner takes all' competitive environment. Similar to in the U.S., Australia and the Netherlands, the UK's move towards encouraging individuals to save into a pension, alongside the increasingly global and competitive nature of business, will radically reshape the industry and the role of asset managers within it.

Against this backdrop, Deloitte LLP commissioned The Economist Intelligence Unit (EIU) to analyse the drivers behind the seismic shifts shaking up the UK market and to explore how UK-based global traditional asset managers are responding. The research included interviews with a number of senior executives at global asset management companies operating from the UK.

Many of the trends identified in the research are already evident in other markets and will become increasingly marked as regulators and governments across the world seek to improve customer outcomes in investment management and tackle the high cost of public sector pensions. To read the full report, please visit: www.Deloitte.co.uk/Seismicshifts.

The Deloitte view

It is clear from the research that the seismic shifts occurring in the industry and across an asset manager's value chain are revealing white-space opportunities and threats. Asset managers with a presence in the UK need to understand where the industry is headed and adapt their model for these long-term changes to stay ahead of the competition.

Given the drivers identified in this research, we believe asset management boards in the UK have four sets of strategic choices to make:

- What client segment mix will be optimal—retail or institutional?
- Which distribution model will best achieve goals—direct or intermediated?
- What should be the preferred product and management style—active or passive?
- How best to capture demographic change—configure for local or global markets?

Building a picture of how these factors will interact will be key to deciding competitive strategy and scenario planning over the next 3-5 years.

View the full report at www.Deloitte.co.uk/Seismicshifts.

To the **point**:

- The UK's investment management industry is at a turning point, as retail flows become the predominant driving force
- The distinction between retail and institutional is blurring; funds are retail, but decision- making becomes more institutional
- Regulation, pension auto-enrolment, the growth of passive investing and platforms along with the increasingly global and competitive nature of business is radically reshaping industry
- These seismic shifts present both white-space opportunities and threats for asset managers with a presence in the UK. Winners are likely to have scale or be in niches