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City Business Series 2000
Statistical Update

Fund Management

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BI (British Invisibles) is a private sector organisation, with 30 years' experience of successfully promoting the UK-based financial services industry throughout the world.

Its membership is drawn from across the spectrum of UK's financial and related business services series, including trade and professional associations, exchanges, the Bank of England, the Corporation of London and leading international financial service companies, that are based in London. BI also works closely with Government departments and national organisations, particularly the Office for National Statistics and the Bank of England in connection with research and statistical work.

BI promotes the international activities of UK-based financial institutions and professional and business services, helping them to develop commercial opportunities. BI arranges missions and conferences world-wide, meetings with senior representatives of foreign governments, and briefings for businessmen, journalists and diplomats.

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BI informs by increasing awareness of the UK's role in international financial markets and of the major contribution of financial services to the UK economy. The City Business Series which covers UK financial and business services remains the centrepiece of research with reports on Derivatives, Legal Services, Banking, Insurance, Maritime Services, Fund Management, and Securities Dealing. Other major publications include International Financial Markets in the UK and The City Table.

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CITY BUSINESS SERIES

BI has published a number of reports in its City Business Series covering UK financial and business services, including reports on Maritime Services, Legal Services, Banking, Insurance, Fund Management, Securities Dealing, and Derivatives.

This report on Fund Management is a statistical update on the earlier report on Fund Management published in February 1997.

The financial sector is by far the largest single positive contributor to the balance of payments with net overseas earnings of £32bn in 1998. It is a large contributor to GDP as well as a substantial generator of employment. Yet, information on financial and related business service sector activities is often not easily accessible.

The City Business Series brings together, for the first time within one publication, statistics on the size and structure of each sector or activity, as well as their contribution to national output, employment, and overseas earnings. International comparisons and shares of world markets are included where possible. The Series therefore meets the widely recognised need to have data on individual financial and business sectors available on a systematic basis, and has the strong support of private sector firms and institutions and public sector bodies.

These reports enable BI to highlight areas where there are gaps in information and problems in making international comparisons. Each report will be updated, incorporating improved quality and coverage of statistics.

This BI report has been compiled by BI's Director of Economics, Duncan McKenzie and Economist, Marko Maslakovic.

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Fund Managers' Association
Institutional Money Market Funds Association
Morley Fund Management
National Association of Pension Funds
NJR Research
Office for National Statistics
PricewaterhouseCoopers
Scottish Financial Enterprise

BI is grateful for those organisations listed on the cover and title page, which have sponsored the report. Contact details of sponsors appear in Appendix 5.

CONTENTS

	Page
Executive Summary	1
Section 1 Funds under management in the UK	3
1.1 Definition of fund management	3
1.2 UK fund management overview	3
1.3 Assets under management	4
1.4 Fund management organisations	4
1.5 Institutional funds	5
1.6 Private clients	7
1.7 Overseas clients	7
1.8 Asset allocation	8
1.9 Use of derivatives	10
1.10 Location of fund management activities within the UK	11
1.11 Management style and strategy	11
1.12 Regulation of the UK fund management industry	12
Section 2 Contribution to the UK economy	14
2.1 Revenue and value added	14
2.2 Employment	14
2.3 Productivity and efficiency	15
2.4 Overseas earnings	15
2.5 Services benefiting from fund management	15
Section 3 International developments and comparisons	16
3.1 Global overview	16
3.2 Pension funds	16
3.3 Mutual funds	17
3.4 Insurance funds	17
3.5 Largest global investment managers	17
3.6 Fund management centres	18
3.7 Asset allocation	18
3.8 The future of funding of pensions	21
3.9 E-commerce	22
3.10 Future market issues for UK firms	23
Section 4 Private wealth management	25
4.1 Quantifying the market	25
4.2 Distribution of private wealth	25
4.3 The UK private wealth market	25
4.4 Source of wealth	26
4.5 Financial asset split	26
Appendices	
1 Functions and history of fund management	28
2 Glossary of terms	29
3 Other sources of information	31
4 Data coverage and quality	32
5 Sponsors' contact points	33

List of Tables		Page
1:	Funds under management in the UK, 1998	3
2:	Largest UK fund management organisations, 1998	4
3:	Market value and average return of pension funds, 1965-1999	6
4:	Largest UK pension fund managers, 1999	6
5:	Largest UK unit trusts and investment trusts, April 2000	6
6:	Private clients of retail stockbrokers, 1998	7
7:	UK annual returns, 1965-1999	8
8:	UK property investments, 1975-1999	9
9:	Global pension fund assets, 1990-2004F	16
10:	Pension assets relative to GDP, 1999	17
11:	Insurance companies' investments, 1997	17
12:	Largest global investment managers, 1998	18
13:	The top international target cities, 1999	18
14:	International pension fund asset allocation, 1999	18
15:	Real returns of pension funds, 1990-1999	19
16:	Source of international portfolio holdings, 1997	19
17:	Destination of international portfolio holdings, 1997	19
18:	UK wealth mix	26

List of Charts		
1:	Growth of funds under management in the UK, 1995 & 1998	3
2:	Fund management organisations, 1998	4
3:	Growth of UK institutional funds, 1965-1998	5
4:	Growth of UK institutional funds (cumulative total), 1965-1998	5
5:	UK institutions' share of total assets, 1965-1998	5
6:	UK share ownership, 1975-1998	7
7:	Overseas institutional clients by geographical area, 1992 & 1999	8
8:	UK pension funds asset allocation, 1965-1999	8
9:	UK bond market by issuer, 1980-1999	9
10:	Pension funds' use of multi asset and specialist managers, 1999	11
11:	Use of active, passive or combination management, 1999	11
12:	Employment, 1995-1999	14
13:	Overseas earnings of fund managers, 1990-1999	15
14:	Global investment management industry, 1999	16
15:	Pension funds - sources of assets, 1999	16
16:	Mutual funds – sources of assets, 1999	17
17:	Size of the global equity market, 1999	19
18:	Relative size of equity market, 1999	20
19:	Size of the global bond market, 1999	20
20:	Types of bonds issued in key world bond markets, 1999	20
21:	Property company shares - top eight markets, 1999	21
22:	Defined contribution schemes in Europe, 1998 & 2003F	22
23:	% of people with internet access, 1998	22
24:	E-commerce revenue, 1997-2003F	23
25:	Private wealth, 1997-2004F	25
26:	Private wealth by source region, 1999	25
27:	Destination of offshore private assets	26
28:	Distribution of UK adult population by individual net wealth	26
29:	Private wealth financial asset split, 1998	27
30:	Functions of fund managers	28

Standard notes and definitions

m = million

bn or billion = 1,000 million

tn or trillion = 1,000 billion or 1,000,000 million

Data may not sum exactly to totals due to rounding.

Unless otherwise stated, figures are not adjusted for inflation.

Data for selected years only are shown in most of the Tables. Where available, figures for other years can be obtained from BI.

EXECUTIVE SUMMARY

UK fund management has developed into a diverse and sophisticated industry during the course of the last century. Its strong reputation as an international fund management centre is based on the substantial foreign presence and a skilled labour force, complemented by a liberalised operating environment within a framework which gives protection against abuses.

The UK is one of the largest markets in the world for fund management with identified assets under management totalling over £2,500bn. Two-thirds of this is managed on behalf of UK institutional clients and a quarter on behalf of overseas clients. The remaining 11% is accounted for by UK private client funds.

The sector has a strong international orientation, reflected in:

- the institutional presence of a broad mix of UK and foreign firms;
- the investment of over a fifth of institutional clients' portfolios in overseas securities;
- the management on behalf of overseas clients of funds totalling £592bn.

The vast majority of funds are managed from London, but Scotland also remains an important centre. London, in 1999, ranked as the world's largest city for fund management with total equities managed by institutions amounting to \$2,461bn. Edinburgh and Glasgow combined were the fifteenth biggest centre globally, and ranked sixth in Europe.

Insurance and pension schemes account for the bulk of UK institutional funds, although unit trusts have become more popular over the past decade. Money Market funds are also a growing market.

Investment banks and insurance companies manage about four-fifths of institutional assets, independent firms a sixth, and a small number of employers continue to manage their own pension funds.

Fund management makes a significant contribution to the British economy, equivalent to 0.5% of the gross value added (GVA) in 1998 - an important component of the financial sector's 6.3% share. Fund management's wider contribution to the economy is evidenced by the promotion of an efficient capital market that mobilises and allocates the nation's savings.

Total employment is estimated at 40,000 in 1999 with a further 12,000 employed by retail stockbrokers

in the management of private client funds. This represents around 4% of the total financial services employment. The funds managed by each employee directly engaged in the management of investments more than doubled in the last decade to reach £409m in 1999.

Overseas earnings generated by fund managers' services were estimated at £540m in 1999. A significant proportion of portfolio investment earnings (£11bn) from overseas is also attributable to fund management activities.

Several other financial services benefit from their links with fund managers, particularly banks (supplying custody, trustee and foreign exchange services), Stock Exchange firms and information providers.

The volume of funds managed internationally has increased substantially in recent years. Global pension assets alone amounted to \$13.0 trillion in 1999, with a further \$11.1 trillion invested in mutual funds and \$11.5 trillion in insurance funds. Merrill Lynch estimates the financial assets of wealthy individuals at \$25.5 trillion in 1999.

International comparisons of fund management activity highlight the UK's strong position as a major centre for fund management. Key aspects of the UK's position include:

- *Pension fund assets:* The UK's \$1.4 trillion in pension assets accounted for around 11% of the world total in 1999. This was well ahead of other European countries and only exceeded by the US and Japan. The UK is also in the group of countries with the highest ratio of pension assets to GDP. The UK accounted for 18% of the total cross-border investment by pension funds in 1999, second only to the US;
- *Mutual funds:* The US is by far the major source of assets invested in mutual funds, with more than 60% of the world total in 1999. Most of the other assets are administered from a few countries, principally France, Luxembourg, Italy, Germany, Japan and the UK;
- *Insurance funds:* The UK insurance industry is the third largest in the world after the US and Japan. UK insurance companies' investments are almost double those of any other European country;
- *Overseas clients:* The £592bn managed on behalf of overseas institutional clients in the UK cannot be directly compared with any other centre, but is unlikely to be exceeded by any other country other than the USA.

- *Largest fund managers:* According to the annual Watson Wyatt World 500, of the \$20 trillion managed by the top 100 investment managers in 1998, US owned companies accounted for almost half the total, Japanese for 15% with Swiss, UK and German companies accounting for around 10% each;
- *Private Wealth:* Merrill Lynch estimates that the private wealth industry was worth over \$25 trillion in 1999. The onshore market holds around two-thirds of this total with the offshore market accounting for the remainder. The UK has a large share of the private wealth industry and accounts for around 15% of the offshore market. This was only exceeded by Switzerland with 33%.

In recent years, there has been substantial restructuring of UK fund management reflecting increased competition and wider global developments. Mergers in the UK in recent years include the merger between Hill Samuel and Scottish Widows, Norwich Union and CGU, Old Mutual and Albert E. Sharp and AMVESCAP and LGT. Some of these mergers are not solely between asset management firms but include related industries such as banking and insurance.

Developed countries are set to experience a dramatic demographic shift during the course of the next 50 years which is likely to entail a major increase in private provision of pensions. The UK is in the strongest position among EU states mainly because of its extensive pre-funding of pensions and a lower state pension, equivalent to around 29% of average pay compared with 40-80% elsewhere in Europe. Personal pension schemes will become more important in the future as governments seek to shift the burden of pensions provision away from the state on to employers and individuals.

Future market issues likely to affect the future development of the UK fund management industry include:

- *Pension reform:* The reforms and privatisation of state pension systems in Europe and elsewhere should provide UK-based firms with more cross-border investment opportunities;
- *Restructuring:* There is likely to be further restructuring, geared to expanding the pool of resources available, developing sophisticated distribution systems, reducing costs and improving the quality service;
- *Track record:* UK along with US firms have a well established track record in the measurement of

returns, a record they should be able to use to their advantage in marketing products in Continental Europe, Japan and emerging economies;

- *Outsourcing:* Large fund managers are increasingly offering their asset management services to outside clients. This is due to the need for reducing costs which is prompting small and medium sized companies to outsource the management of their investments. Third-party fund administration is also growing. This includes services such as custody, accounting, daily valuation and shareholder record-keeping;
- *Investment consulting:* Specialist investments such as venture capital are facilitating an increased demand for investment consulting services. Investment advice in general has gained in importance as a service for most UK pension consultancies in recent years;
- *E-commerce:* Fundamental changes in the fund management industry are likely to occur with the development of the internet and e-commerce. Changes to the fund management industry so far have mostly been confined to marketing and the reduction of distribution charges; recently the boom in on-line trading activity has coincided with a fall in the rate of sales growth in the mutual funds industry.

SECTION 1: FUNDS UNDER MANAGEMENT IN THE UK

1.1 Definition of fund management

Fund managers invest funds on behalf of institutions that are intermediaries between savers and users of capital. Their primary task is to invest the flow of cash from pension contributions, insurance premiums and personal savers in a portfolio of financial assets that will best meet clients' needs.

In doing so they have above all to seek an appropriate balance between risk and reward. They must weigh the requirements of savers for security and liquidity against the range of returns available from different types of investment instruments. As major players in the markets where securities are traded, fund managers also help to determine the cost of capital to industry and the allocation of that capital among competing users.

1.2 UK fund management overview

The UK fund management industry enjoyed tremendous growth during the 1990s and is responsible for over £2,500bn of funds (Table 1). Many factors have contributed to this:

- highly sophisticated and innovative management styles, techniques and strategies;
- a skilled labour force and high quality professional and support services;
- a wide ranging client base: private and institutional, UK and overseas;
- a highly liquid market with the opportunity to trade

in large blocks of shares;

- a history of openness combining relatively easy access to markets and tradition of welcoming foreign firms;
- a liberalised operating environment combined with protection against abuses;
- London is supported by a competitive infrastructure in telecommunications services and airline links.

This section analyses the UK fund management industry from four perspectives:

Assets under management Identified assets totalled more than £2,500bn at end-1998, a 40% increase from the 1995 total in BI's previous report (Chart 1). The increase was partly due to the substantial growth of the equity markets which was paralleled by an equally impressive growth of institutional funds.

Fund management organisations These include institutions such as life insurance companies or their investment management subsidiaries, investment banks and integrated securities houses, independent fund managers, self managed pension funds, and other operators such as retail stockbrokers.

Types of funds UK investment management organisations manage many different types of funds, including life insurance, pension schemes, unit trusts, investment trusts and money market mutual funds. Most large organisations tend to operate more than one type of fund within the same group:

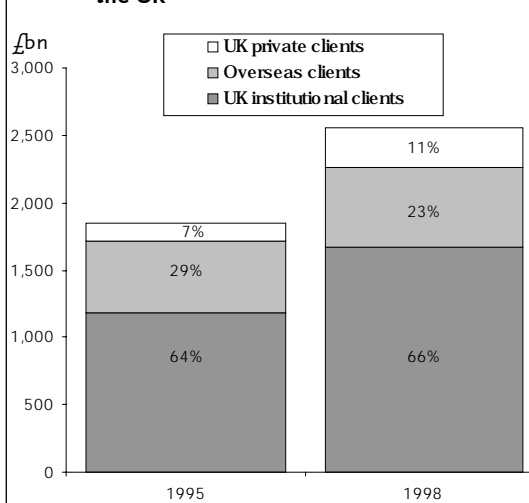
Table 1: Funds under management in the UK

£bn	UK clients Dec-98	Overseas clients Jun-99	Total
<i>Institutional funds</i>			
- pension funds	699	208	907
- insurance	875	60	935
- unit trusts	172	49	221
- investment trusts	51	11	62
- money market mutual funds ¹	7	21	28
- other	-	193	193
less unit and investment trusts held by other funds	-132	-	-132
<i>Institutional total</i>	1,672	542	2,214
<i>Private clients</i>	291	50	341
All clients	1,963	592	2,555

¹ June 2000

Source: ONS, ComPeer, Fund Managers' Association, Imoney.net

Chart 1: Growth of funds under management in the UK



Source: ONS, ComPeer, Fund Managers' Association

for example, life insurers may manage pension funds and unit trusts as well as life policies.

