Number 28
June | 2015

A regular analysis of strategic issues in the institutional investment business

Deeper Perspectives

Targeting growth markets in European Institutional

Consultants do well in markets where fragmentation deprives schemes of the economic ability to retain skilled management in house. This skill often resides in large schemes that are common in continental Europe but rare in the UK.

In our annual drawing together of key themes from the European institutional asset management markets, we project future annual growth rates in institutional assets varying from -0.5% to 31%.

The smaller markets we look at have the highest growth rates. The average growth rates per market are useful, but there is huge variance within markets. An example: in the UK large schemes (DB and DC) have quite different growth prospects than small ones

We estimate that 37% of the funded pension and insurance general account assets in Europe is managed on a third party basis. This ratio varies by market, varying from as little as 7% to as much as 89%.

Of the third party managed pension and insurance general account assets in Europe, we estimate 79% of these are sourced from just 3 countries.

The UK is the most fragmented pensions market in Europe, and we think that this is the root cause of unusual UK market behaviour, in particular why it is so consultant dominated.

SPENCE JOHNSON

Suite 501 Salisbury House
London Wall
London EC2M 5QQ UK
T +44 20 3411 7311

www.spencejohnson.com

Spence Johnson provides five research-based services to asset management and insurance companies. Our clients use us to help them identify or retain clients in five key sectors within their institutional investment businesses

Institutional market of €14.8trn in Europe

The European asset management market is €20trn. The institutional part of the market is €14.8trn, 75% of the total, and this part has grown 30% since 2008. Our Market Intelligence research covers three quarters of the institutional market

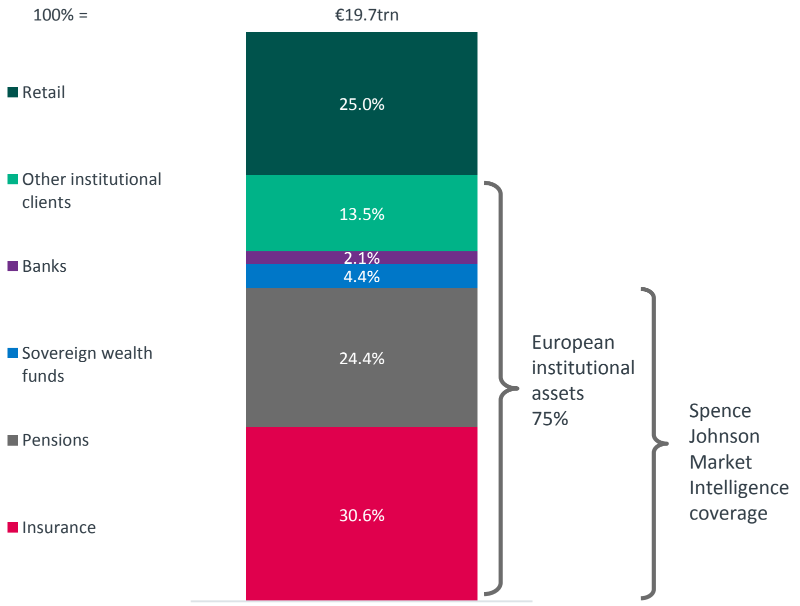
The European asset management market is €20trn. The institutional part of the market (i.e. excluding retail) is 75% of this, as shown in the chart to the right.

Our Market Intelligence research reports cover 55% of the total market, which equates to 73% of the institutional market.

European assets have risen steadily since 2008. Virtually all the growth has come from institutional client assets according to EFAMA, as can be seen in the bottom chart. Institutional assets have grown 75% since 2008, while retail assets have grown 35% in the same period.

