4 UK INSTITUTIONAL MARKET

KEY FINDINGS

MARKET OVERVIEW

- IA members manage £3.9trn in UK institutional client assets globally. Institutional assets declined 16% between 2021and 2022 following market turbulence and the September 2022 gilts crisis, which notably affected the LDI market. However, in 2023 asset levels stabilised.
- Estimates for 2023 suggest aggregate outflows of approximately £80bn, primarily from Liability Driven Investment strategies. In contrast, 2022 saw estimated inflows of £65bn.
- UK institutional client assets are still dominated by pension and insurance clients, comprising 82% of institutional AUM—a figure unchanged from the previous year.
- The proportion of assets managed on behalf of UK pension funds (56%) has fallen since the peak in 2019, when pension fund assets accounted for 65% of UK institutional AUM. The last time pension assets were as low as 56% of AUM was in 2014.

EVOLUTION OF THE PENSIONS MARKET

- UK pension fund assets managed by IA members remained at £2.2trn in 2023, unchanged from 2022 but 22% lower than the £2.9trn recorded in 2021.
- The IA estimates the size of the UK pensions market at £3.8trn in 2023, which is up 2% from the £3.7trn estimated in 2022 but below 2021's £4.2trn estimate.
- DB pension assets were £1.9trn in 2023, broadly unchanged over the year. In 2023, a number of DB schemes moved to full funding and sought to transfer scheme risk to insurers - it is estimated that buy-in and buy-out deals reached £50bn.
- DC pension workplace assets rose by an estimated 10% to £600bn in 2023. Individual and self-invested assets were marginally up from £725bn to £750bn.
- Annuity-backed assets held on insurers' balance sheets grew by 14% to £365bn in 2023. Annuity sales surged 46% in 2023 to the highest level since the introduction of pension freedoms in 2014, totalling £5.2bn.

THIRD-PARTY MANDATES

- Third-party client assets managed by IA members globally reached £3.4trn, up from £3.3trn in 2022. Pension funds account for 62% of total third-party assets, down from 70% in 2021, reflecting a shift in asset distribution. Third-party insurance assets have grown significantly, rising from 14% of third-party assets in 2021 to 18% in 2023.

MANDATE TYPES

- Single-asset mandates represented 51% of institutional assets in 2023, a slight decrease from 52% in 2022. Multi-asset mandates grew by 3% to reach 16% of total assets. LDI mandates accounted for 33% of total mandates down from 36% in 2022, reflecting ongoing changes in asset allocation strategies.

This chapter takes a detailed look at the UK institutional client market. Please note that Chapter 4: UK Institutional Market differs from previous and subsequent chapters of the report in two key respects:

- It covers all assets irrespective of whether they are managed from the UK or offices overseas. We estimate that at least 90% of the assets are managed in the UK.
- The primary focus is on the nature of a mandate rather than on the underlying assets. For instance, a global equity mandate is presented as such, without further breakdown into the underlying constituent countries.

Full details of the asset allocation and investment strategy for the entire institutional market are available in Appendix 2 of this report.

MARKET OVERVIEW

IA members manage £3.9 trillion of UK institutional client assets globally. This is broadly unchanged from 2022 and although assets didn't fall through 2023, it compares with a return to growth of 3% in assets under management overall. Nevertheless, there was a 16% fall in institutional assets between December 2021 and end December 2022. Whilst asset levels are flat in 2023, they have stabilised following the market turbulence of 2022 and the gilts crisis of September 2022, which hit pension scheme AUM particularly hard.

Estimates for UK institutional flows indicate aggregate outflows over the year totalling approximately £80 billion, with money coming largely out of Liability Driven Investment strategies. In 2022, we estimated that there were institutional inflows of £65 billion. As assets haven't fallen in 2023, the overall outflow suggests that client demand in 2023 was weak but that improved market performance helped to maintain assets at 2022 levels.

CLIENT BREAKDOWN

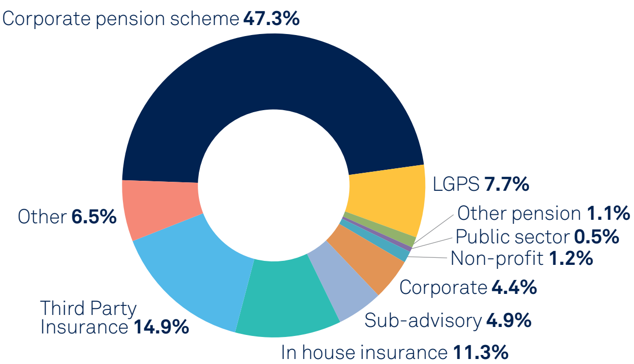
Chart 20 provides a breakdown of the £3.9 trillion by client type. The majority of institutional assets are managed on behalf of pension and insurance clients but corporate pension assets continue to fall as a proportion of institutional assets.

- UK institutional client assets are dominated by pensions and insurance clients (82%) and this remains unchanged year on year.
- UK pension fund assets continue to fall but by a modest 1% from 57% to 56% compared with the major shift in 2022 when assets fell by 5% from 62% in 2021. This was mainly driven by a fall in corporate pension assets, which were down 2% year on year. Growth in Local Government Pension Scheme (LGPS) assets runs counter to this trend, having increased over the year to 7.7% of assets (up from 6.8% the previous year).
- Assets managed for UK insurers rose, increasing one percentage point to 26%. Third party insurance assets were up from 13.9% to 14.9% over the year, whereas in-house assets remained at just over 11% of institutional assets.

Our interviews suggest that in-house insurance assets are set to grow as assets move from being managed for defined benefit pension schemes into insurance buy outs as more DB schemes reach full funding.

"Being owned by an insurance company is fantastic these days, 10 years ago...there's no distribution coming from your insurance parent. Now times have turned, we do have distribution from our insurance parent. The insurers are buying out all the pension schemes so their external client base is shrinking whilst the internal client base is great."

CHART 20: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2023)



Source: The Investment Association

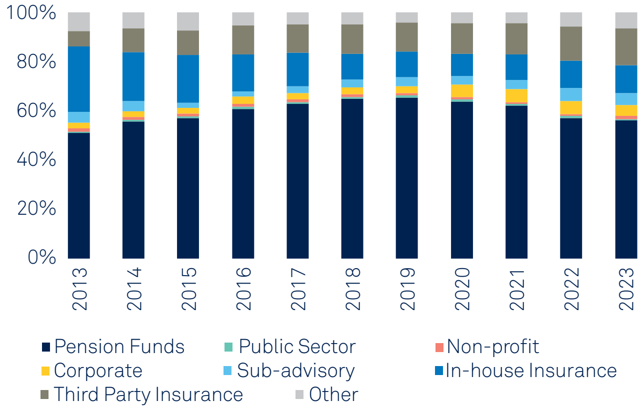
Chart 21 illustrates the change in distribution of UK institutional market assets by client type over the past ten years. Notable trends include:

- **Pension funds:** the proportion of assets taken up by UK pension funds (56%) has fallen year on year since the peak in 2019, when pension fund assets accounted for 65% of UK institutional AUM. The last time pension assets were as low as 56% of AUM was in 2014. Assets fell incrementally in 2023 by 1%, the data show that the share of AUM has remained relatively stable between 2022 and 2023 rather than decreasing substantially.