Clients Funds are managed by firms on behalf of a range of private and institutional clients both resident in the UK or overseas. Institutional clients include pension funds of companies and local authorities, insurance companies and organisations operating unit trusts and investment trusts.

1.3 Assets under management

Institutional clients account for the bulk of the funds under management in the UK (with some 86% of the £2,555bn). According to official data collected by the Office for National Statistics (ONS) and the European Money Fund Report published by Imoney.net, funds managed by institutions for clients resident in the UK totalled £1,672bn, while the Fund Managers' Association's (FMA's) survey provided an estimate of funds managed on behalf of overseas clients, totalling £545bn (Table 1).

Funds managed in the UK on behalf of private clients have been estimated at £341bn, bringing together the ComPeer survey of UK clients of £291bn and £50bn in the FMA survey of overseas private clients assets. These surveys may underestimate total funds under management. For example other funds managed from the UK for which there is no industry estimate include companies that manage their own portfolio of financial assets and funds managed for foreign governments.

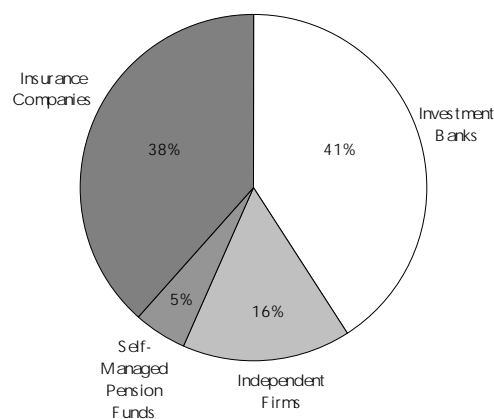
1.4 Fund management organisations

An indication of the respective shares of the various types of institutions involved in fund management can be obtained from the InterSec 250 table of the largest fund management companies outside the US. The table includes 41 UK companies managing funds amounting to over \$2.6 trillion in 1998 (Chart 2):

- *Investment banks:* account for 41% of the total, a small increase from their 38% share in 1995. They represent integrated banking and securities groups that combine securities firms, i.e. brokers or market makers, and fund management firms within the same group;
- *Insurance companies:* have maintained their share in recent years of some 38% of funds managed. They operate their fund management either from their investment department or from a separate subsidiary which might manage funds of external clients as well as those of its parent company;

Chart 2: Fund management organisations, 1998

% share of UK funds, totalling \$2.6 trillion, in survey



Source: InterSec Research Corp.

- *Independent firms:* maintained their 1995 share of 16%. They include any of the fund managers that are not linked to any UK-based banking, securities or insurance groups;
- *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 from 8% in 1995 to 5% in 1998 as companies' pension funds are increasingly managed externally.

The InterSec list is incomplete as it does not include firms that trade under the same name as the foreign parent. However, the concentration of the UK fund management industry is such that the firms listed by InterSec account for the bulk of institutional funds

Table 2: Largest UK fund management organisations, 1998

Fund manager	\$bn
1 Barclays Global Investors	615
2 Invesco Asset Management	285
3 Merrill Lynch Mercury Asset Management	243
4 Axa Investment Managers	224
5 Prudential Portfolio Managers	212
6 Morley Fund Management	200
7 Schroder Investment Management	198
8 Morgan Grenfell Asset Management	171
9 Legal & General Investment Management	132
10 Robert Fleming Holdings	114
11 Standard Life Assurance Co.	109
12 Lloyds TSB Group	105
13 Royal & SunAlliance Group	96
14 Phillips & Drew	89
15 Gartmore Group	83

Source: Institutional Investor

managed in the UK.

Restructuring Substantial restructuring in the UK in recent years has reflected global developments in the fund management industry. This was driven by the need to expand the pool of available resources, develop sophisticated distribution systems, provide a quality service, as well as to widen the search for new customers from different regions.

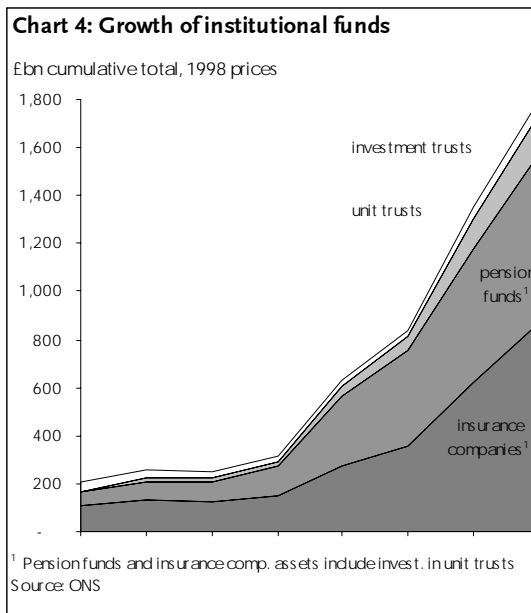
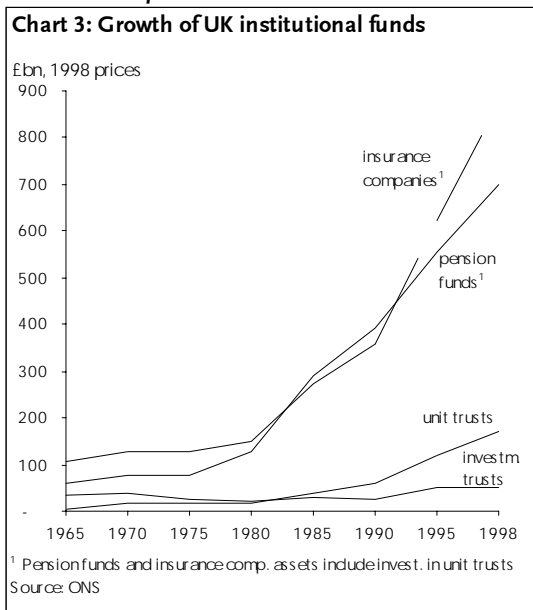
Restructuring in the UK in recent years includes the merger between Hill Samuel and Scottish Widows, Norwich Union and CGU, Old Mutual and Albert E. Sharp and AMVESCAP and LGT. Some of these mergers are not strictly between asset management firms but have included related industries such as banking and insurance.

1.5 Institutional funds

Institutional funds have become increasingly predominant in the UK over the past two decades. In 1998, institutions held £2,214bn of funds under management, accounting for the bulk (86%) of the total (Table 1).

The volume of institutional funds has increased, in real terms, over eight times between 1965 and 1998 (Chart 3). Pension funds and unit trusts have experienced the biggest rise over this period. This is reflected in their respective share of assets, with unit trusts' share rising steadily from 2.7% in 1965 to 9.6% in 1998 and pension funds from 28.6% to 38.9%, although the market share of the latter peaked at over 46% in 1990 (Chart 5).

Insurance companies' share of assets contracted



somewhat between 1965 and 1990, but since 1990, it has increased with the value of assets under management doubling in real terms from £359bn to £875bn.

Pension funds Current UK pension provision embraces both state and private sources of pension income. It consists of three tiers:

- **Basic state scheme:** which is unfunded and pays a flat-rate pension;
- **State Earnings-Related Pension Scheme (SERPS):** which is unfunded and pays a defined benefit pension. Self-employed and employees with a

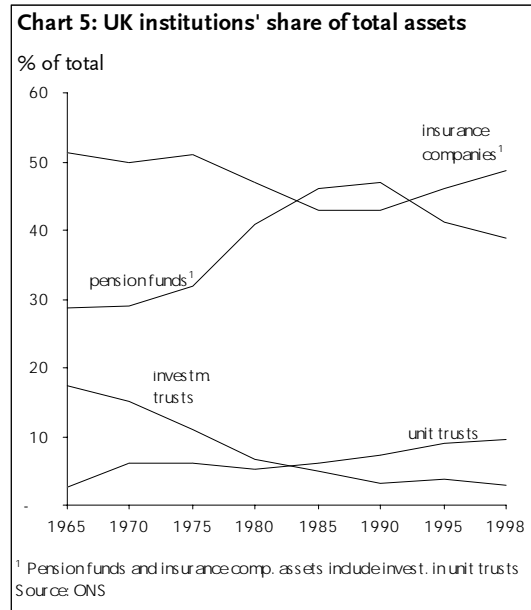


Table 3: Market value and average return of pension funds

	Total £bn	1999 prices £bn	Average return (%)
1965	5	58	7.0
1970	9	81	0.5
1975	17	75	63.8
1980	56	134	26.4
1985	168	293	15.2
1990	303	390	-11.4
1995	509	565	19.6
1998	699	712	14.9
1999 (provisional)	824	824	20.4
Average return (% p.a.)			
1965-1999			12.8
1990-1999			12.3

Source: Phillips & Drew, ONS, FT

private pension scheme have the option of contracting out of SERPS;

- *Private pension provision:* which includes occupational and personal pension schemes. Occupational pension schemes provided by the employer are usually funded and may pay pensions on a defined benefit or a defined contribution basis. Personal pension schemes are always funded and pay on a defined contribution basis.

Pension funds' assets did not grow quite as fast as those of insurance companies rising between 1990 and 1998 in real terms from £383bn to £699bn, resulting in the contraction of their market share. This was mainly because many occupational pension funds have been sufficiently in surplus to permit

reductions in contributions or full contribution "holidays".

In 1999 the average pension fund return was over 20%. The two largest UK segregated pension fund managers have remained unchanged from the previous year, while Barclays Global Investors in 3rd place has overtaken Phillips & Drew. The concentration in the pensions industry has plateaued, with the top five representing 59% of the asset pool managed by the leading 25 managers, in comparison with 64% in 1997 (Table 4).

Unit trusts and OEICs have had a particular boost in the last decade from the growth of tax-free Personal Equity Plans (PEPs) retailed in unit trust form. Their share of total funds under management increased from 2.7% in 1965 to 9.6% in 1998. Open Ended Investment Companies (OEICs) have greater flexibility and were introduced to provide a vehicle which was more familiar to non-UK investors. As of February 2000 approximately 20% of authorised investment funds assets were OEICs. The Association of Unit Trusts and Investment Funds (AUTIF) estimates that in April 2000 there were over 150 unit and investment trust groups, of which, 61 had funds under management of more than £1bn (Table 5).

PEPs have been a tremendous stimulus to the unit trust industry. By March 2000 their total value reached over £59bn accounting for a quarter of total unit trusts' funds. PEPs and TESSAs were replaced by Individual Savings Accounts (ISAs) in April 1999. ISAs allow investment in a range of products including unit trusts, OEICs, stocks and shares, life assurance and cash. Gross sales for ISAs for the

Table 4: Largest UK pension fund managers, 1999

	£bn
1 Mercury Asset Mgt.	72.8
2 Schroder Investment Mgt.	65.2
3 Barclays Global Investors	44.1
4 Phillips & Drew	40.0
5 Deutsche Asset Mgt.	34.8
6 Goldman Sachs Asset Mgt.	25.6
7 Scudder Threadneedle Investments	17.7
8 Hill Samuel Asset Mgt.	15.2
9 Henderson Investors	12.8
10 Fidelity Pensions Mgt.	12.8
11 Foreign & Colonial Institutional	10.9
12 Capital International	9.4
13 J P Morgan Investment Mgt.	9.0
14 Baillie Gifford	8.6
15 HSBC Asset Mgt.	8.3

Source: Financial Times

Table 5: Largest UK unit trusts and investment trusts, April 2000

	£bn
1 Fidelity	14.7
2 Schroder	14.1
3 M&G	11.0
4 Threadneedle	10.4
5 Perpetual	9.3
6 Gartmore	9.3
7 SLTM	8.3
8 Mercury	8.2
9 Scottish Widows Unit Trusts Managers	7.3
10 Barclays	6.8
11 Aberdeen	6.1
12 Lazard	5.9
13 Invesco GT	5.9
14 Friends Provident	5.7
15 Save & Prosper	5.1

Source: AUTIF

financial year 1999/2000 reached £10.6bn. This compares with £12.9bn of gross PEP sales in the previous financial year.

Investment trusts' share of total funds under management has fallen steadily since 1965 from 17.3% to a low of 2.9% in 1998. Consolidation in recent years is likely to continue as there still remains a significant number of small investment trusts.

Institutional money market funds represent diversified pools of high grade, short dated money market assets which are actively managed within specific and transparent guidelines. They increased from some £19bn in 1999 to £28bn in June 2000.

1.6 Private clients

Private clients remain a significant niche in the market with around 13% of the total UK identified funds. As shown in Chart 5, individual ownership of UK shares accounts for nearly 17% of the total or some £240bn in 1998, down from over 50% in 1965. Within Europe the value of private client funds handled in the UK is probably exceeded only by those in Switzerland.

Retail stockbrokers handled an estimated £134bn on behalf of 3.8m clients in 1998 (with an average shareholding of £35,000). FMA's 1999 survey estimates that an additional £62bn was managed by larger organisations, making a total of £196bn.

Although some private clients funds are invested in mutual funds, it is likely that about three-quarters of this £196bn total of funds, or some £150bn, is

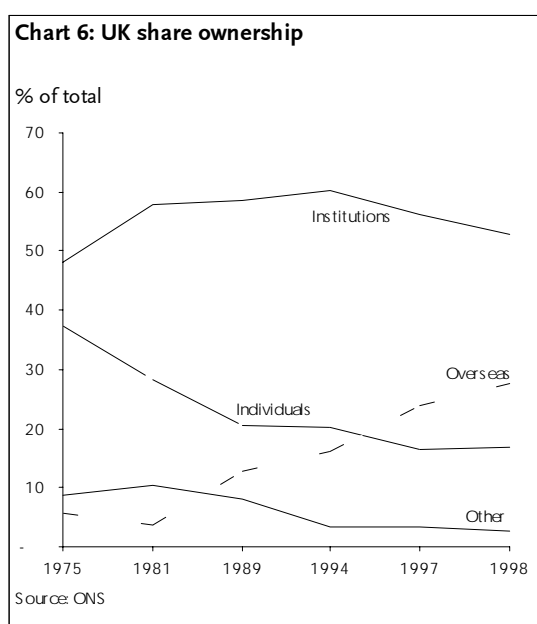


Table 6: Private clients of retail stockbrokers, 1998

Size of portfolio £(000)	No. of client Portfolios 000s	Funds £bn	Funds % of total	Average size of portfolio £(000)
<50	3,479	16	12	5
50-150	155	20	15	131
150-250	71	15	12	218
250-500	58	21	16	365
500-1000	27	20	15	728
1000-3000	13	22	17	1,697
3000+	3	19	14	7,520
Total	3,805	134	100	35

Source: ComPeer

invested directly in UK equities. Consequently fund managers, principally retail stockbrokers, have a significant stake in the £240bn of UK equities held by private individuals.