European assets under management 2014*

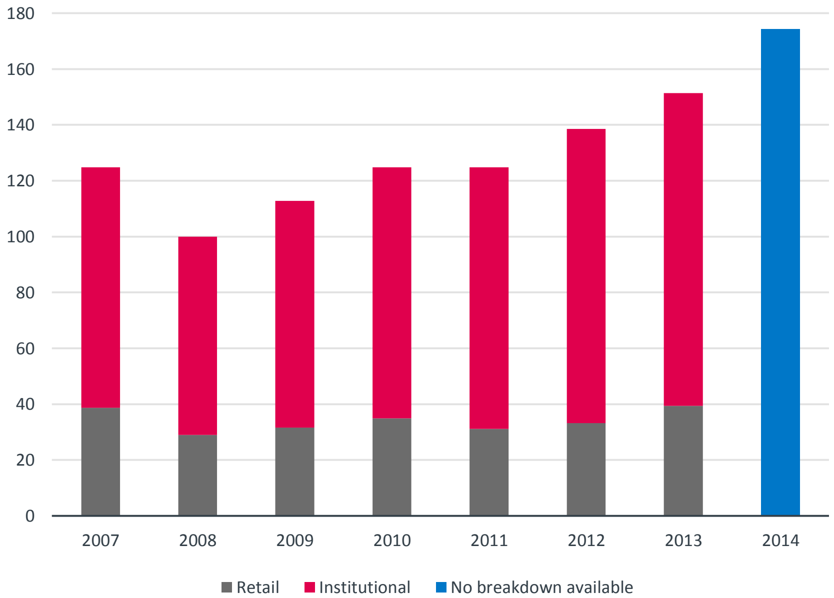
% of Assets



Source: EFAMA and Spence Johnson

European assets under management

Index 2008 total assets = 100



Source: EFAMA

* The top chart is based on a combination of EFAMA and Spence Johnson data. Spence Johnson data shows very similar values to EFAMA. However we remain a bit worried about the treatment of Insurance Unit linked assets, which may in some degree be double counted. We have done our best to avoid this. For more information, please see the Institutional Intelligence Data Supplement, see page 3

Projected annual growth varies: -0.5% to >30%

We project future annual growth rates in institutional assets varying from -0.5% (UKDB) to 31% (Smart Beta). The smaller markets we look at have the highest growth rates.

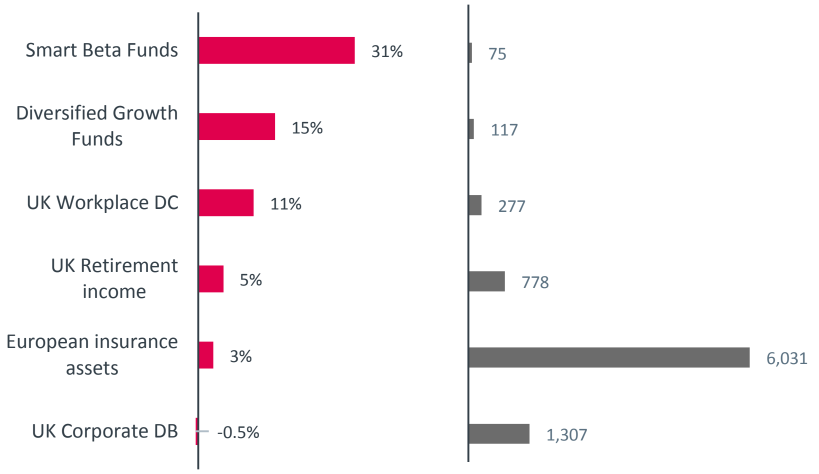
We have projected the growth of assets under management in six of the reports. The projected annual growth rates are shown to the right for the whole of each market. As we show in the charts to the right, growth rates are greater in the smaller markets.

The highest growth we foresee is in Smart Beta*, at a rate of 35% per year. This growth assumes that market conditions remain at the current broad level, so we reserve the right to adjust this projection if conditions change.

The lowest growth rate is for UK corporate DB, where we now foresee a small shrinkage of total assets. Note that this figure does not include Local authority funds in the UK, which will continue to grow.

European assets projected annual growth rates to 2023 and assets in 2012*

% growth per year and €bn AuM in 2012



* The growth rates for Smart Beta and DGFs are for 5 years to 2018

* The growth rates for Smart Beta and DGFs are for 5 years to 2018

We see wide growth variances within markets

The average growth rates per market are useful, but it is important to know how much different parts of any one market can vary in their growth prospects. An example: in the UK large schemes (DB and DC) have quite different growth prospects than small ones

We have shown in the top table how much the average growth rate varies within each market. Some segments within each market will grow much faster than others.