- **Insurance:** the share of assets managed on behalf of insurers had been progressively falling in the period between 2013 and 2020 from 36% to a low of 22%. From 2022, we have seen steady increases reaching 26% in 2023, the highest reported level in seven years. The 1% growth in 2023 in relative terms of the share of assets reflects a 9% increase in the value of insurance assets.

- **Other client groups:** institutional assets managed on behalf of other clients (including corporate and sub-advisory) has fluctuated between 12% and 18% over the past ten years and rose to 18% in 2022. In 2023, it stands at just over 16%. Much of the growth over this period has come from corporate clients who represent 4.4% of assets (up from 2.4% in 2013).

CHART 21: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2013-2023)



Source: The Investment Association

EVOLUTION OF THE UK PENSIONS MARKET

Using both proprietary IA data and third-party data, this section presents a detailed overview of the UK pensions market, looking at assets managed within both Defined Benefit (DB) and Defined Contribution (DC) schemes and where the asset manager has a direct relationship with the pension fund rather than it being distributed via a wrapped product through an insurance company.

As of December 2023, UK pension fund assets managed by IA members amount to £2.2 trillion unchanged from 2022. Whilst assets have stabilised, we have yet to see a return to growth and pension fund assets remain 22% lower than the £2.9 trillion recorded in 2021. Global data[14] suggest that the recovery in assets in the UK pension market was among the weakest globally in 2023. Of the 22 countries the Thinking Ahead Institute tracks in its annual survey of global pensions assets, the UK's growth in pensions assets was the third lowest compound annual growth over 2023.

IA member managed pension fund assets can be grouped into the following three categories:

- **Corporate pension funds**, which can be either DB or DC schemes, account for the majority of UK pension fund assets and are estimated to stand at £1.9 trillion. Corporate pension funds include an estimated £140 billion managed by Occupational Pension Scheme managers.

- **The Local Government Pension Scheme** is a DB pension scheme with almost 6.5 million members and is responsible for over £300 billion in assets managed by IA members – making it the largest public sector pension scheme in the UK. Using recent market value estimates for the LGPS[15], IA members are responsible for managing approximately 85% of LGPS assets.

- **Other pension funds**, include both DB and DC assets managed for pension schemes that do not fit into either category listed above, such as pension schemes run for not-for-profit organisations. Other pension fund assets account for an estimated £45 billion (equivalent to just 2% of pension assets).

[14] TAI Global Pension Assets Survey, compound annual growth rate in local currency of P22 countries.

[15] According to the Local Government Pension Scheme Advisory Board for England and Wales in its Scheme Annual Report 2023, "total closing net assets for the year end were £354,047 million".

4

SIZING THE MARKET

Given the complexity around the distribution of DC and personal pension products, we cannot provide a breakdown of assets by type of pension fund. Using third-party sources, however, we are able to map out the UK pension landscape and provide estimates for the size of the UK DB and DC pensions markets.

We have broadly split DC pension assets into two categories (Figure 9):

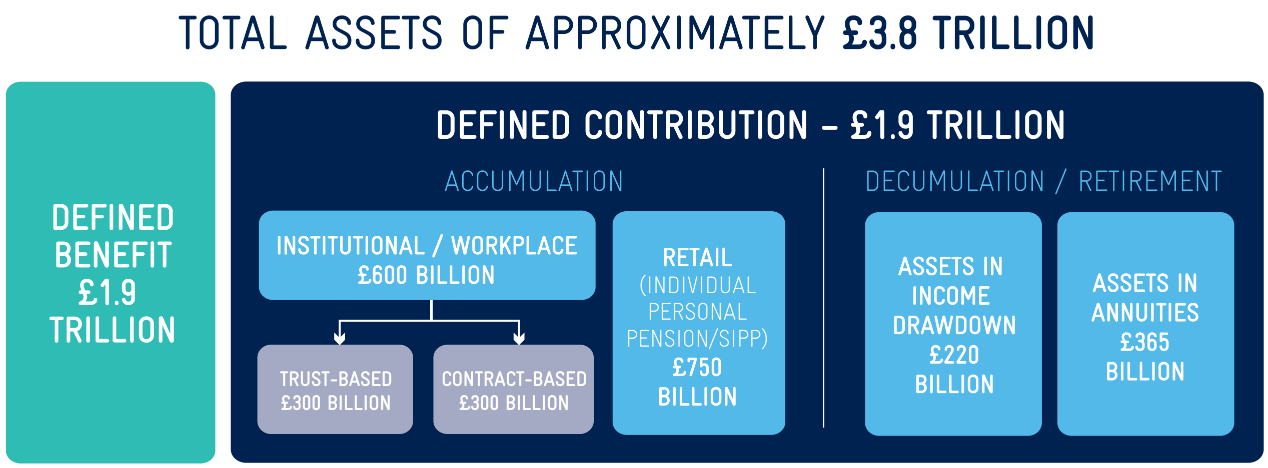
- Assets in the **accumulation** phase of pension saving covers the growth stage over which the aim is to increase the value of contributions made through a workplace pension or a retail pension product until the time of retirement (or drawdown from one's pension pot).

- Assets in the **decumulation** phase pertain to the holdings of retirees who are drawing down their pension savings to generate income during their retirement. This income can be derived through various methods such as income drawdown strategies or the purchase of an annuity, which guarantees a fixed annual income until the end of their life.

Our estimate for the size of the UK pensions market is £3.8 trillion, up 2% from our 2022 estimate of £3.7 trillion but still below the £4.2 trillion recorded in 2021.

- DB pension assets continued to fall in 2023, despite a recovery in capital markets. Total DB assets stood at £1.9 trillion at the end of 2023, unchanged from the previous year, but 21% lower than the level recorded at the end of 2021. In the UK in 2022, the surge in gilt yields following the mini Budget caused gilt prices to plummet. UK DB schemes typically have a high exposure to UK gilts and data from the Pension Protection Fund suggests that in 2022, DB scheme assets fell by 22%. The gilts crisis also led to a 39% fall in liabilities (according to PPF data) and enabled many schemes to look at de-risking options such as pension buy-outs. In 2023, data from Hymans Robertson show that there were a record number of DB pension buy ins and buy outs. Many DB pensions schemes that had become fully funded sought to transfer scheme risk to insurers using insurance-based options such as bulk pension annuitisation. Hymans Robertson reports buy-in and buy-out deals of approximately £50 billion in assets taking place in 2023.[16]

FIGURE 9: OVERVIEW OF THE UK'S PENSION LANDSCAPE (2023)



Sources: The Bank of England, Department for Levelling Up Housing & Communities, Financial Conduct Authority, The Investment Association, MoreToSIPPs, Office of National Statistics, Pensions Policy Institute, Pensions Protection Fund 7800 Index