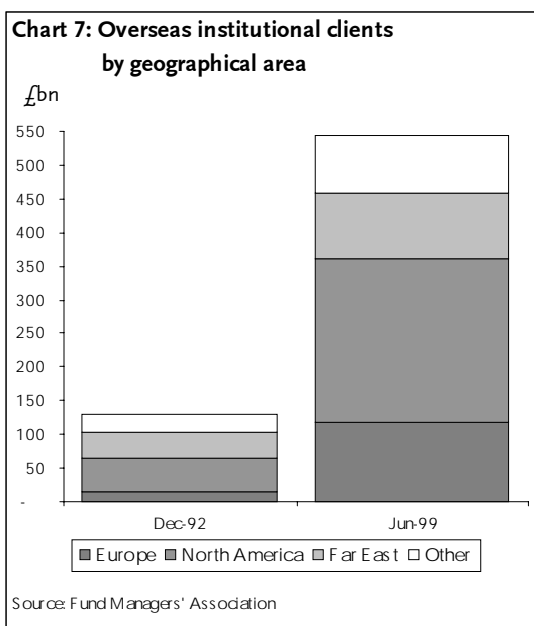
The remainder is in the hands of some 12m predominantly small shareholders who buy and sell equities via their local bank branch, building society or other intermediary including internet access (Section 3.9); as well as some private clients who manage their own portfolios but who may take advice from a broker. With privatisations in the early 1980s, the number of individual shareholders increased from some 4m to over 12m. Over this period the proportion of shares directly held by individuals has fallen from 30% to 17% (Chart 6).

As shown in Table 6, ComPeer estimates also indicate that a great majority of the 3.8m clients of retail stockbrokers are relatively small investors – some 3.5m accounting for £16bn or 12% of the £134bn total, implying an average holding of just £5,000 in this group of smaller investors. At the other end of the scale, nearly half of the £134bn funds were managed on behalf of a small group of 43,000 investors, each with funds exceeding £500,000 and averaging £1.4m per investor.

1.7 Overseas clients

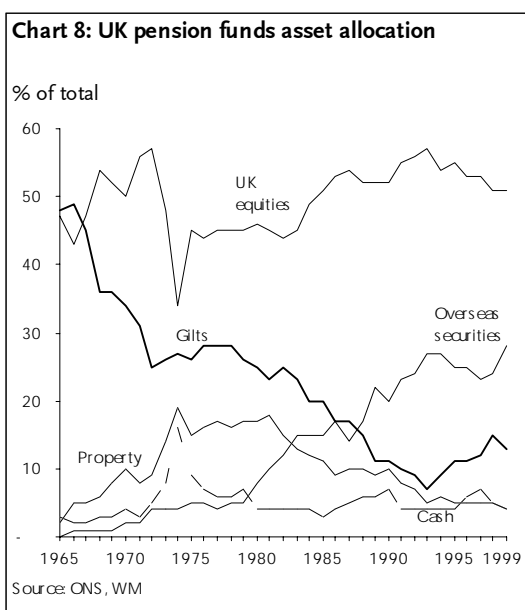
In recent years, the UK has consolidated its position as the most important centre for the management of funds on behalf of overseas clients. FMA's survey seeks to capture those overseas client funds where overall responsibility for management resides in the UK.

The survey shows that funds managed on behalf of overseas clients in June 1999 totalled £595bn, of which £545bn (91%) were for institutional clients and the remaining £50bn for private clients. This is around four times the 1992 figure of £146bn due not



only to growth in the client base, but also to the increase in market valuation and the process of consolidation which has been reflected in some significant acquisitions, particularly in recent years.

As shown in Chart 7, 45% of overseas institutional investment is from North American countries, up from 37% in 1992. European countries nearly doubled their share in this period to just under a quarter. Far Eastern countries accounted for 18%, a fall from 29% in 1992.



1.8 Asset allocation

Institutional fund managers have an array of investment choices available to them at home and overseas including equities, bonds, property and cash. Chart 8 shows the pattern of pension fund asset allocation between 1965 and 1999. UK institutions have traditionally favoured investment in equities, given the generally good long-term return reflecting the higher growth of equity markets relative to other asset classes. Another key feature of UK historical asset allocation is the gradual widening of the number of investment instruments used by UK institutions as can be seen from Table 7.

Domestic equities which already made up over a third of pension funds' portfolios in the 1960s and 1970s, have increased their share to over 50% since 1985 and amounted to 51% in 1999. Since foreign exchange controls were lifted in 1979, pension funds have also broadened their commitment to overseas equities, from 8% in 1980 to 24% in 1999. In aggregate, investments in all types of overseas securities by UK pension fund managers now account for over 28% of all assets, a much higher share than in other major countries.

The turnover in assets held by pension funds varies between asset classes with activity highest in government securities, nearly 100% of the average annual holdings partly due to low transaction costs in the gilts market. Activity was lower for UK equities at 41% in 1999; overseas equity portfolios had a much higher turnover (77%).

Table 7: UK annual returns

Year	UK equities	Overseas equities	Property	Index-linked	Gilts	Overseas bonds	Cash
1965-69	13.4				0.7		7.5
1970-74	-9.5				-1.9		9.1
1975-79	35.5	3.8	19.0		19.2		11.0
1980-84	27.3	27.2	11.2		18.7		13.3
1985-89	20.3	19.7	17.8	7.6	10.8	6.8	11.6
1990	-9.7	-33.1	-8.4	3.5	4.2	-7.6	15.5
1991	20.8	23.2	-3.2	4.4	18.6	19.6	12.2
1992	20.5	16.3	-1.7	17.5	17.0	30.0	9.8
1993	28.4	24.9	20.0	23.0	34.4	14.2	5.9
1994	-5.8	0.6	12.0	-9.1	-12.2	-4.0	5.1
1995	23.9	19.7	3.5	12.9	17.4	20.5	6.4
1996	16.7	1.1	10.0	6.4	9.0	-6.1	6.0
1997	23.6	19.0	16.8	13.7	22.9	4.8	6.6
1998	13.8	22.0	11.8	19.9	29.6	13.6	7.2
1999	24.2	31.0	14.5	4.4	-0.4	-2.1	5.2
Average return (% p.a.)							
1965-99	15.9	16.7	12.9	8.5	10.3	7.3	9.8
1990-99	14.9	10.7	7.1	9.3	13.2	7.6	7.9

Source: Phillips & Drew

Equities have been the favoured investment medium for UK institutional investors since the 1960s. This is partly due to the size of the UK equity market in comparison with the domestic bond market. Although in 1970 they were roughly the same size, the domestic equity market is now more than five times the size of the domestic bond market.

As Table 7 shows, cash and direct property investments have produced the most consistent returns compared with the more volatile returns on equities and bonds. Cash is capital secure in nominal terms but its real value can be eroded by inflation. Equities have generally produced higher returns than other forms of investment with an average annual return of almost 16% since 1965. Gilts also had above average returns with average annual return of over 13% in the last decade. Equity markets as a whole are generally less volatile than individual equities. Index-linked funds reduce the risk of underperforming the market by investing in the portfolio of shares that comprise a particular index.

Venture capital and Private Equity represent investments in companies that are not quoted on stock exchanges. These investments generally involve higher risk. The five year average annual return on such investments in the UK was around 22%, much higher than the growth of the FTSE 100 or FTSE All-Share indices, although the ten year average was lower at 13%. According to a 1998 NAPF survey, allocation to venture capital represents only 0.53% of UK pension funds' total assets. In 1998 almost £6bn was invested in such funds although overseas investments account for nearly three-quarters of this total. UK pension funds accounted

for around 10% of total investments in these funds in 1998.

Bonds The size of the UK bond market was estimated at over £588bn at the end of 1999 (Chart 9). This represents around 3.0% of the global bond market. The various types of bonds can broadly be categorised into government bonds (known as gilts in the UK), which account for around 49% of the UK bond market, corporate bonds (5%), foreign bonds (10%) and Eurobonds (36%). Government bonds are usually considered the highest credit quality in each country and account for the bulk of pension fund investments in bonds.

The proportion of UK pension funds allocated to bonds has fallen gradually from around 48% in 1965 to 17% in 1999, an increase from a low of 10% in 1993. Of this, 9% was accounted for by traditional gilts, 4% by index-linked gilts and 4% by overseas bonds.

In recent years the UK bond market has experienced a shift from gilts to non-government bonds. In 1999 non-government issuance (£299bn) has overtaken gilts (£289) for the first time. These changes partly reflect the reduced supply of government securities, since the overall share of bonds in asset allocation is affected by the state of public sector finances.

Property Sentiment towards property investment by institutional managers has been rather volatile in the last three decades, reflecting changes in investors' needs, changes in the property market itself and varying market conditions.

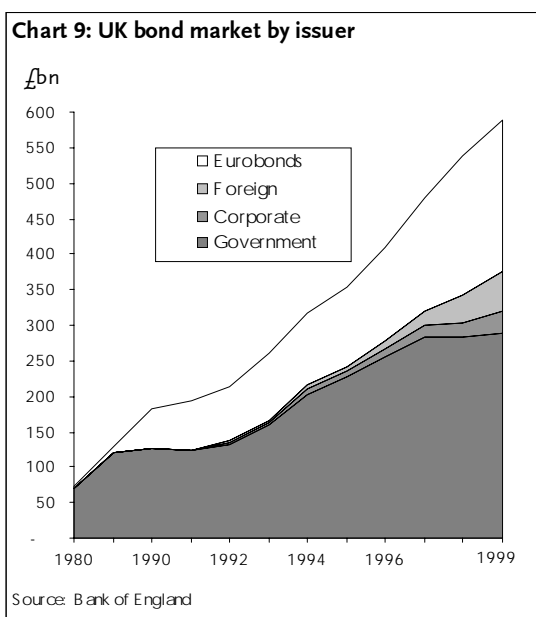


Table 8: UK property investments

Year	Return on direct property	% Return on property pooled funds	Return on property shares
1975-79	11.5	6.2	83.3
1980-84	9.4	7.4	-17.7
1985-89	26.5	25.8	81.4
1990	-8.4	-6.0	-18.1
1991	-3.2	2.5	-13.5
1992	-1.7	3.2	-12.8
1993	20.0	13.7	89.2
1994	12.0	12.8	-18.2
1995	3.5	2.8	5.7
1996	10.0	8.8	28.9
1997	16.8	14.9	24.6
1998	11.8	12.7	-19.9
1999	14.5	13.8	16.3
Average return (% p.a.)			
1975-99	12.3	11.9	14.7
1990-99	7.1	7.7	4.2

Source: Phillips & Drew, IPD, UBS, CAPS, FT, ONS

There are several ways in which funds can invest in property including:

- *Direct property*: direct ownership of properties;
- *Property shares*: investments in shares of property companies;
- *Property unit trusts*: pooled funds which allow investment without involvement in direct management and without compromising tax advantages;
- *Managed funds*: also pooled funds but with a more relaxed regulatory regime and run by life companies.

As shown in Table 8 the returns on various types of investments can vary, with for example returns on direct property and pooled funds exceeding 10% in 1998 while the return on property shares was negative in the same year at almost -20%.

Although the risks and increased tax burden due to the rise in stamp duty in recent years have contributed to the reduction in the proportion of property investments by fund managers, they continue to have a number of valuable characteristics such as lack of correlation with other assets, active management and the high income yield. Between 1970 and 1990 the proportion of UK pension fund investments allocated to property was between 10-20%. This has declined to around 5% in recent years.

Cash Allocation of pension assets to cash has been relatively stable in the last two decades fluctuating between 4% and 7%.

1.9 Use of Derivatives The use of derivatives as a means of facilitating the implementing tactical asset allocation decisions, has become a common feature of many fund managers in the UK and US. Less popular elsewhere in Europe, interest is nevertheless increasing. Because of controversy surrounding the early development of derivatives markets in the UK and US, control in the use of derivatives remains of paramount importance with each fund required to set out a clear policy on the use of derivatives.

There are several different types of derivatives including: futures, options and swaps. When using financial futures to implement tactical asset allocation decisions, a fund does not actually have to buy or sell holdings in the asset concerned. Because cash transactions are deferred, futures can be used

to assist cash flow, with the fund able to commit itself to buying an asset at a time which is deemed to be more favourable. Also, futures can be used for hedging purposes, protecting investments from a fall in capital values by selling futures contracts.

There are two basic methods of trading: exchange-traded which offer a central regulated market in which large numbers of buyers and sellers can come together to deal in a competitive, transparent and open environment; or through the Over the Counter (OTC) markets which are essentially wholesale markets in which individually-tailored derivative contracts are traded between banks, other financial institutions and large corporate organisations. A notable feature of the OTC markets has been the ability to lay off the basis risk in the organised exchanges.

BI's City Business Series report on Derivatives outlines in more detail the role and scope of the derivatives markets.

Funds under management in Scotland

Finance has been an important industry in Scotland for the past three centuries. Employment in Scottish finance and business services has expanded by over 30% since 1986 to a current total in excess of 280,000 people. The sector contributes some 20% of Scotland's GDP.

According to the Scottish Financial Enterprise, the Scottish investment management industry grew by nearly 30% during 1999 to a record £280bn, up from £218bn at the end of 1998. A further £56bn was added in early 2000 through the acquisition of Hill Samuel Investment Management by Scottish Widows Investment Management.

The bulk of the funds originated from the UK (73%) with other European countries accounting for 11%, Asian for 8% and North American 6%. The proportion of funds invested in equities increased to £183bn, representing two-thirds of the total, compared with 62.5% at the end of 1998, with bonds accounting for just under a quarter of the total.

The fund managers are a mixture of quoted companies, partnerships and subsidiaries of some of the major Scottish financial institutions. Overseas players find Scotland a useful base from which to operate largely due to the independence, cost efficiency, prudential care for customers' interests and specialist expertise in niche markets which the Scottish fund management industry provides. The Scottish industry mainly serves institutional clients, but there is a growing interest in personal wealth management.

1.10 Location of fund management activities within the UK

Within the UK, the importance of London is essential to the UK's strong international position. Scotland is also one of the world's major fund management centres with over £330bn under management. While London remains the largest world centre for fund management Edinburgh and Glasgow have improved their position in recent years and were ranked in 1999 as the sixth financial centre in Europe and fifteenth in the world.

Within the UK, FMA's survey indicates that assets managed in Scotland were equivalent to 14% of the total, an increase from their 10% share in 1992. This was mostly at the expense of other locations outside of London. London's share remained steady during the 1990s at around 85%.

1.11 Management style and strategy

The three basic types of management styles and strategies used by pension fund trustees include:

- balanced or specialist management;
- active or passive management;
- use of sophisticated financial instruments.