We show to the right the highest and lowest growth segments in each market. The highest projected growth segment in Smart beta is Risk Smart Beta funds, but the lowest growth is Return Smart Beta funds.

We wanted to show an example of how growth varies within one market. We have noticed a particular feature within UK pension schemes that large schemes will grow their assets at a faster annual than smaller schemes.

This is shown in the bottom chart, which reveals that smaller (retail) DC schemes will grow at half the annual rate of larger (institutional) ones. The same difference is visible in DB, where we foresee large schemes continuing to grow, while small schemes, which are closing at a much faster rate, will shrink much more quickly.

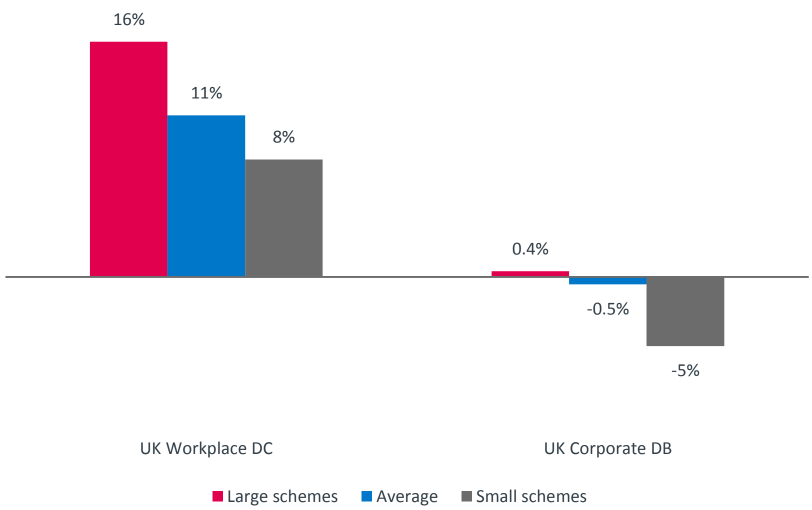
European assets projected growth rates*

% growth per year

	Average growth	Segment with lowest projected growth		Segment with highest projected growth	
Smart Beta Funds	**31%**	Return Smart Beta	**24%**	Risk Smart Beta	**38%**
Diversified Growth Funds	**15%**	**DB schemes**	**9%**	**DC schemes**	**25%**
UK Workplace DC	**11%**	Active equity	**3%**	Multi asset/DGFs	**22%**
UK Retirement income	**5%**	Pensions annuities	**0%**	Drawdown	**13%**
European insurance assets	**5%**	General account assets	**3%**	Unit linked assets	**7%**
UK Corporate DB	**-0.50%**	Growth assets	**-4%**	Matching assets	**4%**