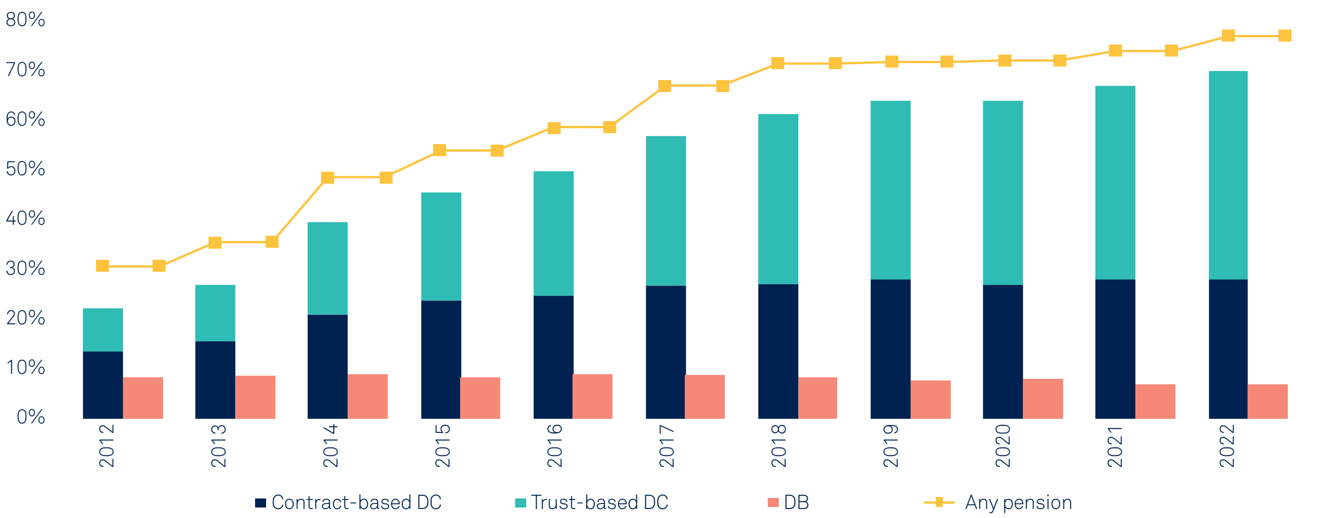
[16] Hymans Robertson, Risk Transfer Report 2024.

- DC assets in the accumulation phase increased in 2023: we estimate that while individual and self-invested assets were marginally up from £725 billion to £750 billion, DC workplace assets managed through trust-based or contract-based schemes increased by 10% to reach £600 billion. DC assets have grown by almost 30% since 2019.
- For decumulation assets, assets in income drawdown were approximately £220 billion at the end of 2023 according to data collected by the FCA. This is unchanged from the level reported in 2022.
- Assets backing annuities, which sit on insurers balance sheets, grew 14% over the year from £320 billion to £365 billion, though the growth was not enough to recover the losses recorded in 2022 when assets fell 25% over the year. Data from the ABI show that annuities are back in vogue-as interest rates increased to 5.25% in 2023, so annuity rates have become more attractive.

Insurers tend to use bonds to back annuities and bond returns are improved by higher interest rates. The attraction of buying an annuity is that it provides a guaranteed annual income for the life of the person taking out the annuity. In 2023, sales increased 46% totalling £5.2 billion, the highest sales year since the pension freedoms were introduced in 2014.[17]

In the private sector, the shift in new members and asset flows has moved toward DC schemes, with DB and DC scheme assets now broadly equal, as illustrated in Figure 9. According to data from the Pensions Regulator, the number of active DB scheme members in employer sponsored private sector schemes was 440,000 in 2022 (the latest data). This is approximately 7% of total DB scheme members in private sector pensions. By comparison, there are around 16 million active DC members. The latest data from DWP on people accessing private pensions show that nearly half (49%) in 2023/24 were taking a lump sum or another DC product, which illustrates the ongoing shift from DB to DC in the private sector.

CHART 22: PENSION PARTICIPATION FOR PRIVATE SECTOR JOBS (2012-2022)



Source: The Pensions Regulator and The Office of National Statistics

[17] The Pension Freedoms removed the requirement in the UK to annuitise at the age of 75. As interest rates were low, the annuity rates that could be obtained were not attractive. Allowing assets to continue to be invested in decumulation enabled portfolios to grow, with the potential to provide a better annual retirement income than annuity rates at the time. The freedoms also gave the option to annuitise when rates became more attractive rather than being forced to take out an annuity by a fixed date.

Chart 22 shows pension participation rates in 2022 for private sector jobs[18] broken down into DC and DB participation. It is based on the number of active members and shows the significant growth in membership of DC schemes, the highest growth in active membership coming from DC master trust schemes:

- Private sector DB scheme participation remains at 7% in 2022. In the decade preceding 2021, participation in DB schemes had fluctuated between 8% and 9%.

- DC pension participation rates have risen from 22% to 70% over the last decade coinciding with the introduction of auto-enrolment for large employers in 2012. The phased roll out meant that by 2017, all eligible employees were automatically enrolled into a workplace pension. Many small and micro schemes were enrolled into NEST, the government backed master trust scheme that has a public service obligation to take on all UK employers and this is part of the reason that active members in master trust schemes are a higher proportion of active DC scheme membership. The latest data on opt out rates from the Department for Work and Pensions show that while opt out rates from active savers remain stable and very low at less than 1%, there continues to be some volatility for new member opt out rates. There was a spike in opt-out rates in 2020 to approximately 11% at the height of the COVID-19 pandemic, up from 8-9%. With members facing sustained cost pressures while inflation remains elevated, the proportion of newly enrolled employees opting out of their workplace pension rose again to 10.2% in 2022 but has fallen back to just over 8% in the third quarter of the 2023/24 financial year.

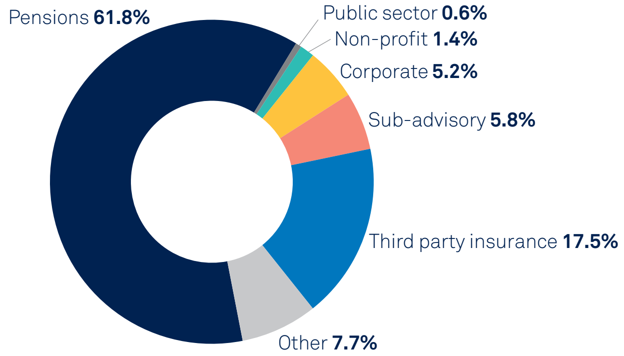
TRENDS IN THIRD-PARTY INSTITUTIONAL MARKET

Full details of the asset allocation and investment strategy for the entire institutional market are available in Appendix 2 of this report. The remainder of this chapter uses IA data to look more closely at the institutional market that is available to third-party clients, that is, excluding mandates managed in-house for insurance parent groups and occupational pension schemes.