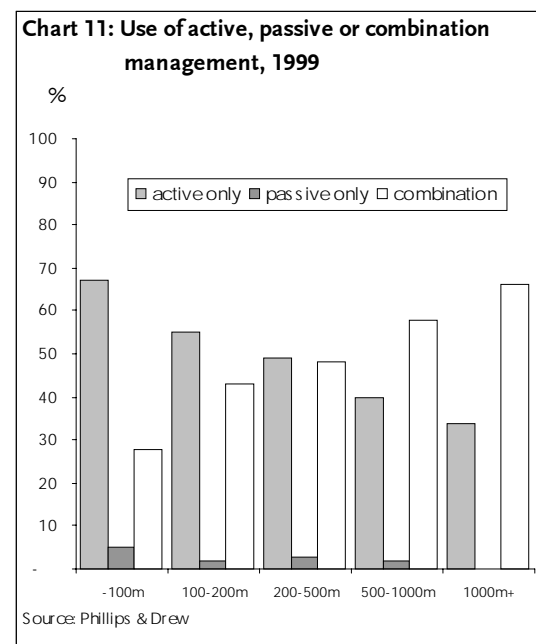
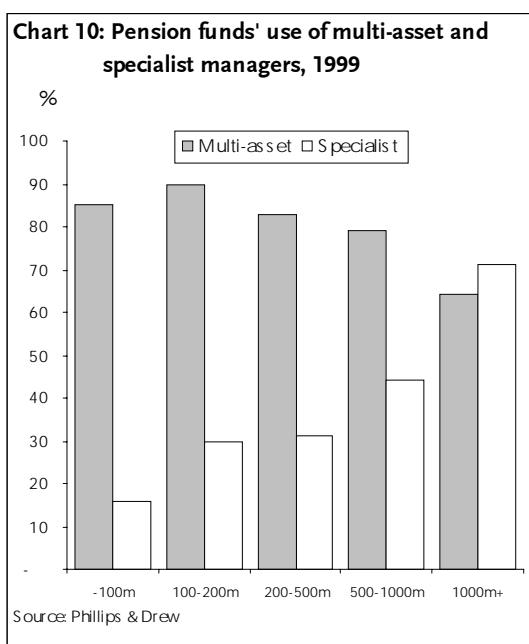
Decisions on the appropriate management style will depend on the aims and objectives of the fund sponsors or clients.

Balanced and specialist managers Balanced managers are a subset of multi-asset managers. They have responsibility for a wide range of asset classes making decisions on both asset allocation and the stock selection decisions within each asset class. Typically asset allocation will relate to the type of liabilities and to an industry average, with the expectation that funds will achieve an average return. The balanced manager may hope to gain an edge by trying to select the best performing stocks within an asset class.

Specialist management involves a narrow focus for particular managers on one or more asset classes where they offer particular expertise. This may include the management of equities in Europe or in Far Eastern emerging markets. Overseas bonds/ portfolios would also typically be delegated to a specialist.

As shown in Chart 10 multi-asset management (including balanced management) continues to dominate with over 80% of pension schemes allocating at least some of their assets to such arrangements. This is especially evident with smaller schemes. The tendency in the UK has been for pension schemes to use specialists to complement multi-asset fund management.

There is evidence of an increase in the use of specialist management. In 1999 over 70% of the schemes over £1bn used specialist management, a substantial increase on the 50% in 1997. On average 41% of funds used specialist management in 1999, an increase from 27% in 1997.



Some specialist fund managers in London may act almost entirely for overseas clients, for example offsetting a currency imbalance in the underlying portfolio by operation in the London money markets.

Active and passive management A passive manager is essentially one who designs a portfolio with the objective of tracking a particular index. The active manager, by contrast, uses primary research (externally sourced from stockbrokers or generated internally), to make stock selections offering the best potential return.

According to the Phillips & Drew annual survey of investment management arrangements, the majority of pension schemes in the UK use either active management only or a combination of active and passive (each 49%). Only 2% of the pension schemes use an exclusively passive approach. It is evident from Chart 11 that the size of the pension scheme influences the type of management applied - the larger the scheme the more likely it is to adopt a combination of active and passive.

The survey further indicates that there have been changes in overall strategies with 51% of the schemes increasing their exposure to bonds during 1999, 38% reducing exposure to UK equities and 23% increasing exposure to overseas equities.

1.12 Regulation of the UK fund management industry

Fund management in Britain, particularly at the retail end, has been regulated by the authorities as part of the legal framework to protect investors. With increasing liberalisation of financial markets, the regulatory framework has had to adapt to combine a legal framework that gives adequate protection against abuses with one that allows maximum freedom in making investment decisions.

The liberalisation of fund management in the UK was facilitated by the abolition of exchange controls in 1979, which resulted in a substantial rise of investments in overseas equities. The Financial Services Act (1986) which accompanied the deregulation of the London securities market and the removal of restrictions on the ownership and functions of traders led to a substantial reduction in the cost of trading for institutional investors.

A major reform of UK financial regulation is currently under way. The Financial Services Authority (FSA) - until October 1997 known as the Securities and Investments Board (SIB) is the main body for ensuring that the system operates effectively. In June

1998 the responsibility for banking supervision was transferred from the Bank of England to the FSA. Following the Royal Assent of the Financial Services and Markets Act in June 2000, the FSA has acquired its full range of powers as the single statutory regulator for all financial business.

FSA's responsibilities include regulating more than 22,000 firms which are authorised to conduct investment business in the UK. It is planning to bring the regime fully into operation during 2001. The FSA regulates firms which were previously the responsibility of a number of specialist bodies, although these were recognised and supervised by the FSA. This includes three Self-Regulating Organisations (SROs) whose work is currently carried out by staff of the FSA, operating under contract and working within the single FSA management arrangement:

- *Investment Management Regulatory Organisation (IMRO)*: regulates firms whose main investment business falls within: managing investments, acting as a manager or trustee of authorised unit trust schemes, managing or operating other collective investment schemes and investment advice to institutional investors;

- *Securities and Futures Authority (SFA)*: regulates firms involved in the securities and futures sectors of the financial services industry;

- *Personal Investment Authority (PIA)*: regulates all types of investment business conducted with the private investor.

Where breaches of regulatory requirements are found, the FSA is empowered to take a range of actions to remedy and punish wrongdoing. These include powers to require that consumers be compensated for losses arising from breaches. They also include the power to impose fines, and, in very serious cases, to terminate the authorisation of a firm.

The Financial Services Act established a special regime for members of certain professions whose main activity is the practice of their profession but who also carry on investment business. Such firms may conduct investment business following 'certification' by their professional body which regulates both their main activity and their investment business. The new legislation will revoke this special Recognised Professional Bodies arrangement and in future all professional firms conducting investment business will be regulated directly by the FSA.

Changes in the regulation of occupational pensions were implemented by the 1995 Pensions Act as a result of concern about the security of company pension funds. The Act established a Pensions Regulator and a compensation scheme for members of pension schemes that become insolvent through theft, fraud or misappropriation. The Minimum Funding Requirement (MFR) was also introduced to ensure minimum solvency ratios for employers' pension schemes.

The UK pensions system will see further fundamental changes. Changes will include the introduction of a

new pension regime known as "Stakeholder pensions" which will represent a combination of institutional schemes and retail pension products. "Stakeholder pensions" will be designed to benefit the self-employed, people who change jobs frequently and those in part-time work. They will provide economies of scale through pooling savings in multi-member schemes and will not penalise those on modest income or people who take a career-break or transfer jobs.

SECTION 2: CONTRIBUTION TO THE UK ECONOMY

The value of the fund manager's role in balancing risk and reward in the sophisticated management of a portfolio of securities and as the steward of the future income stream from clients' investments was described in Section 1. In this section, an attempt is made to estimate that contribution in terms of value added, employment, productivity and efficiency, and overseas earnings. The fund managers' wider contribution to the economy also lies in the promotion of a broad and efficient capital market that mobilises and allocates the nation's savings as well as those investments which originate overseas.

2.1 Revenue and value added

Total revenue from fees in the fund management industry is estimated by PricewaterhouseCoopers in 1998 to be around 0.22% of funds under management for institutional funds, that is £4.9bn. This puts the total revenue generated at around £5.9bn including revenue for private clients separately estimated by Compeer at £958m in 1998.

While there is no official estimate of the contribution of fund management to the total UK gross value added (GVA), we can attempt an estimate from industry sources. The income measure of GVA is calculated from income of labour, land and capital, which in the case of commercial companies is largely derived from the pay bill and gross trading profits.

The 1999 survey by PricewaterhouseCoopers of larger fund management organisations provides some pointers on these. Applying this survey's estimates of cost margins to total identified institutional assets of £2,214bn, implies total costs equivalent to 0.15% of funds under management, that is £3.3bn in addition to total costs of funds under management of private clients amounting to £783m.

Approximately 55% of costs are attributable to employment for institutional clients and 60% for private clients, which would put income from employment at around £2.3bn. Pre-tax profits in the survey amount to 0.06% of funds under management for institutional funds, that is £1.3bn in addition to £175m for private clients – equivalent to £1.5bn for the whole industry.

On this basis, a rough estimate of value added in 1998 is £3.9bn. This is equivalent to some 0.5% of the GVA and therefore an important component of the financial sector's total contribution to GVA of 6.3%.

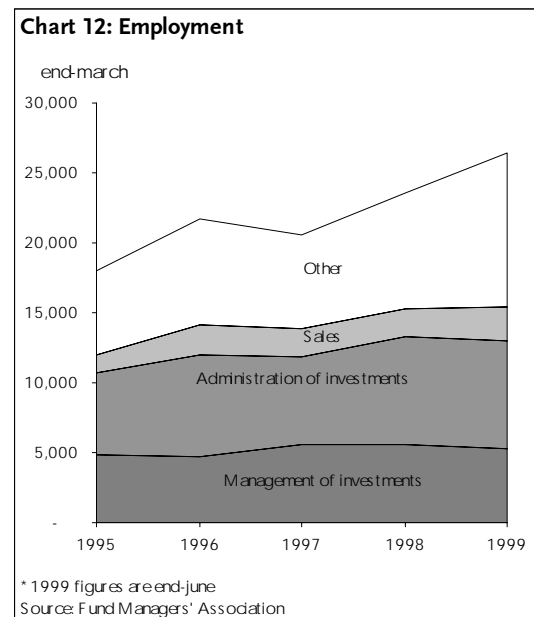
2.2 Employment

The most comprehensive measure of employment in fund management appears in the survey undertaken by the FMA. This includes around 80 firms and the bulk of institutional funds under management.

The survey estimates the total employment of the fund management industry at 26,436 in June 1999, a rise of over 12% over the previous year. Overseas staff account for nearly a fifth of the total with the number of UK staff estimated at 20,820 (Chart 12). Staff directly involved in the business of managing, administering and selling investments was up from 9,002 in 1992 to 15,367 in 1999. Between the last two surveys in 1998 and 1999, staff involved in the management and administration of investments fell slightly while other categories saw a significant increase. In addition to the staff directly associated with investment business, there is also, according to the FMA, a less well defined miscellaneous category of other staff which in June 1999 was 11,069 bringing the total number to 26,436.

UK owned firms account for nearly half of the total employment and around 60% of investment professionals. US firms account for the bulk of the remainder with 24% of the total and 14% of investment professionals while EU controlled firms accounted for 15% and 14% respectively.

Total employment in the fund management business including the large number of smaller firms is estimated at around 40,000. These figures do not include retail stockbrokers, who are thought to employ around 12,000 people.



2.3 Productivity and efficiency

A steady long term improvement in productivity is indicated by FMA's survey which shows that funds managed per employee directly engaged in the management of investments rose from £181m in 1991 to £409m in 1999, while in the administration of investments the equivalent increase was from £127m to £285m. This improvement partly reflects the increase in market values, but many firms have benefited from rationalisation and economies of scale resulting from the large number of acquisitions in recent years.

Research by PricewaterhouseCoopers has indicated that fund managers' margins have remained relatively stable with average profitability (margin/revenue) in the region of 30%. This contrasts with the steady growth in market values. According to the survey, managers are facing a downward trend in pricing which is expected to continue. This was especially evident for UK institutional business whose pricing experienced a steady decline of around 5-6% per annum in the last five years.

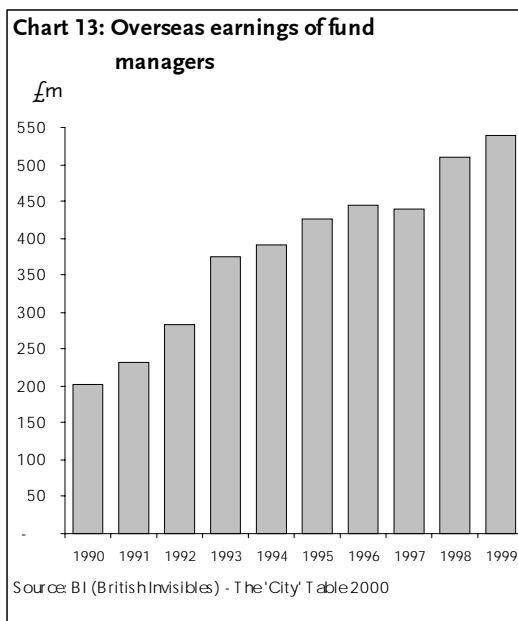
Another factor contributing to the containing of margins has been a marked improvement in cost control in 1999. The costs of managing a basket of investments have increased significantly over several years, and by over 30% in the past two years. There was a substantial peak in costs in 1998, due to increased IT and administration costs, understood to be due to project work. Analysis of costs by activity indicates that the most significant long-term increases are in marketing, accounting, administration and transaction processing.

While costs are generally under the direct control of management, revenues are much more subject to market demand. PricewaterhouseCoopers concludes that firms must not be complacent. They must prepare their organisations for survival with much lower revenues either through cost management, transformation of operational processes or by finding new ways to add value.

2.4 Overseas earnings

ONS's Pink Book estimates the overseas earnings generated by fund managers' services at £540m in 1999, having risen steadily from £202m in 1990 when the data were first collated (Chart 13). This may understate overseas services income, because the survey does not capture some insurance companies and investment banks where fund management is integrated with other operations.

On a more general view, net earnings from portfolio



investment by financial institutions, which will have owed much to the activities of UK fund managers, amounted to £11.0bn. Foreign ownership of many of these managers, of course, means that there is also a net outflow of profits and dividends to foreign parents and shareholders.

2.5 Services benefiting from fund management

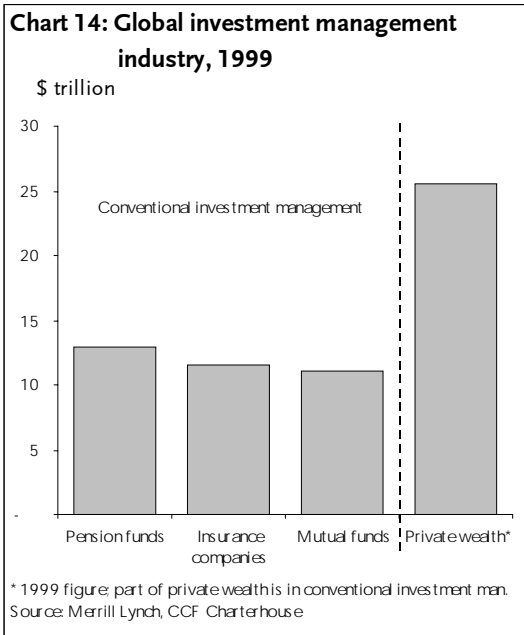
There are many links between fund management and other financial services. The most significant being with banks, Stock Exchange firms and information providers:

- **Banks:** are a major beneficiary of fund management operations, providing custody, payment and foreign exchange services. Although some fund managers supply custody as an integral part of their service, the proportion of funds using independent custodians has risen from 50% in 1997 to 71% in 1999, and is more common amongst the larger funds. Custodians may also provide fund administration services such as accounting, performance analysis and portfolio valuations;
- **Stock Exchange firms:** The scale of fund managers operations means that they contribute substantially to the activity and liquidity of the markets;
- **Information providers/analysts:** The industry depends on the availability of in-depth research on economic and company developments. It therefore supports a considerable number of information providers, including analysts and financial press.