UK DB and DC pensions assets projected growth rates to 2023

% growth per year

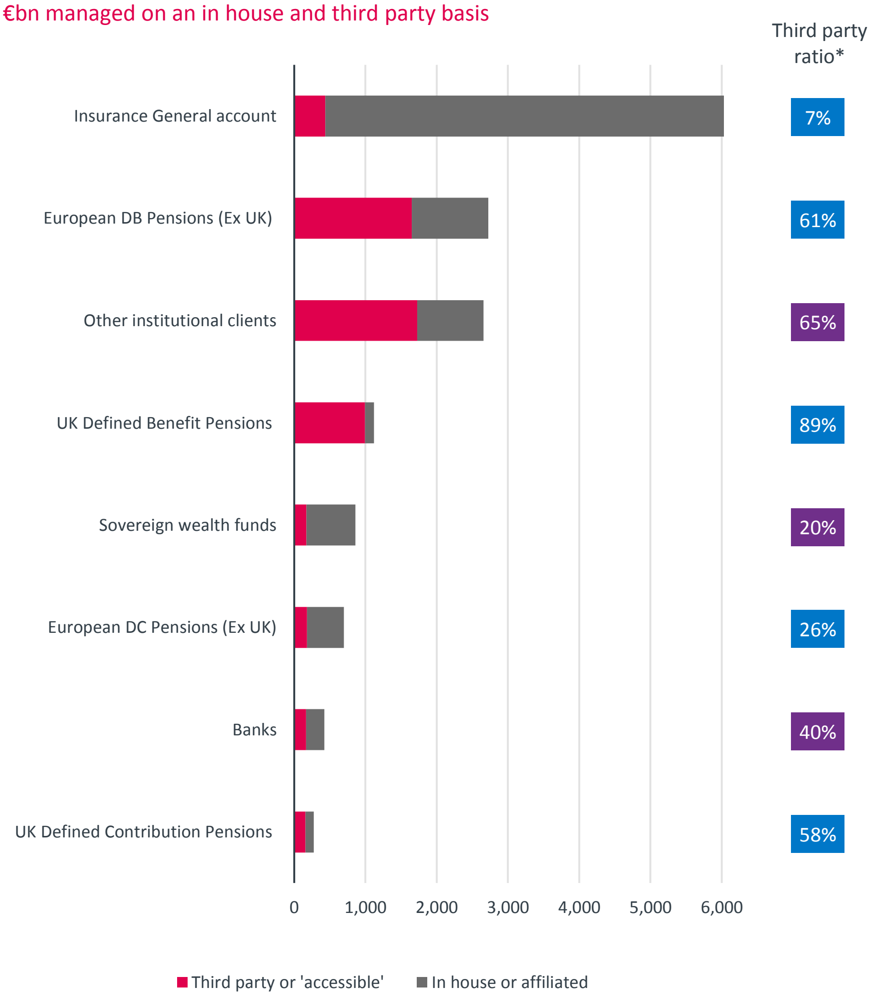


* The growth rates for Smart Beta and DGFs are for 5 years to 2018

€5.5trn of assets are managed by 3rd parties

Of the total European institutional assets of €14.8trn , we believe that €5.5trn (37%) is managed on a third party basis. The third party ratio varies by market: 7% of insurance assets are managed by third parties, while 89% of UKDB assets are managed this way.

European funded workplace pension and insurance general account assets
€bn managed on an in house and third party basis



For more information, please see the Institutional Intelligence Data Supplement, see page 3

***Note on Third Party ratio data**
We have particular visibility on European insurance and pensions assets, and feel confident in our third party ratios for these segments. They are marked in blue. However, we are less familiar with the other assets which are shown here: 'Other institutional assets', Banks and Sovereign wealth funds. Because the data for these is estimated, we have indicated this in purple.

UK is 50% of 3rd party pension and insurance GA

Of the third party assets managed pension and insurance general account assets in Europe, we estimate 79% of these are sourced from 3 countries: UK, Netherlands and Germany. And 50% is in just one of these: the UK.

The UK is the largest institutional market in Europe.

79% of third party assets managed pension and insurance general account assets in Europe are to be found in three countries: UK, Netherlands and Germany, and of these, 50% is in the UK alone.