Excluding in-house insurance mandates, total third-party client assets managed by IA members globally stands at £3.4 trillion as of 2023. This is up from £3.3 trillion in 2022 but assets have not recovered from a sharp fall through 2022 driven by capital market performance, and in the UK, exacerbated by the gilt market shock in September 2022. Third party client assets remain well below the £4.0 trillion managed at the end of 2021.

In Chart 23, we see that pension fund assets account for an even larger share of the third-party market.[19] At almost two thirds of total assets (62%), this is broadly unchanged from 2022 although this is significantly down from 70% in 2021. Much of the lost share in pension assets has gone to the third-party insurance category which has seen two percent growth to 18% of third-party AUM (up from 14% in 2021). This may be indicative of the rise in DB pension scheme buy-outs where assets would move to be managed by insurers who would either contract mandates in-house or appoint third parties to manage mandates.

CHART 23: THIRD-PARTY UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE (2023)



Source: The Investment Association

[18] All 2022 data in Chart 21 is based on TPR scheme returns as at December 31 2022 except DC workplace contract data, which is based on the ONS ASHE survey data (2021) and where we have assumed no change in the percentage year on year. Data between 2011 and 2021 is based on the ONS ASHE survey, which was last published in April 2022.

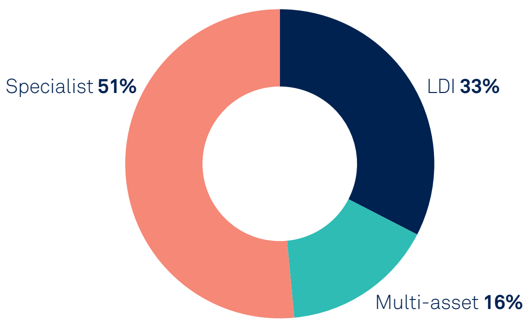
[19] Across all institutional assets pension funds account for 56% of AUM. See chart 23: Third-Party UK Institutional Clent Market by Client Type (2023).

MANDATE BREAKDOWN

Chart 24 breaks the institutional market down into three categories of mandate:

- **Single-asset, or 'specialist' mandates**, which focus on a specific asset class or geographical region. In 2023, assets managed in single asset strategies fell one percentage point to 51% of mandates.
- **Multi-asset, or 'balanced' mandates**, which cover a number of asset classes and regions. Balanced mandates were used in 16% of assets managed by third-party clients at the end of 2023, up three percentage points since 2022.
- **LDI mandates**, which are specifically designed to help clients meet future liabilities. These mandates frequently make greater use of derivative instruments and are therefore included on the basis of the notional value of liabilities hedged, rather than the value of physical assets held in the portfolio. Assets in LDI mandates continued to fall in 2023 accounting for 33% of total mandates, down three percentage points from the previous year.[20] We cover LDI assets in more detail in the next section.

CHART 24: UK THIRD PARTY INSTITUTIONAL MANDATES INCLUDING LDI (2023)



Source: The Investment Association

UK DB PENSIONS SECTOR AND THE STATE OF LIABILITY-DRIVEN INVESTMENT STRATEGIES

Chart 25 shows the total notional value of the assets hedged using LDI strategies over the last decade. LDI assets increased each year from £520 billion in 2013 to a peak of £1.5 trillion in 2021. The notional value of assets has since fallen to £1.1 trillion as of the end of 2023.[21]

CHART 25: NOTIONAL VALUE OF LDI (2013–2023)

Source: The Investment Association

Last year's edition of the survey explained in detail how liability driven investment strategies have played an increasingly important role in managing DB assets as schemes have sought to match investment assets to their future liabilities in order to hedge their interest rate and inflation risk. It also covered the impact of the September 2022 gilt crisis on LDI strategies. Here we summarise the main factors affecting LDI strategies in 2022. For a more detailed analysis, please refer to the Investment Management Survey 2022-23.

[20] The share of UK third- party institutional mandates managed using LDI strategies fell by 4 percentage points between 2021 and 2022.
[21] The number of LDI managers is concentrated so IA data is likely to represent a top range estimate.

The impact of the UK Gilt shock

In September 2022, following the unfunded spending plans proposed in the mini Budget, the yield on UK government debt ("gilts") rose by 130 basis points over three days – an unprecedented rise. The price of gilts moves inversely to the yield, so asset values fell sharply.

This had a significant impact on DB schemes using LDI strategies. DB pension schemes are significant holders of gilts, which offer stable, albeit low returns and regular interest payments with a very low risk of default. DB schemes have, over much of the 21st century, struggled to close their deficits meaning that the assets managed through the scheme are not sufficient to cover scheme liabilties: the guaranteed level of income in retirement for scheme members. To manage this, schemes must find ways to reduce their deficit. As major holders of UK gilts, DB schemes used the gilt repo market to raise cash to invest in higher growth assets such as equities (see Box 6 for a detailed explanation of leverage, collateral and repo in LDI strategies). This involves an agreement with a counter party to sell the gilts for cash on the condition that the gilts are repurchased at a future date for a set price agreed with the counterparty. In order to manage the counterparty risk of defaulting on the agreement to re-purchase the gilts, schemes must post collateral with the counterparty that is retained if the scheme defaults. The level of collateral that is required increases as the value of the gilts falls.

The September 2022 UK gilts shock triggered collateral calls for gilts repo arrangements, commonly used as part of LDI strategies. This meant that schemes had to sell assets for cash to meet these collateral calls or raise further cash via the repo market. In many cases, schemes sold other liquid assets such as corporate bonds and equities but some schemes sold gilts, pushing more gilts onto the secondary market and further depressing prices. However, in other cases some schemes either did not have liquid assets to sell (or chose not to) and instead cut their hedging levels to reduce collateral calls. This was achieved by reducing their exposure to gilt repos, effectively selling gilts. This caused more gilts to flood the market further driving down prices. As a result, we reported a 24% fall in LDI assets on a matched basis in 2022. The data for 2023 suggests that assets in LDI strategies continue to fall, down a further 7% based on a matched sample of respondents.

The fall in LDI assets is not necessarily an indication that pension schemes are moving away from using LDI strategies. Indeed, in the aftermath of September 2022, the Bank of England's Financial Policy Committee worked with the FCA and the Pensions Regulator to increase the resilience of LDI strategies by raising collateral buffers to cover yield increases from 100 bps to around 370 basis points in 2024.[22] Pension schemes are now required to respond to an event that requires recapitalisation within 5 days, speeding up operational timelines and further boosting LDI resilience.

We have also seen scheme liabilities significantly reduced by the rise in long-term interest rates and overall DB pension schemes have benefited from higher gilt yields. 2023 data from the Pension Regulator show that the number of pension schemes with 100% or greater funding levels has risen from 2,565 at the end of 2022 to 3,620 in 2023 and scheme deficits have more than halved over the same period. The Pension Protection Fund measures the aggregate funding ratio of DB pension schemes, which stood at 127% in August 2022 and is 143% as of December 2023.[23]

[22] Bank of England, Financial Stability Report, June 2023.
[23] The PPF's liabilities are lower than the 'technical provisions' measure of liabilities that schemes fund towards, so this is an optimistic picture. The PWC buyout index measures scheme funding ratios at 119% as at December 2023. However, both indices show that funding ratios have risen.