SECTION 3: INTERNATIONAL DEVELOPMENTS AND COMPARISONS

3.1 Global overview

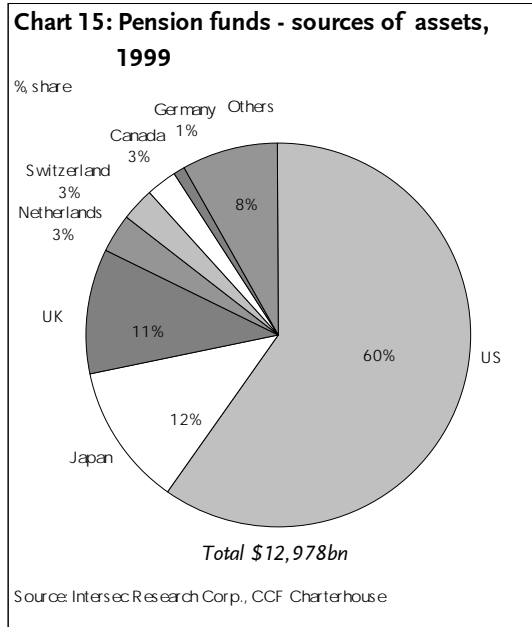
The volume of funds managed internationally has increased substantially in recent years. Global pension assets alone amounted to \$12,978bn in 1999, with a further \$11,073bn invested in mutual funds and \$11,500bn in insurance funds. Merrill Lynch also estimates private wealth at \$25,500bn in 1999. In total, assets of the world fund management industry are likely to have exceeded \$35,000bn in 1999, an increase of more than half since 1995 (Chart 14). Section 3 will show that the UK is a major player in this industry although the rankings based on sources of assets understate its position due to the substantial proportion of funds managed in the UK on behalf of overseas clients.



3.2 Pension funds

Global pension funds have increased by over 60% since 1995 partly due to the process of pension reforms around the world. The UK's \$1.4 trillion in pension assets was exceeded only by the US and Japan - the US was the source of over \$7.8 trillion or 60% of the world total in 1999 (Table 9). Most of the remainder originated from the Netherlands, Switzerland and Canada (Chart 15).

The large volume of pension assets in the US and Japan is mainly a reflection of their larger domestic markets with populations of 270m and 126m, compared with the UK's 59m. Pension assets sourced in the UK are substantial compared with



other major European countries – Germany, France and Italy – a result of the high proportion of funded pension schemes in the UK.

As shown in Table 10, the UK ranks relatively highly regarding the ratio of pension assets to GDP with 95%. The highest ratios in countries with significant pension assets are in the Netherlands and Switzerland .

The UK accounted for 18% of the total cross-border investment in 1999, second only to the US. Around a

Table 9: Global pension fund assets

\$bn	1990	1999	2004F	(% Non-domestic assets)	
				change 1999-04F	1999
US	3,650	7,765	9,965	28	11
Japan	574	1,544	1,979	28	21
UK	775	1,365	2,025	48	25
Netherlands	251	427	582	36	36
Switzerland	107	351	477	36	23
Canada	235	345	466	35	17
Australia	79	139	289	108	21
Germany	118	139	181	30	9
Other Europe	226	294	816	178	9
Other Asia	84	199	380	91	12
Latin America	25	134	222	66	4
Africa	---	104	214	106	3
World total	4,922	12,978	17,596	36	15

Source: CCF Charterhouse, Intersec Research Corp.

Table 10: Pension assets relative to GDP, 1999

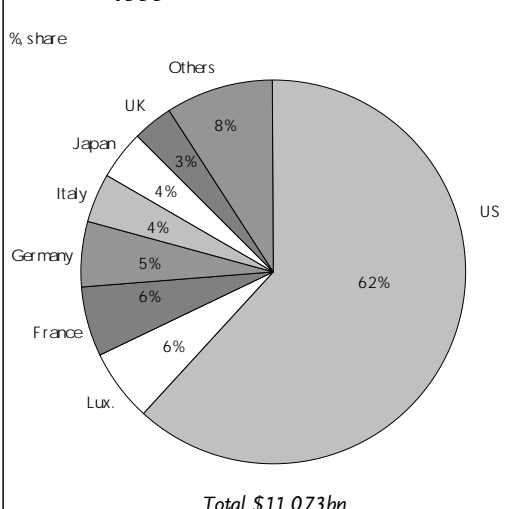
\$bn	pension assets	GDP	pension assets as % of GDP
Switzerland	351	241	146
Netherlands	427	371	115
UK	1,365	1,431	95
US	7,765	9,254	84
Australia	139	400	35
Japan	1,544	4,836	32
Italy	70	1,093	6
Germany	139	1,989	7
France	71	1,351	5

Source: InterSec Research Co., CCF Charterhouse

quarter of UK pension assets were invested overseas which was only exceeded by the Netherlands which has a smaller pool of pension assets.

Intersec forecasts further substantial growth for pension assets of over 35% by the year 2004 to reach \$17.7 trillion from \$13.0 trillion in 1999 (Table 9). Growth in the smaller European countries is expected to be above average. Higher than average growth is also predicted to be in Asian and African countries and Australia, although from a lower base. Funds have already more than doubled in these countries between 1990 and 1999 and are forecast to double again by 2004.

Chart 16: Mutual funds - sources of assets, 1999



Source: ICI, FEFSI, CCF Charterhouse

3.3 Mutual funds

Mutual funds have more than doubled since 1995 to reach \$11,073bn. The US is by far the major source of assets invested in these funds with more than 60% of the world total in 1999. Most of the other assets are administered from a few countries, principally France, Luxembourg, Germany, Italy, Japan and the UK (Chart 16). Despite steady growth in recent years, UK's total of \$371bn represented only 3% of the world total.

3.4 Insurance funds

Estimates by Charterhouse Securities indicate that there were around \$11,500bn of insurance funds under management in 1999. This represents an increase of around 80% from 1995. Based on the most recent OECD 1997 data, the US accounts for approximately one-third of the identified total followed by Japan which accounts for around a fifth. The UK, as with pensions, is the largest source of funds in Europe. UK insurance companies' investments in 1997 were more than £1,100bn, almost double those of any other European country (Table 11).

Table 11: Insurance companies' investments, 1997

	\$bn
USA	2,710
Japan	1,824
UK	1,126
Germany	700
France	639
Netherlands	223
Switzerland	185
Italy	157

Source: OECD

3.5 Largest global investment managers

It is estimated by P&I/Watson Wyatt World 500 that in 1998, the top 100 investment managers had total assets under management of over \$20 trillion. US-owned companies accounted for almost half the total, Japanese for 15% with Swiss, UK and German companies accounting for around 10% each.

UK companies that appear in the top 50 of this list include Barclays Global Investors (ranked 6th), CGU (33rd), Prudential Portfolio Managers (35th) and Schroders (39th).

Table 12: Largest global investment managers, 1998

\$bn

1	UBS	Switzerland	1,145
2	Fidelity Investments	US	786
3	Kampo	Japan	702
4	Credit Suisse	Switzerland	680
5	AXA Group	France	655
6	Barclays Global Investors	UK	615
7	State Street Global Advisors	US	495
8	Merril Lynch AM Group	US	489
9	Vanguard Group	US	448
10	Zurich Group	Switzerland	415
11	Morgan Stanley Dean Witter	US	381
12	Allianz	Germany	372
13	Bankers Trust	US	362
14	Capital Group	US	357
15	Nippon Life Insurance	Japan	356

Source: P&I / Watson Wyatt World 500

Table 13: The top international target cities, 1999

\$bn, ranking by institutional equity holdings

1	London	UK	2,461
2	Metropolitan New York	US	2,363
3	Tokyo	Japan	2,058
4	Boston	US	1,871
5	San Francisco	US	726
6	Los Angeles	US	569
7	Paris	France	458
8	Philadelphia	US	419
9	Zurich ¹	Switzerland	414
10	Denver	US	340
11	Amsterdam	Netherlands	327
12	Chicago	US	316
13	Frankfurt	Germany	310
14	Toronto	Canada	289
15	Edinburgh/Glasgow	UK	253
16	Houston	US	242
17	Hartford ²	US	199
18	Milan	Italy	196
19	Minneapolis	US	186
20	Geneva	Switzerland	185
	<i>Other UK cities</i>		
36	Manchester	UK	81
56	Birmingham	UK	32
72	Bristol ³	UK	15

¹ includes Basel, Winterthur² includes Greater Connecticut³ includes Southwest

Source: Thomson Financial Investor Relations, Target Cities Report 2000.

3.6 Fund management centres

London, in 1999, ranked as the largest fund management centre in the world with total equities managed by institutions amounting to \$2,461bn according to the Thomson Financial Investor Relations list of the top international target cities. Collectively, the US represents the largest market. New York with \$2,363bn is the largest fund management centre in the US with a further six cities from the US in the top 10 (Table 13).

In Europe, the largest centre outside London is Paris. Zurich is the next largest followed by Amsterdam, Frankfurt and Edinburgh/Glasgow. Milan and Geneva are the only other European cities featuring in the top 20. The only centre outside Europe and North America to appear in the top 20 list is Tokyo having fallen in the rankings from 1st to 3rd place in recent years.

In addition to London and Edinburgh/Glasgow, other UK cities featured in the list include Manchester which is ranked as the 12th largest centre in Europe, Birmingham (ranked 17th in Europe) and Bristol/Southwest (22nd).

3.7 Asset allocation

Asset allocation around the world varies considerably (Table 14). In the UK, there has been a rising proportion invested in equities mirrored by a lower share in gilts and property (Section 1.8 - Chart 8). Domestic and foreign equities account for three-quarters of assets in UK pension funds, which is only exceeded in developed countries by Hong Kong. Elsewhere, pension funds in the US and Japan both invest more than half their assets in equities. However, the proportion of equity investment is lower elsewhere in Europe, mainly due to investment restrictions which may set a ceiling on certain types

Table 14: International pension fund asset allocation, 1999

% share	UK	US	Japan	Austral.	Nether.
Domestic equities	51	55	40	39	12
International equities	24	10	19	16	38
Domestic bonds	9	27	32	22	22
International bonds	4	1	7	3	19
Cash	4	4	2	12	3
Property	4	3	-	5	6
Other	4	-	-	3	-
Total	100	100	100	100	100

Source: Phillips & Drew

Table 15: Real returns of pension funds

% per annum	5 yr. Ave.		10 yr. Ave.
	1999	1995-99	1990-99
US	12.9	14.5	10.7
Netherlands	21.5	13.1	9.9
UK	18.6	13.6	8.8
Australia	7.0	8.7	8.8
Japan	21.1	10.3	4.2

Source: Phillips & Drew, OECD

of investment, e.g. equities and foreign bonds, or a minimum holding of other assets. The general effect of these restrictions in continental Europe is to cause significant investment in domestic bonds and limited investment in equities or overseas assets.

As shown in Table 15 UK pension funds along with those in the US and Netherlands have achieved high returns over 5 and 10 year periods. This is partly due to the substantial proportion of assets invested in domestic and international equities in these countries. Japanese pension funds have achieved much lower 10 year returns as a result of poorly performing domestic investments. The high returns of Japanese pension funds in 1999 were a result of massive deregulation in recent years and a consequent rise in equity investment.

According to the 1997 IMF Coordinated Portfolio Investment Survey the majority of international portfolio holdings are in debt securities (56%), with equity accounting for 42% and the money market for the remainder. The US is the major source of investments with almost a quarter of the total. The UK is the second largest source with 9% of the total and 12% of equity investments followed by Japan (Table 16).

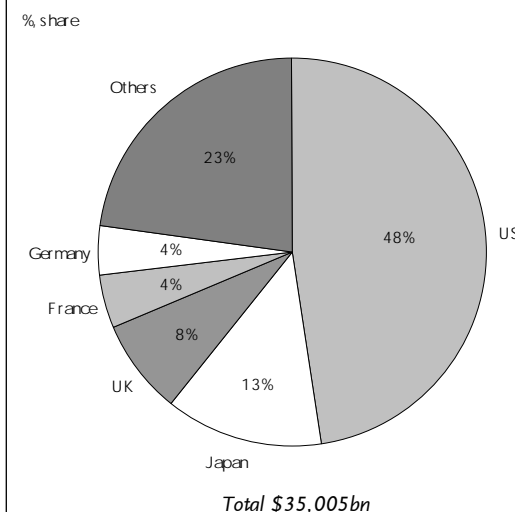
The US is also the major destination for international

Table 16: Source of international portfolio holdings, 1997

	Equity	Debt		Money Market	Total
		Securities	Market		
US	428	886	36		1,350
UK	314	232	7		553
Japan	242	145	7		394
Netherlands	164	117	2		283
France	163	105	2		271
Canada	82	178	2		262
Others	1,175	1,758	42		2,975
Total	2,568	3,422	98		6,088

Source: IMF

Chart 17: Size of the global equity market, 1999



Source: FIBV

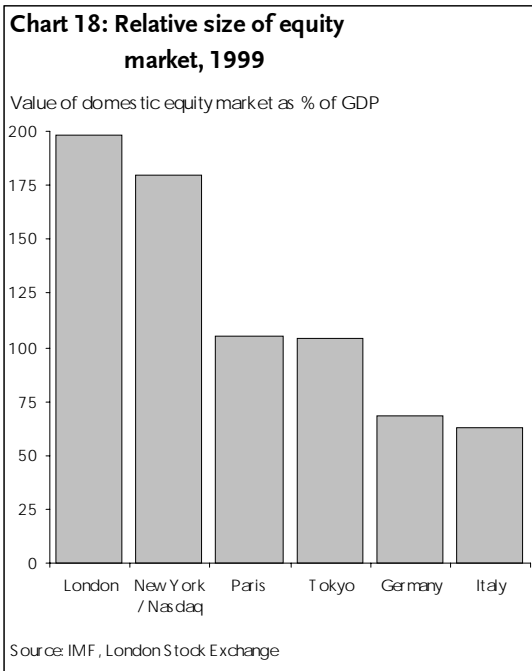
portfolio holdings and accounts for almost a third of the total and nearly a half of the equity investments. The UK is slightly ahead of Japan as the second most popular destination with around 16% of the world total (Table 17).

Equity markets The US accounted for almost half of the world's equity markets, which had an estimated market capitalisation exceeding \$35 trillion in 1999. Although the Japanese stock market was the largest in the world in 1989, the fall in prices there meant that in 1999 its share was around 13% of the total. The UK equity market is the largest in Europe with market capitalisation of some \$2,855bn, followed by the French stock market with \$1,503bn and German with \$1,432bn (Chart 17).