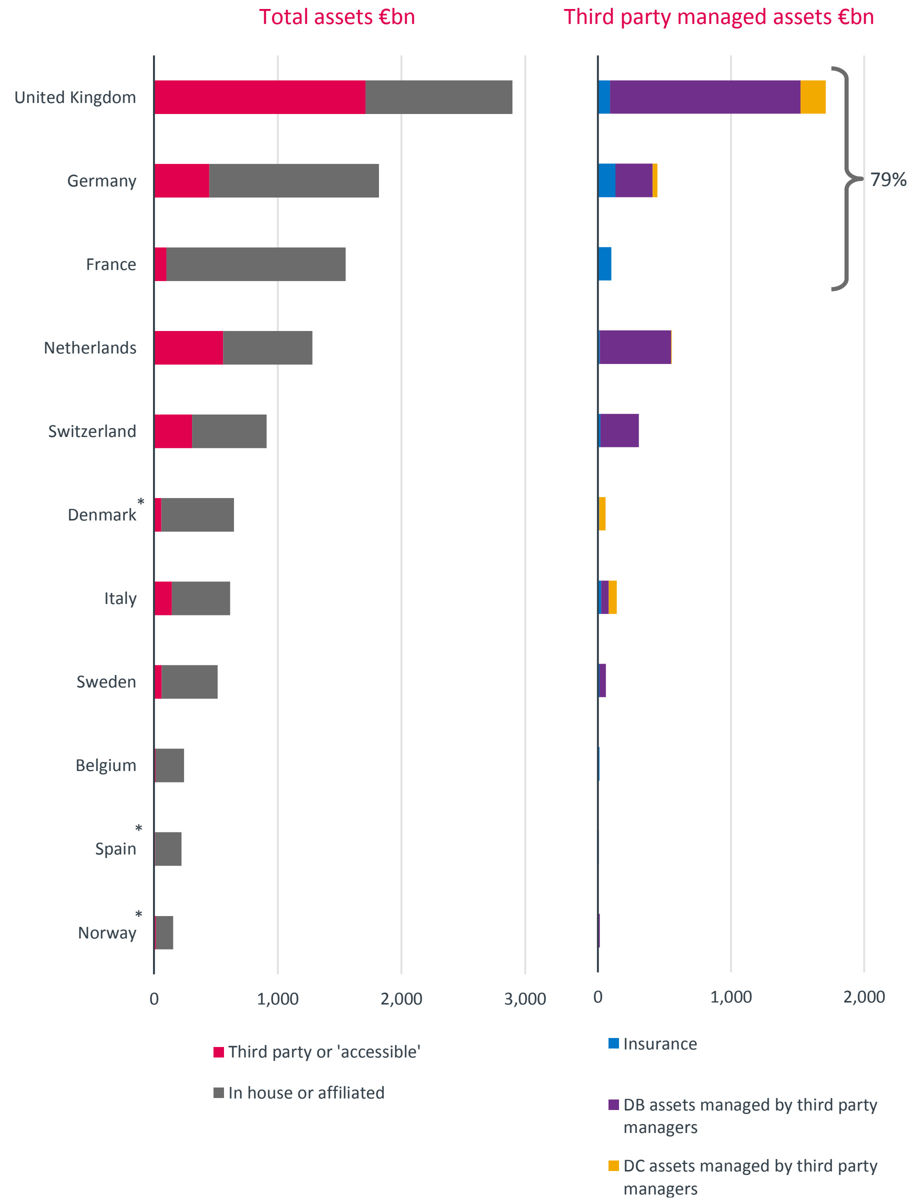
This is largely the result of the UK's very large DB funded pensions market which on its own makes up 42% of the European total of third party managed funded insurance and pensions assets.

Note on our European pensions research

We have measured European pensions by selecting the 8 countries which hold most funded pensions, and this excludes France, Belgium and Spain from our pensions data on the chart shown.

Within each country we have selected the pensions elements which are in our judgement both funded and workplace, and as a result we looked at a total of 45 elements across the 8 countries in our European Pensions report, and focused on the 28 elements which were both funded by assets and in a workplace environment – we avoided retail and insured elements.

Third party insurance and pensions assets under management*



Source Spence Johnson analysis.
* France Belgium and Spain: pensions data not included
Please note: Insurance and pensions are not mutually exclusive

* For more information, please see the Institutional Intelligence Data Supplement, see page 3

Fragmentation has big impact on UK behaviour

The UK is the most fragmented pensions market in Europe. This is the root cause of unusual UK market behaviour, and in particular why it is so consultant dominated.

As we have already pointed out in *Edition 25 of Deeper Perspectives*, the UK is the most fragmented pensions market in Europe. But this point is worth making again, along with its consequences this time.

There are 218,000 workplace schemes in the UK, due to the vast number of very small DC schemes that exist. But there are only 4,300 equivalent schemes in total across all the other European countries we show in the top chart.