This has shortened the journey to scheme buyout, where the scheme enters into an insurance buy-out arrangement to fully transfer the liabilities from the company balance sheet. This is often done through taking out an insurance policy that passes on the pension scheme's responsibilities to its beneficiaries to an insurer through a bulk annuity arrangement. According to a PWC survey[24] of UK DB pension schemes for almost a third of schemes, the long term funding target is buy-out.

Data from LCP suggest that buy out volumes increased substantially over 2023 to just under £50bn, compared with about £30bn in each of the five years prior. They project pension buy-out volumes to reach c.£400 to £600bn in the next decade, which will see demand in the bulk annuity market rise. Longer term, this would cause assets in LDI strategies to continue to fall, however we would make two observations that could have an impact on the level of assets managed in LDI strategies in the future.

(i) We have reached the top of the interest rate cycle. Further falls may see some of the progression towards buy out unwind and cause some worsening of funding depending on the degree of hedging employed. Whilst TPR research[25] suggests that 55% of schemes have a long-term objective of buy-out, of the schemes wanting to pursue a buy out strategy, 48% have a time-frame of more than 5 years to achieve it when interest rates could look quite different.

(ii) There are moves to encourage schemes to run on rather than go to an insurance buy out. This could happen individually or through a DB superfund. With plans to allow sponsors to capture previously trapped funding surpluses, there is now an incentive for schemes to run on instead of pursuing an insurance buy out option.

CHART 26: DB PENSION SCHEME FUNDING RATIOS (2008-2023)

Source: PPF7800 Index

[24] https://www.pwc.co.uk/pensions/insights/uk-defined-benefit-pensions-survey.html.
[25] The Pensions Regulator,Defined Benefit Schemes Survey Research Report.

BOX 6: WHAT IS LDI?

Liability-driven investment (LDI) is an investment strategy that Defined Benefit (DB) pension schemes use to manage the financial risks they face in their provision of pension benefits.

LDI strategies invest in assets that have interest rate and inflation sensitivities which broadly match those of the scheme's liabilities. This strategy ensures the scheme's funding position (i.e. the difference between its assets and liabilities) remains more stable as it is hedged against movements in interest and inflation rates. Such liability hedging is a normal part of risk management by DB schemes and has been extensively used in the UK with the approval and encouragement of regulators.

The role of leverage, repo and collateral

Gilts are heavily used in LDI strategies as they provide exposure to interest rates and inflation without introducing significant additional risks. However, underfunded DB schemes also need to invest in growth-seeking assets to close any deficits. In order to have sufficient money to invest in these assets, schemes use leverage to gain greater exposure to the gilt market, freeing up more money for investing in growth assets. One way for DB schemes to create leverage is by entering into gilt repo agreements, under which they sell gilts to a counterparty in exchange for cash and an agreement to repurchase those gilts at a pre-agreed price in the future. The cash they receive can then be invested elsewhere, for example in growth assets such as equities or in more gilts.

The repo facilitates exposure to the change in the value of gilts which schemes seek in order to gain the exposure to interest rates and inflation to match that of their liabilities. However, in entering into this agreement, both sides in the transaction face the risk of the other party failing to complete the agreement at its termination. This counterparty risk arises because as the price of the gilts in the repo changes, the pre-agreed re-purchase price becomes more or less attractive to one or other of the parties.

To mitigate this counterparty risk, collateral must be posted as the repo position changes in value. The party for whom the repo agreement has become less valuable will post collateral which will be retained by the other party in the event that the counterparty fails to re-purchase the gilts. The amount of collateral required to cover leveraged LDI positions has generally been low and relatively predictable as gilt yields do not typically change significantly over short periods of time. However, in extreme market conditions collateral calls can be higher than expected.

MULTI-ASSET VS. SPECIALIST MANDATES

Given that LDI strategies are used almost exclusively by DB pensions, their inclusion in the data can mask some interesting trends in the broader market. The analysis presented in this section excludes the value of LDI mandates to allow us to uncover some of these trends.

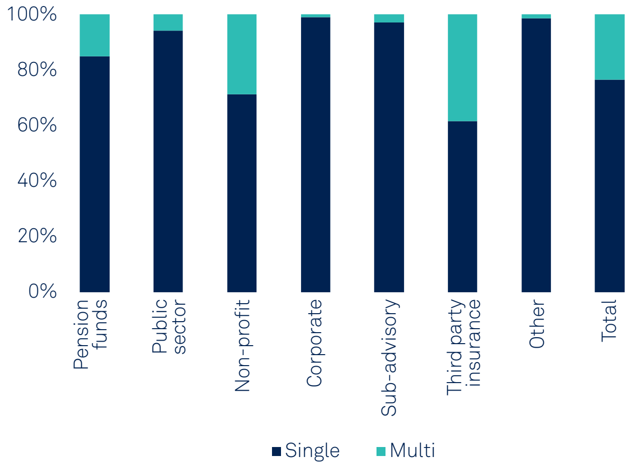
- UK institutional clients continue to have a strong preference for single asset or specialist mandates, which make up 76% of all third-party mandates, excluding LDI. Over the long term, single asset mandates have dominated but we have seen the proportion of mandates managed on a single asset basis fall by four percentage points in 2023 as a higher proportion of assets are managed in multi-asset mandates.

- The data show that the rise in the proportion of assets managed using multi-asset mandates has occurred across different client groups with the highest share of multi-asset mandates being managed on behalf of third- party insurance clients and non-profit organisations (29%)

- The use of multi-asset mandates is most prevalent among third-party insurance clients, accounting for almost two fifths (39%) of assets managed for this group, it is also where the biggest shift has occurred year on year, increasing from 34% in 2022.

- A high proportion of pension fund assets are managed in single asset mandates but the proportion managed in multi-asset strategies rose by 2 percentage points year on year to 15%.

CHART 27: UK THIRD-PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST (2023)

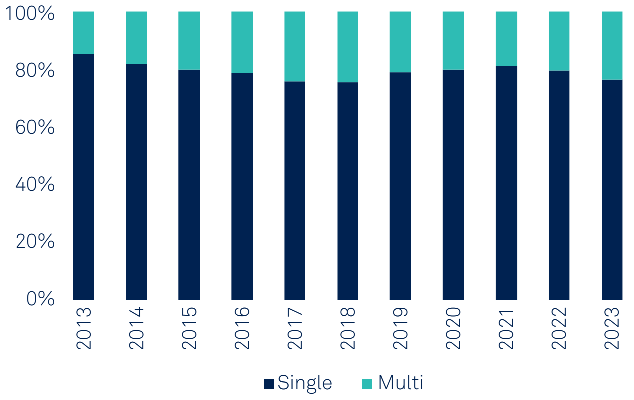


Source: The Investment Association

Chart 28 (overleaf) shows that whilst multi-asset mandates have always made up a smaller proportion of the assets managed for third-party institutional clients, there was a steady rise in the share of multi-asset mandates between 2013 (13%) and 2018/2019 when multi-asset mandates accounted for 24% of client mandates. Some of this growth may be attributed to DC pension default arrangements making greater use of multi-asset mandates.