Table 17: Destination of international portfolio holdings, 1997

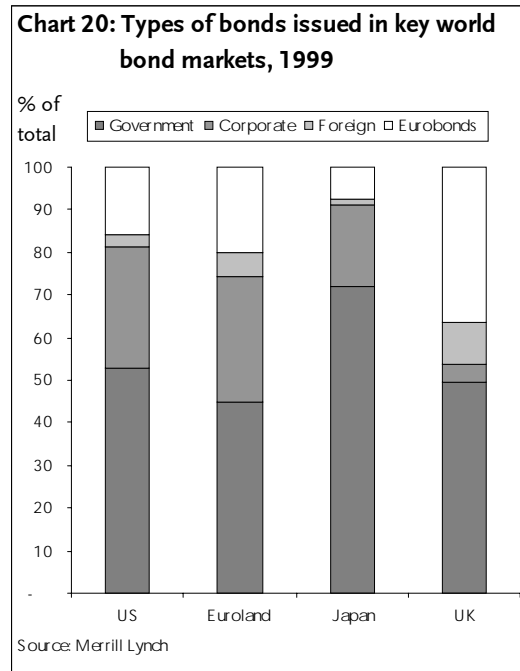
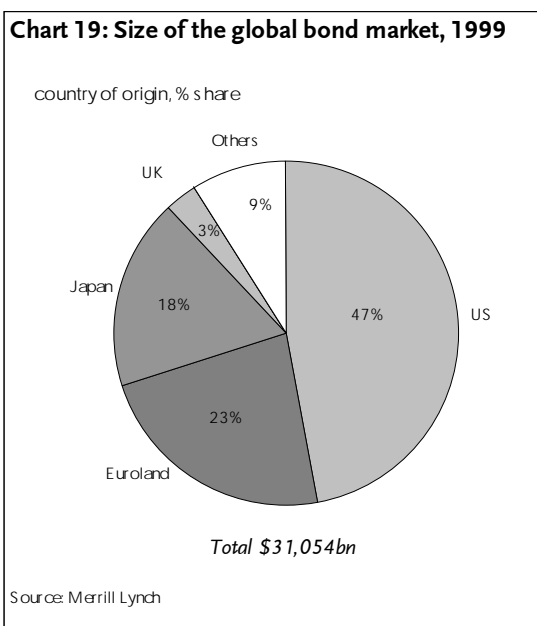
	Equity	Debt		Money Market	Total
		Securities	Market		
US	1,197	543	-		1,740
UK	462	483	27		972
Japan	159	712	31		902
France	100	206	-		306
Netherlands	127	115	-		243
Canada	47	18	5		69
Others	476	1,345	35		1,855
Total	2,568	3,422	98		6,088

Source: IMF



In May 2000 the London Stock Exchange and Deutsche Börse announced plans for their merger to create a new company to be called iX. In addition, iX and Nasdaq have signed a memorandum of understanding to create a pan-European market. iX will provide the largest European stock market, with 53% of traded volume and, through Eurex, the biggest derivatives market worldwide.

Based on the value of listed companies in the

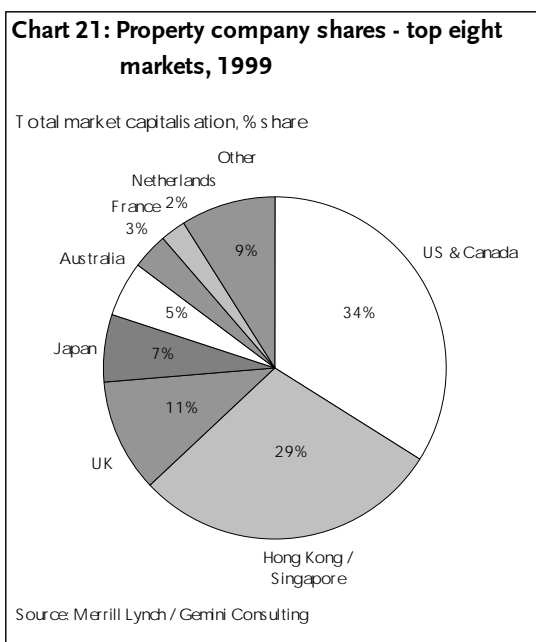


domestic equity market, the UK had the highest market capitalisation, when measured as a percentage of GDP at 198% (Chart 18). This was several times that of the large European countries, with France, Germany and Italy all between 60-105%, and higher even than the USA (taking New York and Nasdaq together) at 180% and Japan at 104%.

European comparisons of the structure of share ownership need to be taken in the context of the larger UK equity market, but a number of features stand out: the proportion of shares held by the UK financial sector at over 60% is higher than in most other countries; individual ownership of shares - 17% of the UK total is generally lower than in other European countries, although the greater size of UK market capitalisation implies a more significant penetration of individual share ownership.

Bond markets The total value of the world's bond markets exceeded \$31 trillion at the end of 1999, an increase of over 8% from 1998. The US bond market accounted for the bulk of the world total with a 47% share, followed by the Euroland with 23%, Japan with 18% and the UK with a 3% share (Chart 19).

The share of government bonds has declined in the last decade, mirrored mainly by a rise in Eurobonds which grew by over 25% during the previous year. The share of government markets as a percent of the world bond market fell to a new ten year low in 1999 of 55%. This was followed by corporate bonds with



26% of the total, foreign bonds with 4% and Eurobonds with 15% (Chart 20).

Emerging and converging market bonds offer a possibility for higher returns but with a higher uncertainty. It is estimated that the total size of this market was almost \$1.2 trillion in 1999. Most of this was accounted for by non-Japan Asia (60%), followed by Latin America (21%), with Eastern Europe, Middle East and Africa accounting for the remainder.

Property Property investments have been rather volatile in the past two decades reflecting wider changes outside the property market itself. Information on the direct property market is not widely available outside the US and UK. Chart 21 outlines the total market capitalisation of property company shares of the top eight markets. The UK is positioned strongly with a total of \$40bn or around 11% of the top eight markets total.

Many factors can affect the size and value of a domestic property market, such as supply and demand and taxation issues but with globalisation, there will be increasing pressure on internationalising the domestic property markets in order to provide diversification benefits to companies.

Alternative investments Institutional investors invest in a variety of alternative investments, most significant of which are private equity and in the US hedge funds. These investments include:

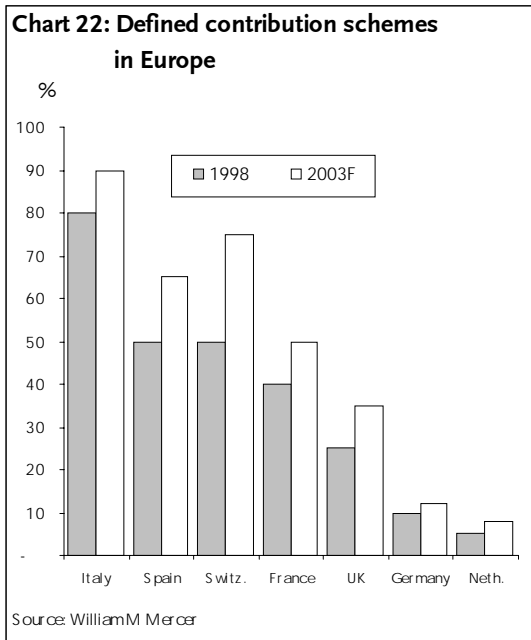
- *Private equity*: Represents investments in companies which are not quoted on the exchanges. These investments offer very high potential returns but with a high degree of risk;
- *Hedge funds*: Include various investment funds with a variety of investment strategies. The bulk of investments primarily originate from the US. UK pension funds do not have significant investments in such funds due to the potential increase in their leverage and regulation which requires them to choose "prudent investments". In addition hedge fund profits are treated as trading profits and are therefore subject to tax;
- *Precious metals*: Gold investments have various advantages such as: high liquidity, diversification benefits and relatively low risk;
- *Commodities*: Represent investments in commodity funds or investments through the futures market;
- *Art and collectibles*: Offer possibilities for diversification although a small number of institutional funds invest in art and collectibles due to the low liquidity, high transactions costs and high risk.

3.8 The future funding of pensions

Developed countries are set to experience a dramatic demographic shift during the course of the next 50 years due to increasing life expectancy and a falling birth rate. It is estimated for example that the dependency ratio of people aged 65+ to those aged 20-64 will increase from the current level of around 28% in the UK to 50% in 2050. This implies a declining proportion of people in the workforce, a trend that will be compounded by extended periods of education for an increasing proportion of people and early retirement. The current ratio of four people in work for every pensioner is expected by 2040 to decline to 2:1.

Many countries are therefore reviewing their pension funding systems. In Europe reform is being approached in many ways including: reducing the pensions paid by raising the retirement age, restricting eligibility for early retirement and privatising part of the state pension.

The UK is in the strongest position of the EU states mainly due to the extensive pre-funding of pensions and the state pension being lower than in other



countries - around 29% of average pay compared with a range of 40-80% elsewhere in Europe.

William M Mercer estimates that at end-1999 Germany had \$294bn in funded pension assets, Italy \$250bn, France \$64bn and Spain \$29bn which compares to the \$7.8 trillion in the US and \$1.4 trillion in the UK, Europe's most developed pensions market.

The development of suitable pension systems is likely to shift away from pensions based on final salaries towards defined contribution or money purchase plans, which are the basis for both private pensions and increasingly many company plans. Defined contribution schemes give members their own individually identifiable retirement funds where the final retirement pot is dependent on the contributions made and the underlying investment performance. They also offer greater flexibility for job mobility.

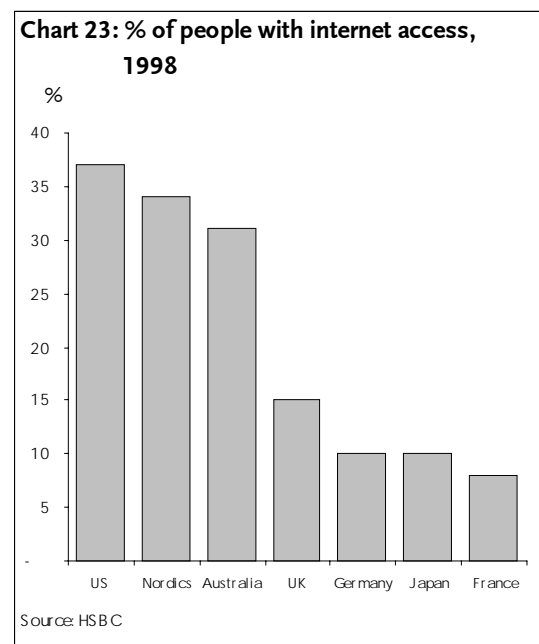
As shown in Chart 22, the percentage in defined contribution schemes in the UK is lagging behind other European countries such as Italy, Spain, Switzerland and France. It is estimated that in 1998 a quarter of employer-sponsored plans in the UK were defined contribution and this is predicted to rise to 35% by 2003. This is mainly because the defined benefit scheme has been the backbone of the UK as well as the US pension industries, where final pension income is determined by salary and length of service.

UK institutions could benefit greatly from these changes. Freedom of access and investment would release the broad expertise of UK-based institutions in dealing with a diverse range of assets, handling international as well as domestic funds, equities as well as bonds. Such expertise is not necessarily shared by many of the large institutions elsewhere in Europe which are orientated mainly to domestic markets and government bonds.

All these changes are partly being driven by governments which are seeking to shift the burden of pensions provision away from the state and on to employers or individuals. As state retirement schemes are cut back across the continent, people will be increasingly dependent on privately funded and employer sponsored schemes, mostly defined contribution arrangements.

3.9 E-commerce

Internet usage has grown at a remarkable pace in recent years and it is estimated that there are over 200m users worldwide. The US is at the forefront of this revolution with over 35% of its population having internet access in 1998. Australia also has a high percentage with over 30% as do the Nordic countries which are well ahead of their European counterparts with just under 35%. 15% of the UK population has internet access which is more than Japan, Germany and France each with around 10% (Chart 23). The UK has the most Internet users in Europe (8.1m), followed by Germany (7.1m) and



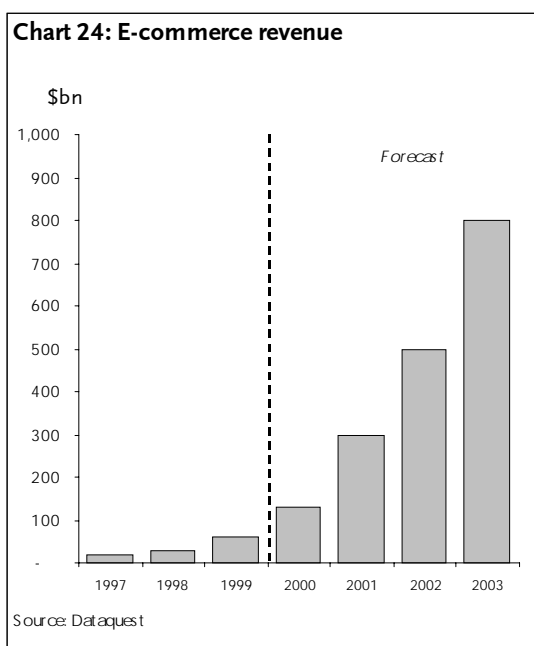
France (2.8m).

Various estimates on the impact of e-commerce on prices and costs indicate that the reduction achieved by the use of the internet as a distribution channel averages around 10%. Forecasts for the growth of e-commerce suggest that the trend for internet usage is still in its early stages. Total e-commerce was estimated at just over \$100bn in 1995 and as Chart 23 shows, this is forecast to grow to almost \$1,000bn by 2003. IDC estimates that the UK retail e-commerce market will grow from \$500m in 1998 to \$10.8bn by 2002.

The internet and e-commerce are introducing fundamental changes to the fund management industry. So far these changes have mainly been confined to marketing and lowering distribution charges although recently the boom in on-line trading activity is coinciding with a fall in the rate of sales growth.

Within the securities markets, the use of the internet is mainly associated with low cost execution for share dealing. Recent data indicates that on the NYSE and NASDAQ, there is a decline in average trade size suggesting that individual activity is on the increase and that a growing number of people are actively investing their own portfolios.

According to the 1999 PricewaterhouseCoopers Fund Management Survey there is scope for using internet technology in business to business process



automation and automation of processes and sharing information within an organisation. UK's authorised investment fund industry is seeking to develop business to business process automation through its Electronic Message Exchange (EMX) dealing system. More than 80 fund managers, stockbrokers and internet companies have already agreed to take part in electronic trading of funds on the EMX system. Other projects include the platform for electronic trading of mutual funds in Europe launched by Cap Gemini Ernst & Young.

Other CBI/PricewaterhouseCoopers survey evidence also indicates that while the vast majority of UK fund managers are now investing in e-business development, they are somewhat behind players from other financial services sectors. According to the Compeer Retail Broking Survey, more than 36% of their survey sample anticipate a considerable impact of the internet in the next two years while 40% expect a limited impact.

In the months ahead internet capabilities will continue to evolve and provide new business opportunities. This will be further enhanced with the introduction of interactive television. Growth of new businesses will be facilitated by lower business costs, lower barriers to entry while increased competition will put pressure on prices. Consumers will have the option of choosing the lowest prices and search for services most suitable for their needs.

3.10 Future market issues for UK firms

Section 3 has referred to a number of issues likely to affect the future development of the fund management industry. Firms based in the UK are well positioned to gain new business, particularly in the international markets, where the growth prospects look strongest:

- *Pension reform:* The reforms and privatisation of pension systems in Europe and elsewhere should provide more cross-border investment opportunities. Fund managers in the UK should also be able to contract further business from external appointments with the easing of investment restrictions and diversification of international fund managers' portfolios;
- *Restructuring:* Over the past few years, there has been substantial restructuring of UK fund managers, which has helped to strengthen their international links. There is likely to be further restructuring globally, geared to expanding the pool of

resources available, developing sophisticated distribution systems, reducing costs and improving the quality of service;

- *Track record:* UK along with US firms have a well established track record in the measurement of returns, a record they should be able to use to their advantage in marketing products in Continental Europe, Japan and emerging economies, as the market for fund management in these countries develops;
- *Outsourcing:* Large fund managers are increasingly offering their asset management services to outside clients. This is due to the need to reduce costs which is prompting small and medium sized companies to outsource the management of their investments. Third-party fund administration is also growing. This includes services such as custody, accounting, daily valuation and shareholder record-keeping;
- *Investment consulting:* Specialist investments such as venture capital are facilitating an increased

demand for investment consulting services. Investment advice in general has gained in importance as a service for most UK pension consultancies in recent years;

- *E-commerce:* The growth of the internet is likely to introduce fundamental changes to the fund management industry through developing marketing opportunities, new distribution channels and facilitating the development of securities markets (Section 3.9).