In Europe schemes are much larger than in the UK. This is shown in the middle chart. The average size of DB scheme in Europe (excluding the UK) is €787m, twice the average size of the UK. DC style workplace schemes in the UK are on average tiny (average €2m) by comparison to elsewhere in Europe (€455m).

This means that the assets per scheme are much lower in the UK than elsewhere. Denmark has average assets per scheme of nearly €5bn. But the UK has assets per scheme of only €9m UK (so small that the number is hardly visible on our bottom chart).

4 consequences of fragmentation in the UK

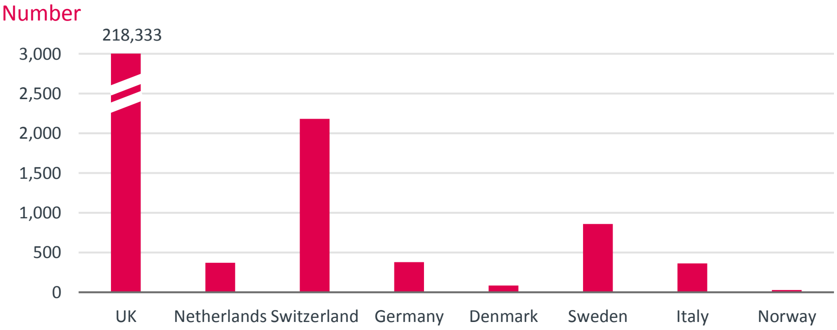
Consultants Consultants do well in markets where fragmentation deprives schemes of the economic ability to retain skilled management in house. This skill often resides in large schemes that are common in continental Europe and rare in the UK.

Third party management Lack of the in-house skills in turn drives the use of third party managers, which is much higher in the UK, as we show elsewhere in this report.

Costs of governance Small schemes in the UK face much higher costs of governance than large schemes, as we show elsewhere in this report.

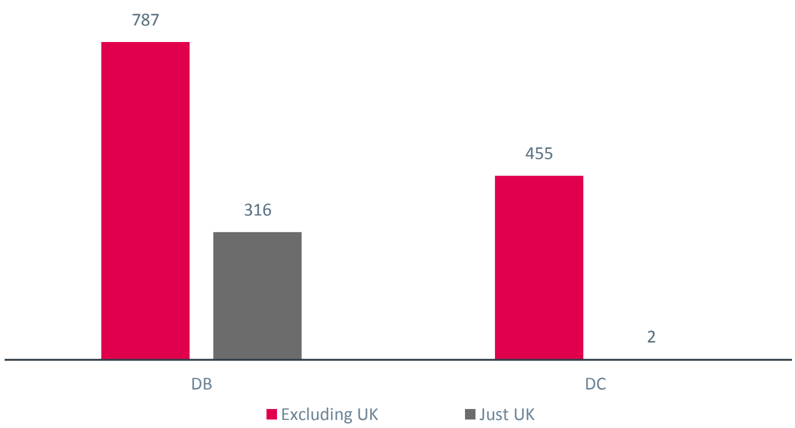
Scheme closure Unsurprisingly small DB schemes are closing fastest. Small DC schemes, which face equally marked diseconomies of scale, are flooding into Master Trusts in the UK because these new collective structures offer cost reductions of 50% on what small scheme members would have to pay if their scheme remained stand-alone.

Number of underlying pension schemes (aggregate of DB and DC)