From 2020, we saw this trend reverse as the share of multi-asset mandates fell to 19% in 2022. Growth in multi-asset mandates used by default funds halted and many pension schemes have opted for investment consultants to build allocation strategies using single asset mandates rather than using multi-asset mandates where investment managers set the allocation. 2023 marks the first year since 2018 that we have seen growth in the share of assets managed through multi-asset mandates, albeit incremental growth of one percentage point. The most significant growth has been in the use of multi-asset mandates by third-party insurance clients. Third party insurers are not required by law to take investment advice from consultants, unlike pension schemes, which may mean that they have more freedom to use multi-asset strategies. New product launches using the LTAF structure have also mainly been multi-asset strategies and longer term, as more LTAFs are launched, this could support growth.

CHART 28: UK THIRD-PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST (2013–2023)



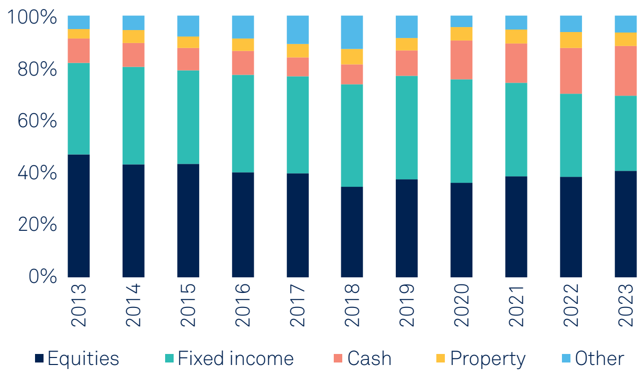
Source: The Investment Association

ASSET ALLOCATION TRENDS WITHIN SPECIALIST MANDATES

Chart 29 shows a breakdown of specialist or single strategy mandates by asset class over the last ten years.

- The share of assets in **fixed income mandates** continues to fall, now accounting for 29% of assets managed through specialist mandates. This is the lowest level recorded in our data, down from a peak of 40% in 2019 and represents a fall of 3% from 2022. This suggests that in 2023, the performance of fixed income mandates had not yet recovered from the challenging market conditions for bonds in 2022.
- Whilst higher interest rates continued to affect the performance of equities in 2023, with a challenging outlook for equity growth strategies, if a globally diversified equity mandate matched the return of the MSCI World benchmark, it would have returned 16% in 2023 as markets recovered from 2022. The share of assets in **equity mandates** increased 3 percentage points in 2023 to reach 41%.
- The increasing use of specialist **cash mandates** among UK institutional clients continues for the sixth year in a row, accounting for 19% of all assets in single asset third party mandates. Market turbulence in recent years has increased the demand for liquidity and UK institutional clients have been through a number of notable liquidity stress periods over the last decade including the Brexit referendum in 2016, the 2020 'Dash for Cash' and the 2022 gilt crisis. In 2023, LDI pooled funds are also now required to hold a higher cash buffer level, moving from a 100 bps buffer to 370 bps. It's reasonable to assume that some of this increase is being held in cash-like strategies such as money market funds.
- The proportion of assets in **other specialist mandates** increased marginally from 6.3% to 6.5%. This was largely driven by an increase in allocation to private debt and infrastructure.

CHART 29: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2013-2023)



Source: The Investment Association

Asset allocation patterns differ quite substantially across different segments of the institutional market as each client segment has differing long-term investment objectives. Chart 30 highlights some distinct differences in the asset allocation profiles for each client group:

- Pension funds and third-party insurers have similar asset allocation profiles. Both invest just over a third of assets in fixed income strategies. Pension funds allocate 42% of assets to equities with third-party insurers allocating 50% to equities. Both client groups saw marginally higher allocations to equities compared with the previous year and insurance clients saw a five percentage point fall in the allocation to fixed income.

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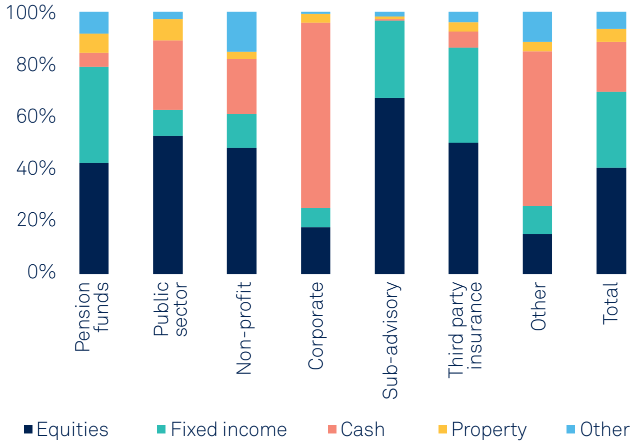
- Corporates hold a substantially higher proportion of highly liquid assets for cash management purposes with almost three quarters (71%) of assets invested in cash in 2023, which is up from 65% in 2021.

CHART 30: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2023)



Source: The Investment Association

Defined benefit (DB) schemes still make up the vast majority of UK pension assets, although the number of DB schemes has fallen by 68 over the last year from 5,131 to 5,063 schemes eligible to use the Pension Protection Fund (PPF). This is as a result of schemes winding up, schemes merging and some schemes entering the PPF assessment period.[26] We use data collected by the PPF to look at the asset allocation patterns of funded DB schemes more closely and at how allocation has changed over the last twenty years. The latest data shown in Chart 31 is as of 31 March 2023 and shows the weighted average allocation of assets by DB schemes.[27] This data captures the impact of the market turbulence in 2022, precipitated by the Russia/Ukraine war, and the gilts market shock in September 2022:

- Fixed income has fallen as a percentage of assets year on year from 72% to 69%, the highest fall of any asset class. Bond prices fell across 2022 following rising yields as central banks raised base rates. The highest fall in fixed income AUM came from index-linked fixed interest, which fell by 4%. The gilt shock in September 2022 is also a factor and government fixed interest fell by 2.5% as a proportion of fixed income assets. However, corporate bond allocations in fixed interest portfolios rose by over 6% year on year.

- Assets in equities also fell by 1.5% to 18.0% overall. Rising interest rates create challenging market conditions for equity strategies, which had also benefited from QE through the previous decade. Within equities, assets allocated to private equity grew as a percentage of total AUM to 5.3%, up from 4.2% the previous year – private equity assets now represent a third of equity AUM in DB schemes, up from 12% five years ago. The growth in share of private equity assets may in part be due to a lag in private equity valuations compared with listed equity, which mean that asset values are higher and we could see a re-balancing across private and public equity in coming years. UK listed equities have fallen further and are now down to 1.4% from 1.7% in 2022. UK listed equities as a percentage of equity AUM account for 7.6%, significantly below the 20% allocation for total industry equity AUM (See Chapter 3).