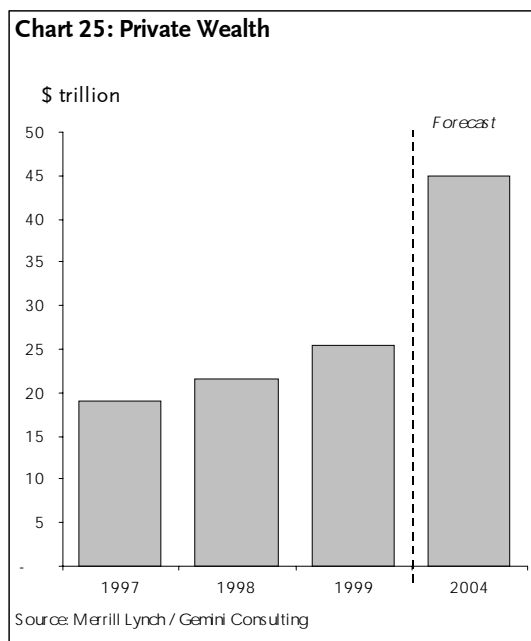
There are some concerns in the industry that a critical point may have been reached due to increasing competition from offshore centres. It is important that the UK is not disadvantaged by a tax and regulation system that results in funds moving elsewhere. Such potential weaknesses need to be overcome in order for London and the UK to maintain their strong position as an international fund management centre.

SECTION 4: PRIVATE WEALTH MANAGEMENT

4.1 Quantifying the market

It is estimated by the Merrill Lynch/Gemini Consulting World Wealth Report 2000 that there were around 7 million people with financial assets in excess of \$1m; their combined financial assets totalled \$25.5 trillion (Chart 25). This means that the private wealth industry is larger than the global insurance industry, pensions industry or mutual fund industry. However, these categories overlap since the private wealth industry is also an investor in conventional asset management.

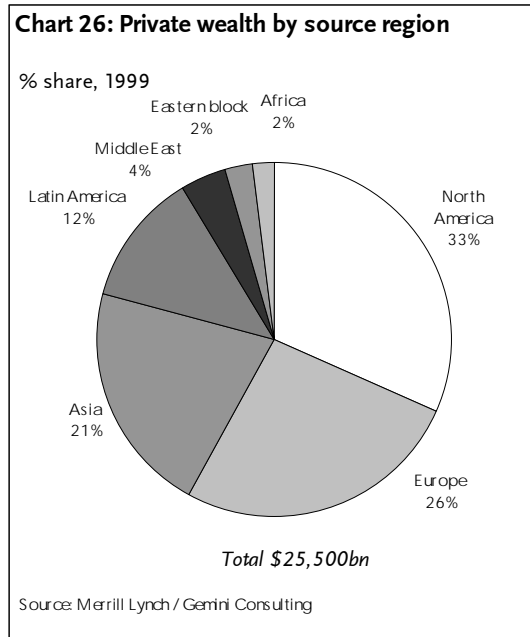
Private wealth grew by over 18% in 1999 and it is estimated that growth in the next five years will average around 12% per annum to reach \$45 trillion in 2004. The major factors behind the rise in 1999 were the global real GDP expansion and buoyant investments in global stock markets which grew by 37% during 1999.



4.2 Distribution of private wealth

Europe and North America account for more than half of the total private wealth (Chart 26). North America accounts for almost one-third of the total with Europe accounting for 26%, Asia for 21% and Latin America 12%. The Middle East, Eastern bloc and Africa together hold less than 10% of the total.

The onshore market is estimated to account for two-thirds of the private wealth industry. Switzerland and the UK hold the highest share of the private wealth management industry for the offshore market with 33% and 15% respectively. The US and the Caribbean



are the next largest destinations with 12% each (Chart 27).

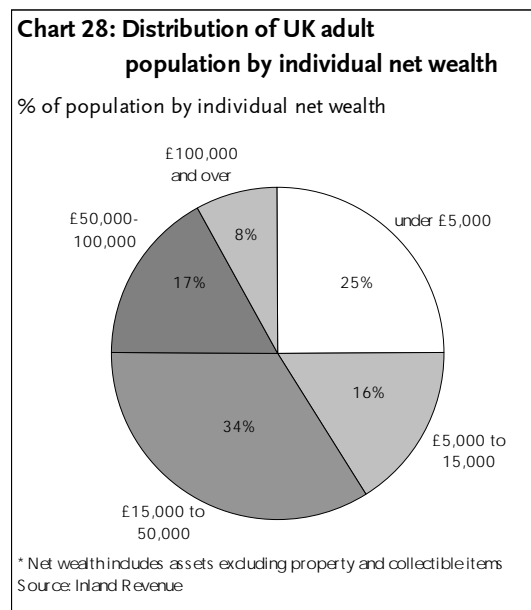
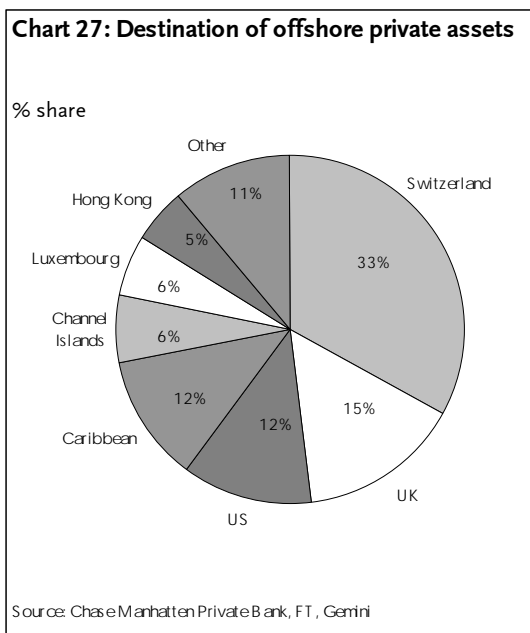
The latest PricewaterhouseCoopers annual European private banking survey indicates that the onshore market is growing faster than the offshore market. Switzerland, the Caribbean, Dublin and Singapore are expected to become more important destinations for offshore wealth while London is expected to remain the second largest centre for private wealth management.

4.3 The UK private wealth market

The UK individual wealth mix can be classified into the following categories:

- *Emerging affluent:* with assets between £50,000 and £100,000 in addition to property and collectible items; they numbered over 2.7m or 4% of the total population;
- *Affluent:* with assets between £100,000 and £500,000 (3% of the total population);
- *Wealthy individuals:* with assets over £500,000 (2% of the total population).

As shown in Table 18 the allocation of assets differs significantly between the three categories. While half the assets of wealthy individuals are held in offshore accounts, affluent individuals hold around a fifth offshore. Wealthy and affluent individuals invest the bulk of their onshore assets in equities, 23% and 29% respectively. Emerging affluent individuals hold



the highest proportion in private pension funds (51%) and they also have the highest proportion of cash among the three categories (18%).

The Inland Revenue estimates that the most wealthy 1% of the UK population hold 19% of UK's marketable wealth, the most wealthy 10% hold 50% while the most wealthy 50% of the adult population hold 92% of the total marketable wealth.

As shown in Chart 28 over 90% of the UK population have net wealth of under £100,000 excluding occupational pensions with a quarter holding less than £5,000. The largest category are individuals with net wealth between £15,000 and £50,000 accounting for just over one-third of the total population.

Table 18: UK wealth mix

	Emerging affluent	Affluent	Wealthy
Assets (£000)	50-100	100-500	>500
Number (million)	2.77	1.42	0.15
Total assets (£bn)	188	260	231
<i>Allocation, % share</i>			
Private pensions	51	24	11
Cash	18	15	6
Shares	13	29	23
Unit Trusts & PEPs	8	8	9
TESSAs	5	4	1
Offshore	5	20	50
	100	100	100

Source: Gemini Consulting

4.4 Source of wealth

There are two basic profiles of High Net Worth Individuals (individuals with liquid financial assets exceeding \$1m): "new money" or earned wealth and "old money" or inherited wealth. In addition to the growth in their total number, the composition between the two profiles is changing with earned wealth increasing at a faster rate.

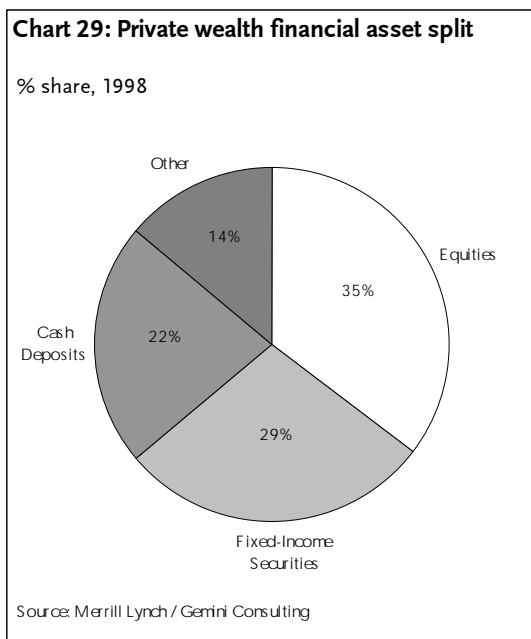
Investors who have earned their wealth are most active in its management as well as being more demanding, informed, educated, IT literate, global and risk-taking in managing their finances. This is also the case with the younger generation of investors who have inherited their wealth; they tend to be more active in managing their assets than the older generation.

4.5 Financial Asset Split

US and European capital markets account for the bulk of private wealth investments regardless of where the assets are officially domiciled. During 1998 equities accounted for more than a third of portfolios, fixed income securities for 29% and cash deposits for less than a quarter (Chart 29).

Regional returns on private wealth investments during 1999 were as follows:

- Private wealth in North America and Europe grew by 17% and 19% respectively. This was largely due to substantial portfolio allocation in equities.



- Asian private wealth experienced the highest growth during 1999 (almost 23%). The major factors contributing to this were: strong economic growth and an average rise in the value of Asian stock markets of nearly 70%.
- Private wealth in Latin American countries grew by around 15% underpinned by a shortfall in the underlying economic growth.

APPENDIX 1: FUNCTIONS AND HISTORY OF FUND MANAGEMENT

Functions of fund management Fund management covers a broad range of activities. In Chart 30, taken from the PricewaterhouseCoopers Investment Management survey, these are broadly divided between front office and back office functions. Front office functions include those directly related to the management of funds such as: decisions on asset allocation and risk management, investment analysis, dealing and cash management.

Back office functions are mainly support activities including: transaction processing, systems support, accounting and administration. Such fund management services can be delivered either by investment departments of parent firms or by independent managers who offer their services for a fee.

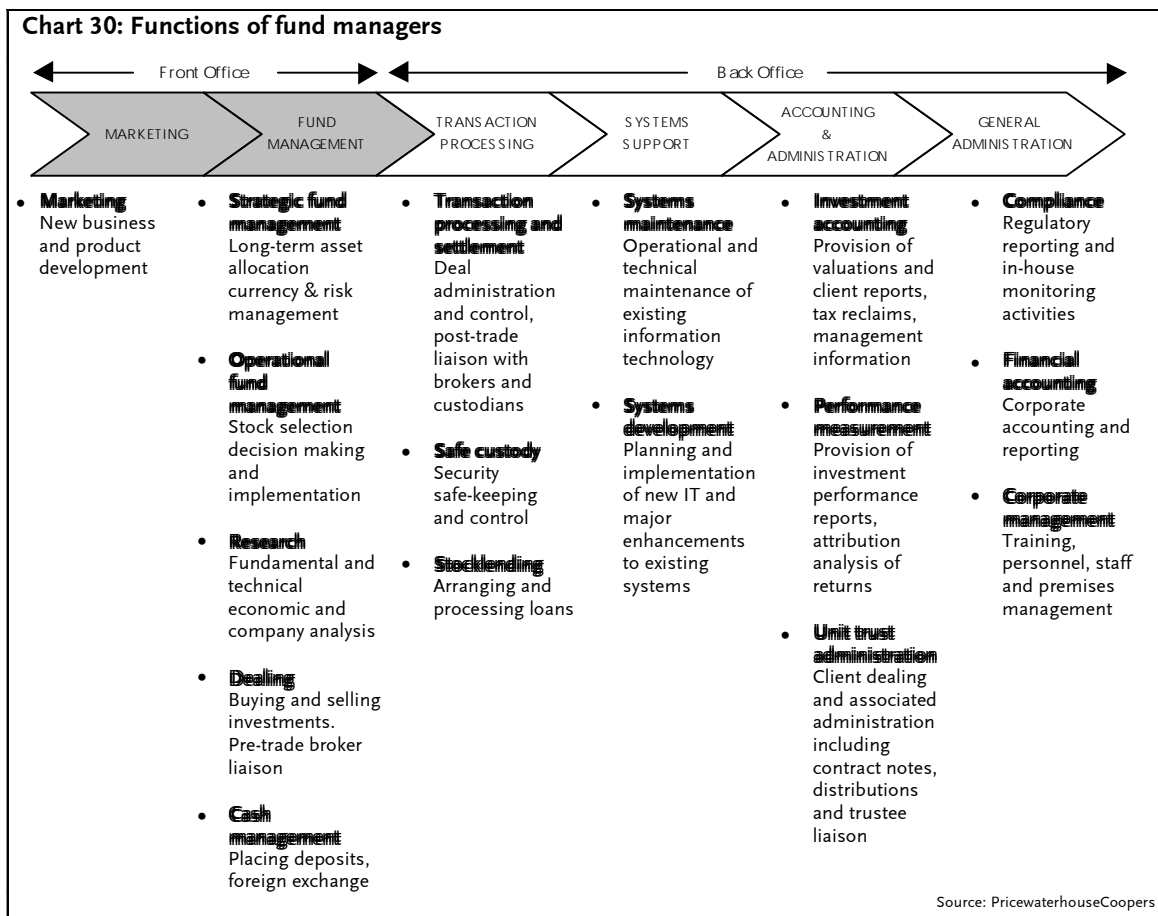
History of fund management The rise of professional fund managers in Britain began during the 19th century as the savings habit spread among the new industrial middle classes and the first private sector pension funds and the first investment trusts were developed.

The first quarter of the twentieth century saw a substantial increase in corporate pension provision. Private trusts were first used as a legal vehicle for

pensions at the turn of the century; the use of pension trusts was boosted by exemption from income tax granted in 1921. Pooled, or “group”, pension schemes in Britain were first offered by an insurance company in 1927. Such schemes proved attractive to employers as they offered lower administration costs, and a wider pooling of risk, than schemes run by the employers’ themselves.

The fund management industry had broadened its scope during the 1930s with the introduction of the first unit trust. In the 1960s other financial institutions, such as merchant banks, entered the fund management business. The increasing competition for funds also spawned a wider variety of products and investment vehicles.

Specialist property trusts were launched in 1966, followed by investment products in such areas as small companies, new technology, venture capital and overseas investment. The expansion of equity investment since then was underpinned by a newly developed approach to investment by institutions which emphasised optimal diversification strategies as a mechanism for reducing risk. Structural changes in UK fund management during the 20th century have mainly been characterised by continuing consolidation.



APPENDIX 2: GLOSSARY OF TERMS

Active management A style of investment management where the fund manager aims to outperform a benchmark by superior asset allocation, market timing or stock selection.