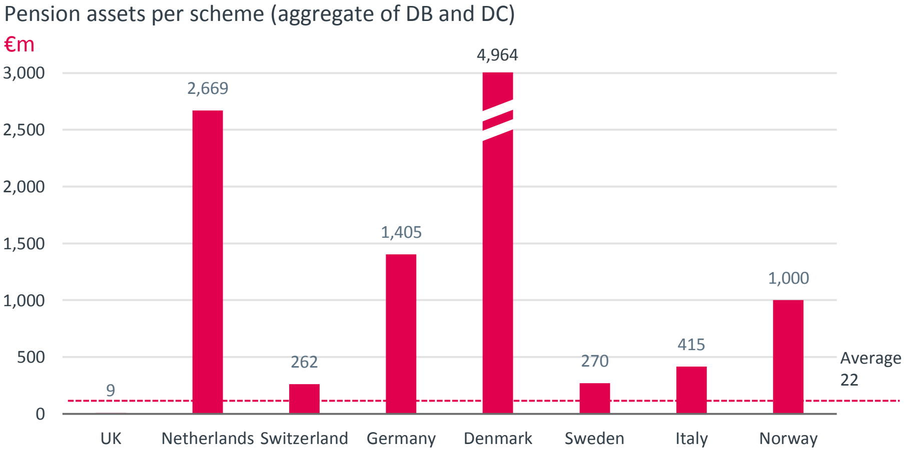


Spence Johnson analysis

Average size of European pension schemes



Pension assets per scheme (aggregate of DB and DC)



Source EurP MI p 47

Specialist strategies are replaced by solutions

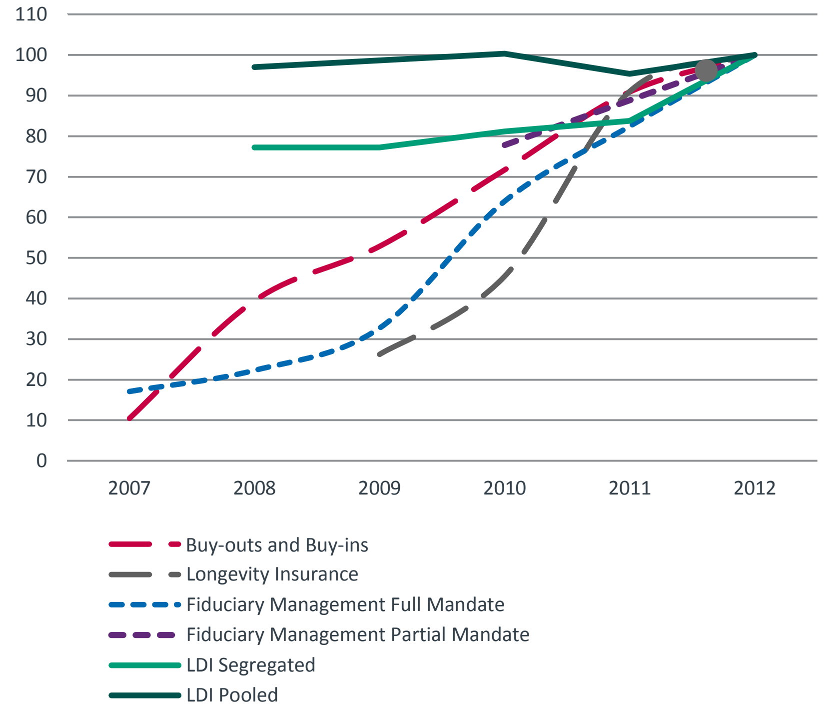
Solutions, most often in the form of LDI, fiduciary management and multi-asset funds, are taking an increasing share of assets. We think they will represent 70% of DB assets in the UK, where key solutions have grown between 5 and 10 times in size since 2007.

Investment solutions, in the form of liability driven investment (LDI), fiduciary management and multi-asset funds like DGFs, currently represent 44% of assets in UK DB today we think, and will represent over 70% by 2023. Specialist investment offerings are correspondingly shrinking in market share.

We have measured the relative growth of the solutions that have emerged in the UK DB markets. The summary is shown to the right, which offers an index of DB solutions growth since 2007. LDI, which started to grow earlier than the other solutions we have shown here, is now less fast growing. Fiduciary management and longevity insurance are the fastest growing.