The year 2022 marked the end of an economic cycle that had started during the Global Financial Crisis in 2008 and was characterised by low interest rates and a cycle of quantitative easing by central banks. These conditions favour strong equity performance. Market conditions have had an impact on DB scheme allocation patterns but over the longer term, so does the age profile of DB scheme members. As many schemes have closed to new joiners, scheme members are ageing and regulatory requirements have driven a higher allocation to fixed interest. In 2001, allocation to fixed interest was just 20% of total assets whereas allocation to equities was 71% of AUM.

In 2023, fixed interest accounted for two thirds of assets and equity fell to just under a fifth of DB scheme AUM.

[26] The PPF assessment period occurs when an employer becomes insolvent and the fund assesses whether the defined benefit pension scheme will receive compensation. It typically runs for 2 years.

[27] Whilst PPF data counts cash and property under other investments in the Purple Book, we have broken these asset types out in the chart. Other excluding property and cash represents assets in annuities, diversified growth funds, absolute return strategies and miscellaneous.

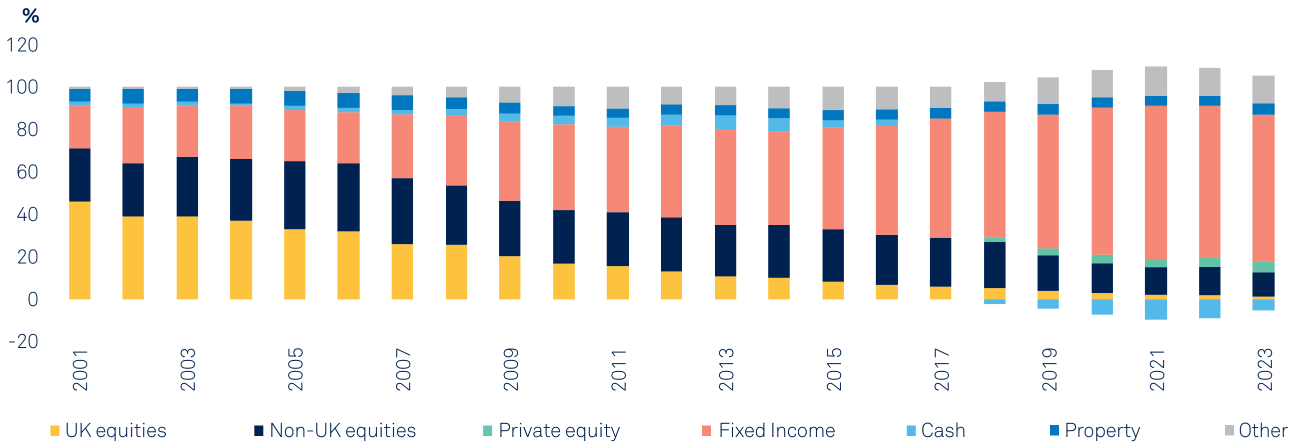
We observe two important long-term trends within these asset classes:

- UK DB schemes were heavily invested in equities in 2001, making up 71% of total assets, of which 46% was invested in UK equities. By 2023, the total equity allocation had fallen to 18% with UK equities accounting for 1.4% of total AUM and 7.6% of equity AUM. The fall in allocation to UK equities has happened across the institutional and retail markets. UK equities have underperformed other global equity markets over the longer term, although in 2023 the relative performance of the UK has improved. This is a factor in the fall in allocation but the main driver of this trend is a move to de-risk portfolios through more global diversification.
- Over the long term, DB schemes have looked to manage inflation risk by allocating a higher proportion of assets to index-linked fixed interest, which are linked to an underlying consumer or retail price index. Index-linked bonds are 44% of fixed income assets up from 34% in 2008. Government bonds (excluding index linked) have fallen to 19.5% from 33% over the same period.

Whilst DB scheme assets make up the majority of pension fund assets, defined contribution pension schemes have seen significant growth as more DB schemes outside the public sector close to new joiners and as UK working adults are automatically enrolled into DC pensions. Chart 32 compares the asset allocation of DC savers in the accumulation phase of pension saving, with 30 years to retirement, with savers that are 5 years away from retirement and the final cohort of savers who are at retirement. This chart is based on the average asset allocation for master trust and group personal pension default fund strategies and the data is derived from the Corporate Adviser Master Trust and GPP Defaults report.

- **At retirement:** 31% of assets are invested in equities for DC savers at retirement. The share of overall allocation to UK equities is just 2.35% with overseas equities making up the lion's share at 28.2%. Fixed income makes up 43.0% of allocations – corporate bonds (27.2%) are the highest bond allocation for DC savers at retirement but allocations to government bonds (11.7%) and index-linked bonds (4.1%) are also higher than allocations for savers with 5 years until retirement. Savers have the option to take their 25% cash lump sum from their pension at retirement and the allocation to cash is high at 16.5%.

CHART 31: UK DEFINED BENEFIT SCHEME ASSET ALLOCATION (2000–2023)

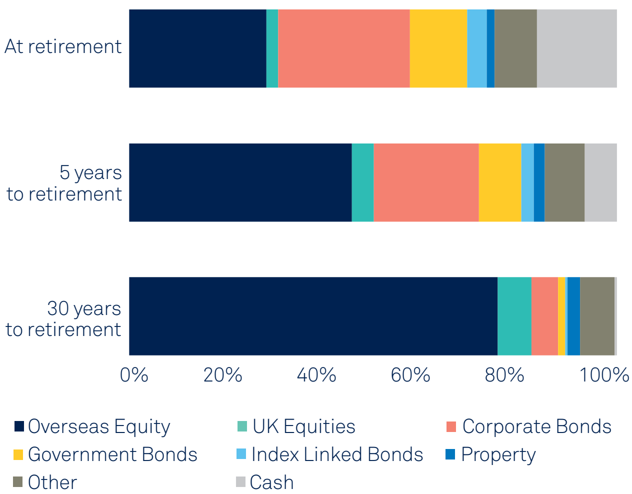


Sources: UBS Pension Fund, Pension Protection Fund – The Purple Book 2022.

- **5 years to retirement:** The allocation to equities is beginning to reduce as pension funds move to limit the impact of equity market volatility on the value of pension pots near retirement. Equities are 50.2% of assets, just over 30% lower than the allocation to equities for savers 30 years from retirement. Overseas equities account for 45.7% of total allocation. Fixed income now makes up a third of assets and corporate bonds are 21.6% of overall allocation, the highest of the three bond types. The proportion invested in cash is 6.6%.

- **30 years to retirement:** For these savers, the main objective is to deliver the best risk-adjusted growth for a cohort with long retirement horizons. The vast majority of assets are allocated to overseas equities at 75.6%, which also provides good diversification across different regions and helps to manage risk. UK equities make up just 6.9% of assets. Corporate bonds are again the largest category of bond but are just 4.5%. The allocation to fixed income is 7.4% overall and cash makes up just 0.5% of the portfolio. Allocations to property are 2.5% and 'Other' represents 7.1%. The allocation to property and 'Other' remains steady across all three cohorts.