Annuity Form of financial contract, usually offered by insurance companies, to provide a given income at a regular interval from retirement till death; usually backed by long-term bonds; can be flat rate or indexed.

Asset allocation The distribution of funds (or the process of distributing funds) in a portfolio across various asset classes, currencies and geographical areas.

Asset class A collection of assets with similar legal, trading and risk characteristics. The asset classes most commonly held by investors include equities, bonds, property and cash.

Balanced portfolio manager A manager who both sets the asset allocation - subject to guidelines set by the investors - and chooses the individual securities for clients' portfolios.

Contracted out Feature of private pension plan in the UK and Japan permitted to replace state system of earnings-related social security.

Contribution holiday Period during which an employer ceases to contribute to an overfunded defined-benefit pension scheme, so as to eliminate the surplus.

Defined-benefit pension scheme Pension scheme where the benefits are defined in advance by the sponsor, independently of the contribution rate and asset returns, as where a pension is related to final salary.

Defined-contribution pension scheme Pension scheme where only contributions are fixed, and benefits therefore depend on the return on the assets of the fund.

ERISA (Employee Retirement Income Security Act) US pension law of 1974 which defined fiduciary responsibilities, set minimum-funding standards and investing rules, and set up the benefit insurance scheme.

Equity The capital of a company belonging to the ordinary shareholders who have voting rights allowing them to influence the management of the company.

Expected return Gain from holding a financial claim net of expected loss from default risk, etc.

External management Fund management conducted by a company other than the sponsor.

401 (k) plan US defined-contribution pension plan where contributions by the employer depend on profitability, employee contributions are also tax free, employees can determine the amount of saving they do, and participation is optional.

Funded pension scheme Scheme where pension commitments are covered by real or financial assets.

Hedge fund An investment fund that takes a very high degree of risk, often by gearing the fund, in the hope of achieving a very high return.

Hedging The process of fixing the currency exposure of a trust portfolio, and hence reducing the effect of exchange rate fluctuations on the portfolio's value. Hedging is used to reduce the risk of loss through adverse movements in interest rates, equity markets, share prices or currency rates.

Indexation (Inflation) rule that benefits be increased in line with an index of prices or wages; (portfolio) holding of all the securities in a market in line with their relative capitalisation, or a subset whose combined risks and expected returns approximate those of a market index, (e.g. the FTSE 100 index); (global) holding of assets in all securities markets proportionate to their global capitalisation weights.

Indexed bond Bond whose return is tied to an index, such as the index of consumer prices.

Internal management Fund management conducted under the auspices of the sponsor.

Interest-rate parity Market condition in which the differential between forward exchange rate and the spot rate equals the differential between foreign and domestic interest rates for the same period.

Investment company A variable capital company which serves as a collective investment vehicle; similar to a unit trust.

Investment trust This is a closed-ended investment vehicle which issues shares to investors and invests the proceeds in a portfolio of shares. Like a unit trust or variable capital (open ended) investment company, this sort of vehicle allows investors to build a diversified portfolio with reduced transaction costs, but unlike these other vehicles its share price can diverge from its net asset value.

Liquidity The amount within a portfolio which is held in cash rather than being invested.

Maturity (1) time between issuance and repayment of principal on a debt instrument; (2) a mature pension fund has a long-term equilibrium ration of workers to pensioners, and a constant average age of members.

Minimum-funding regulations Rules for pension schemes to ensure that a satisfactory relationship between assets and liabilities is maintained in defined-benefit funds.

Money-purchase plan Form of defined-contribution plan where employer makes regular payments equal to a proportion of employee's compensation. Often used more loosely as a synonym for defined-contribution plans.

Mutual fund US terminology for open-ended collective investment vehicles; usually unit trusts.

Open-ended investment company (OEICs) Corporate form of investment vehicle to be introduced into UK legislation in early 1997.

Option The contractual right, but not the obligation, to buy or sell a specified amount of a given financial instrument at a fixed price before or at a designated future date. A call option confers to the holder the right to buy the financial instrument. A put option involves the right to sell the financial instrument.

Passive management A style of investment management that seeks to attain performance equal to market or index returns.

Pay-as-you-go An unfunded pension scheme; contributions of employers and current employees are relied on to pay pensions.

Pension plan Contract setting out the rights and obligations of members and sponsor in an occupational pension scheme.

PEP UK personal equity plan, which enables individuals to accumulate limited quantities of equities, trust units etc each year in an account where capital gains and dividends are tax free.

Personal pension Individual defined-contribution pension contract, usually arranged with a life-insurance company.

Pooled fund A fund in which several investors hold units. The assets are not held directly by each client, but as part of a "pool". Unit trusts are a type of pooled fund.

Preference shares A class of share capital which receives a fixed rate of return, and comes ahead of ordinary shares in order of priority in a winding up.

Present value calculation Summation of future cash flows by use of an appropriate discount factor.

Property unit trusts (PUTs) Pooled investment vehicles that enable investors to hold a stake in a diversified portfolio of properties.

Real return Return on an asset less inflation.

Segregated fund Where the assets of a particular fund are managed independently of those of other funds under the fund manager's control.

Sovereign An agency or fund which invests a foreign government's assets. The Kuwait Investment Office (KIO) is a prominent example in the UK.

UCITS (Undertaking for Collective Investment in Transferable Securities) Open-ended investment vehicles which invest in equities and bonds and are capable of being marketed across border under the 1985 EU UCITS Directive.

Unit trusts Established under a trust deed, these vehicles allow investors to pool their holdings, achieving diversification with lower transaction costs than they could investing individually. Unit trust holdings are normally valued daily and dealing in units takes place at a price related to net asset value.

Venture capital Often identified as a distinct asset class, venture capital serves mainly as a source of funds for start up companies and leveraged buy-outs. It typically carries higher risk (and hence higher expected return) than equity, as well as being less liquid.

APPENDIX 3: OTHER SOURCES OF INFORMATION

The following publications, many of which have been used in the compilation of this report, give further details on issues and statistics relevant to the fund management industry.

AUTIF

Funds Under Management, April 2000

CCF Charterhouse

Major Themes in the Global Fund Management Industry, May 2000

ComPeer Limited

Private Client Stockbroking & Fund Management Survey: Year 7 (1999)
Retail Broking Survey, 1999

Euromoney

Intersec 250, August 1999

Institutional Investor

Euro 100, November 1999

IMF

Results of the 1997 Coordinated Portfolio Investment Survey

FSA

Household Sector Saving and Wealth Accumulation, February 2000

Fund Managers' Association

Fund Management Survey, 1999

KPMG

The State of the Investment Management Industry in Europe, winter 2000

Merrill Lynch/Gemini Consulting

World Wealth Report, 2000
World Wealth Report, 1999
Size and Structure of the World Bond Market, 2000

Office for National Statistics

Insurance Companies', Pension Funds' and Trusts' Investment, Q4, 1999

Thomson Financial Investor Relations

2000 International Target Cities Report

Phillips & Drew

Pension Fund Indicators, a Long-term Perspective on Pension Fund Investment, 2000
Investment Directions, Survey of investment Management Arrangements, 1999

PricewaterhouseCoopers

2000 Investment Management Survey
1999 Investment Management Survey

APPENDIX 4: DATA COVERAGE AND QUALITY

The starting point of the analysis in this report is the data collected by the Office of National Statistics (ONS) on the pool of assets held by institutional funds based in the UK. This is published quarterly in both a “First Release” and subsequently in the Business Monitor MQ5. Information on institutional investment also appears in ONS Financial Statistics.

The broader picture for funds under management in the UK is filled out with various industry surveys including those undertaken by the Fund Managers Association (FMA), InterSec Research Corp., PricewaterhouseCoopers, ComPeer, Imoney.net and CCF Charterhouse, although inevitably their coverage while extensive, is not complete. The reports by the FMA and PricewaterhouseCoopers, for example, mainly cover the largest fund managers.

The industry surveys by the FMA and PricewaterhouseCoopers, in particular, permit some estimates to be made of fund management’s contribution to GVA, employment and productivity, supplementing the ONS data on overseas earnings.

Overall, the data collected by the ONS and from industry surveys together provide sufficient coverage to give a good indication of the scale of funds under management in the UK and their contribution to the economy.

International data collected by InterSec Research Corp. and Technometrics give some indication of the UK’s position internationally, particularly from the perspective of pension funds. The management of pension fund assets, generally, is the subject of a much greater volume of research than insurance companies’ assets. This means that, for example, international comparisons of asset allocation, investment restrictions, rates of returns and forecasts of market growth are generally focused on pension funds alone. Furthermore, in the context of the UK, data on the use of various management styles and derivatives also generally relate to analysis of pension funds.

APPENDIX 5: SPONSORS' CONTACT POINTS

Cazenove Fund
Management Limited



Cazenove Fund Management is the investment management arm of Cazenove & Co., the independent UK securities house managing portfolios totalling US\$20 billion. Assets are managed on either a segregated or on a pooled basis on behalf of high net worth individuals from around the world, UK and international charitable foundations and UK and international pension funds. In addition, we have a range of onshore and offshore mutual funds invested in international markets.

Key characteristics of our organisation are as follows:

Our **independence** and **focus on fund management** allows us to work with a wide range of international institutions including trust companies, banks, government and non government organisations and pension funds without conflict of interest.

The scale of our funds under management is large enough to fund an institutional investment process but small enough to allow for diverse client relationships. Because no one area of our business dominates any other, all our clients have equal access to the process.

Our partnership structure leads to **continuity and stability** in terms of personnel and business strategy.

We are investment driven which has been born out in our performance over the last five years; this has been especially marked in our global and specialist European equity strategies.

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DeAM UK



Deutsche Asset Management UK (DeAM UK) offers clients a broad combination of qualities – a truly global network, a comprehensive product range, superior performance returns and tailor-made financial solutions – together with the financial strength and resources of the Deutsche Bank Group.

Headquartered in London, DeAM UK comprises over 130 portfolio managers covering equities, bonds, and property investments across the entire risk/return spectrum for institutional clients, both defined benefit and defined contribution, charities, private clients, insurance companies and retail clients.

DeAM UK is the fourth largest institutional fund manager and Deutsche Asset Management (DeAM) is the world's fourth largest fund manager. As at the end of December 1999, DeAM had more than £360 billion of assets under management worldwide. Of this, £67 billion is managed in the UK and more than £38 billion is managed on behalf of UK pension fund clients.

DeAM UK services clients through:
Deutsche Asset Management Ltd which provides investment management services for all UK-based clients, as well as marketing and client service support;
Deutsche Property Asset Management Ltd which provides investment advice to UK and overseas institutional clients investing in UK real estate;
Deutsche Investment Funds Ltd which is the marketing company for UK retail investors;
Deutsche Investment Trust Managers Ltd which provides investment trust management services;
Deutsche Unit Trust Managers Ltd which manages Deutsche Asset Management UK authorised unit trusts; and
Deutsche Asset Management Life & Pensions Ltd which provides life assurance and pension products.

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Fidelity Investments



Fidelity International Limited (FIL), which trades under the name Fidelity Investments, serves the major markets of the world by providing investment products and services to individual and institutional investors outside the US. FIL's products and services include equity funds, fixed-income funds, money market funds and institutional portfolio management. Following significant overseas expansion during the 1990's FIL today has a team of over 360 analysts and fund managers in a network of international offices trading 24-hours a day, covering all the major world stock markets. The combined assets under management of FIL and FMR Corp., a US company and affiliate, exceed US\$ 1 trillion as at March 2000.

FIL opened its London office in 1979. In March 2000 Fidelity topped the table for mutual funds under management in the UK and is now in the country's top ten Pension Fund Management Groups.

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Managing Director, Institutional, Richard Horlick
Managing Director, UK Retail, Richard Westcoat
Chief Investment Officer, Simon Fraser

Merrill Lynch Investment Managers



Investment Managers

Merrill Lynch Investment Managers (MLIM) is one of the world's leading investment firms with more than \$560 billion under management. MLIM and the companies from which it has developed have over 35 years' experience in helping clients to achieve their financial goals.

The firm provides a broad spectrum of innovative products for institutional, mutual fund and private investors, including active, passive, quantitative, hedge fund and private equity funds. Clients include five of the world's top ten pension funds; twenty five of Japan's top fifty corporates; seventeen Central Banks across four continents; over half of the UK FTSE 100 and more than 500,000 retail customers worldwide.

MLIM has over 3,500 employees in twenty one countries, and as the investment division of Merrill Lynch, can access an unrivalled range of world-class products, market intelligence, services and technology resources for the benefit of its clients.

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Newton Investment Management Limited

NEWTON

Founded in 1978, Newton currently manages more than £19 billion (as at 30 April 2000) on behalf of private investors and institutions worldwide.

Newton pioneered the global thematic investment approach, recognising that no economy, industrial sector or company should be seen in isolation in a global market for goods and services. This approach, combining the skills of global industrial analysts and individual portfolio managers, has driven the returns enjoyed by Newton's clients.

Since 1998, Newton has won more than 60 awards for consistency, client service and performance.

Headquartered in London, Newton also has offices in Leeds, Edinburgh, Jersey, Guernsey, India, the Isle of Man, Argentina and Hong Kong.

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Mark Allpress, Head of Sales

Chief Executive, Collin Harris
Chief Investment Officer, Charles Richardson
Marketing Director, Guy Hudson

A Mellon Asset Management Company

ABI



The Association of British Insurers represents nearly the whole of the UK insurance company market to Government, Parliament, civil servants and regulatory bodies.

The British insurance market is the biggest in Europe, and the third largest in the world, with well over £100bn turnover in a year. About two-thirds of this is for life and pensions and one-third for non-life business.

UK insurance companies have huge, and growing, sums invested in connection with their customers' life, pension and other insurance policies - currently around £1,000bn. This is split approximately 90% life and 10% non-life.

Around 230,000 people are employed in insurance and pension funding, and another 135,000 in auxiliary sectors. These 365,000 people make a contribution of nearly 2% to the UK's Gross Domestic Product.

British insurers are important contributors to the UK's balance of payments, with total overseas earnings of around £7bn, made up of insurance exports, investments, profits and dividends.

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AUTIF



The Association of Unit Trusts and Investment Funds (AUTIF) is the trade body representing the UK unit trust and investment funds (mutual funds) industry. Its members are responsible for over 99% of the industry's funds under management.

AUTIF is a powerful force in the financial services industry, working closely with the regulatory and tax authorities in the UK, the EU and around the world, as well as other major trade associations.

The aims of the Association are to improve the environment in which its members operate; to maintain the industry's reputation; to bring about conditions conducive to promoting the growth of the industry, and to provide added value services to member firms.

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Philip Warland, Director General
Anne McMeehan, Director of Communications
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Victoria Nye, Director of Training and Education

IMMFA

In June 2000, a group of 22 leading European offshore money market fund managers formally joined forces to create a new trade body, the Institutional Money Market Funds Association (IMMFA), based in London. IMMFA was founded to represent its members' interests within the cash management product arena of triple-A rated, stable and accumulating net asset value money market funds currently domiciled in offshore European financial centres.

Despite their relative infancy, these money market funds have become a US\$ 46.5bn business in Europe, growing at 80% per annum and available predominantly in US Dollar, Euro and UK Pound Sterling at present. Market growth is set to continue as corporations seek higher levels of return, diversification (both currency and instrument) and risk management than those available via traditional bank sources. In view of this continued growth, the core objectives of IMMFA include industry standardisation, investor awareness and making representation to Governments, legislative and regulatory bodies to attain formal recognition and regulation for the product within the cash asset class.

Ashley D Meek, IMMFA Secretary

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