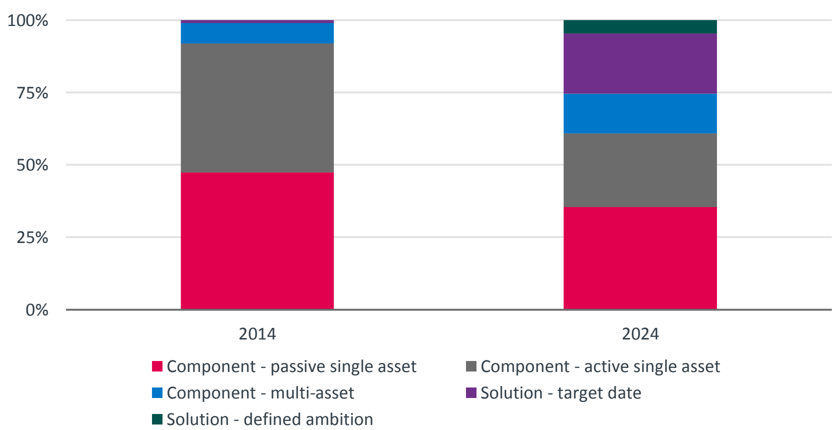
What we mean here by solutions is anything which is perceived by investors to be a mechanism which helps them achieve their goals. In UK DC solutions are playing an increasingly important role in the form of multi-asset offerings such as DGFs and Target Date funds, as can be seen in the 2014 default fund analysis shown in the bottom chart. What we have identified as components in this chart are single asset class funds, and these are predicted to play an increasingly less important role in DC in coming years.

Index of growth of UK DB solutions
2012 = 100



Various sources

Total UK DC default funds: component funds vs solutions products (2014-2024)
% of total DC default assets



Source DC MI p81

Previous editions

Previous editions Available from http://www.spencejohnson.com/

June 2015 – Number 27 - Opportunities in insurance asset management
The search for yield in a low interest rate environment and regulatory pressure are driving outsourcing opportunities

March 2015 - Number 26 - Excellent Client Management Provides Tangible Added Value
In this edition Spence Johnson reveals what it is that makes for excellence in client management.

February 2015 - Number 25 - Opportunities across the map
We look at how asset concentration and distribution issues are related in Europe.

December 2014 - Number 24 - The year of the master trust
As with target date funds, master trusts also offer a less intermediate channel than those for more traditional trust or contract-based schemes, especially in the large scheme sector.

November 2014 - Number 23 - European growth opportunities for US asset managers
The European Institutional market is a market going through transformation. As this transformation takes place, we have identified 3 growth opportunities that US managers could take advantage of.

October 2014 - Number 22 - Opportunities in a transformed market
Retirement Income is now predominantly an investment based fund market. Both the life & pensions and asset management sectors are facing major challenges to protect and grow their strategic interests in this £1.7 trillion opportunity.

September 2014 - Number 21 - Solutions will win in the end game
Not only will the specialist third party asset manager share be greatly reduced but the source of assets greatly changed. Specialist providers in the future will look to solutions providers for nearly 40% of their assets.

May 2014 - Number 20 - DGFs still room for new players
The speed of adoption by DB schemes witnessed in 2013 was much faster and more significant that expected. The market grew by £10 billion from this source in 2013, off a previously estimated base of only £30 billion.

April 2014 - Number 19 - Smart Beta the new alternative
Alternative index product flow is estimated to be largely from UK clients, unlike flows into advanced beta and advanced index products which are estimated to emanate more from European clients.

December 2013 - Number 18 - The three spirits of pensions, past, present and future
In this holiday edition of Deeper Perspectives we evoke the Three Spirits of Pensions – Past, Present and Future – to enlighten and inspire our readers about the exciting world of pension investment.

November 2013 - Number 17 - New opportunities for asset mangers in workplace pensions
In this new edition of Deeper Perspectives we make four predictions of the future of workplace pensions that could have a significant impact on your strategic planning today.

October 2013 - Number 16 - New opportunities emerge in Insurance Asset Management
We describe how the management of insurers' general accounts is a growing and changing revenue opportunity for European asset managers

June 2013 - Number 15 - Growth of US OCIO reveals one clear winner
We share some high level findings of our OCIO Market Intelligence report, and we describe one very clear winner emerging in this market

Nov 2012 - Number 14 - Growth in DC assets
DC assets will grow at 11.6% pa to triple in size over the next 10 years, we say.