CHART 32: UK DEFINED CONTRIBUTION SCHEME ASSET ALLOCATION (2023)



Source: Corporate Adviser, Master Trust & GPP Defaults report,

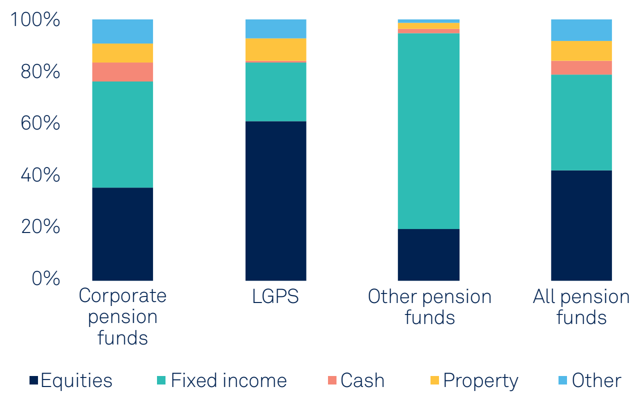
Local Government Pension Scemes (LGPS) are DB schemes that are open to new members. We can compare the asset allocation of the LGPS with the asset allocation of corporate pension funds, which represent a mix of assets managed through DB and DC schemes but where DB assets make up the largest proportion.

- LGPS have a significantly higher weighting to equities (61%) than fixed income (22%). This is far higher than the 18% allocation to equities by DB schemes overall (See Chart 33). LGPS remain open to new members and so have a younger age profile with longer retirement horizons. This allows the LGPS to make greater use of equity strategies to drive asset growth to meet long term funding needs. The LGPS also operate under a different regulatory framework and don't need to match assets to liabilities –LDI strategies are not used by LGPS.

- Corporate pension funds in this chart represent both DB and DC assets and have almost double the proportion invested in fixed income (40%) and almost half the proportion invested in equities (36%) compared with the LGPS. This higher allocation to fixed income indicates that private sector DB assets currently make up a higher proportion of corporate pension fund assets than DC.

- The equity allocation of corporate pension funds is up by 3% over the year. Fixed income allocation has fallen by 2%. This is likely to be related to market performance but we will see a shift in the balance of the assets of corporate pension funds as DC schemes become a more significant component.

CHART 33: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS AMONG UK PENSION FUNDS (2023)



Source: The Investment Association

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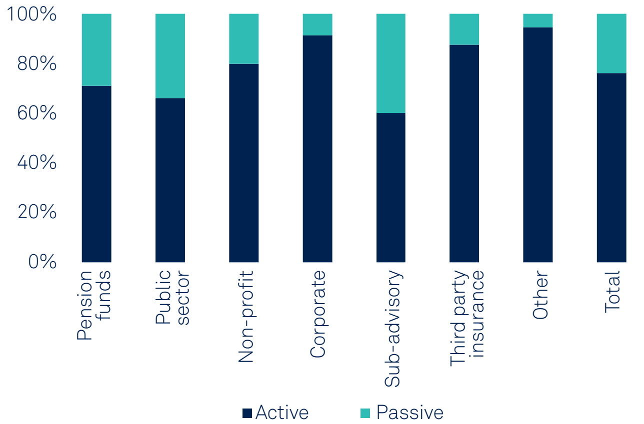
ACTIVE VS. INDEXING

Growth in indexing strategies has been a stand out trend in the investment industry over the last ten years as investors have opted for low cost exposure to equity and fixed income indices. Passive AUM now stands at 32.4% of total industry AUM. However, growth in indexing strategies has been slower for mandates managed on behalf of third party institutional clients. Overall, indexing strategies account for 24% of assets and we have seen a fall of 6% year on year as active strategies reach 76% in 2023. Over the five years preceding 2023, active assets had fluctuated between 72% and 69% of third party institutional mandates.

Pension funds and sub-advised mandates remain the client types with the highest allocation to indexing strategies at 29% and 40% respectively. We have also seen a notable increase in indexing strategies managed on behalf of the public sector through 2023 to 34%. This is partly to do with structural changes in the way that assets are managed on behalf of public sector schemes. Indexing assets remain outside the LGPS pooling process, mainly because they are already very low cost and so there is little cost advantage in driving scale through pooling. The pooling process means that the LGPS legally becomes the asset manager and then appoints investment managers to manage assets on their behalf. This is having some impact on the reducing proportion of active third-party mandates managed for public sector schemes.

CHART 34: ACTIVE AND INDEX THIRD-PARTY MANDATES BY CLIENT TYPE IN 2023 (SAMPLE ADJUSTED)



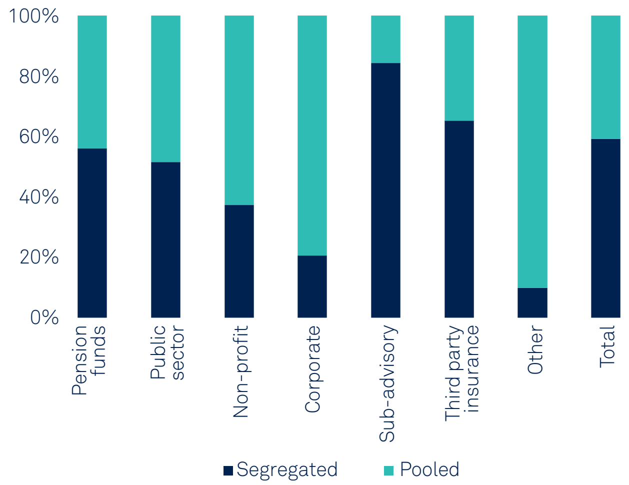
Source: The Investment Association

SEGREGATED VS. POOLED

Segregated mandates continue to account for the majority of assets managed on behalf of third party institutional clients at 59% compared with pooled assets[28] (41%). However, we have seen a rise of 8% in the proportion of pooled assets between 2022 and 2023. Growth in pooled assets occurred across every client segment barring sub-advisory.

One of the advantages of segregated mandates is that they offer a bespoke asset allocation approach for third party clients. However, for larger pension schemes, a fund of one structure is becoming increasingly popular. The fund is bespoke to the pension scheme but gives the protection of being invested in an authorised vehicle as well as being simpler to administer because it does not require a separate relationship with a custodian. We count this structure as pooled in our data and the growth of the fund of one structure is contributing to the increase in the share of pooled assets for pension schemes, which is now 44%. Not all pooled strategies are bespoke, however, and the high proportion of pooled mandates run for corporate and non-profit clients may reflect a focus on using scale to bring down costs over a bespoke segregated mandate approach.

CHART 35: SEGREGATED AND POOLED MANDATES: THIRD-PARTY INSTITUTIONAL CLIENTS (2023)



Source: The Investment Association

[28] Pooled assets can be run through mandates or funds. As part of the LGPS pooling process some LGPS have chosen to create their own pooled funds and are FCA regulated investment managers.