Investment Management Review

SHAREHOLDERS WRONGLY BELIEVED TO BE THE OWNERS OF COMPANIES

Rethink indicated for investors’ stewardship and shareholder value (p.10)

Plus

REGULATORS MIGHT RESHAPE ASSET MANAGEMENT (pp.16,18,21 + editorial)
Threat to business models and margins feared

A STEP CLOSER FOR THE FINANCIAL TRANSACTION TAX (p.12)
Capital market players might not be ready
FROM THE EDITOR:

DISRUPTION OF ASSET MANAGEMENT

Asset management is set to groan under the weight of multiple pressures that might radically change its current shape in the next decade or so. Two forces are exerting a pincer effect: exchange-traded funds (ETFs) pushing from below and regulatory changes pressing down from above.

The rapid growth of the ETF sector is already transforming the fund industry. Some traditional groups have had to disregard fears of cannibalising their own higher margin active offerings in joining the ETF bandwagon. It is not out of court for the ETF industry, already having around $3tn under its belt, to double or even treble in size over the next ten years, as the momentum shows no sign of slowing.

The shift towards passive is clearly a driving force behind ETFs, and their cheapness is a compelling feature. With the top ETF providers cutting fees to as low as three basis points, industry-wide revenue pressures can only intensify.

ETFs comprise a direct threat to the active sector on another front. In expanding into Europe with cheap active ETFs, Vanguard is now taking on the mainstream industry. This move highlights the growing belief that active ETFs are the next big thing in the sector.

Increased adoption of smart beta products is another factor militating in favour of ETFs, particularly the active variety, continuing to capture market share.

Potential regulatory pressure will be more indirect. It is unlikely that the authorities will pronounce explicitly on fee levels, as it requires judgment that is outside their remit. But there is plenty else they could do. More disclosure, when required, will be a major contributor, as clients’ understanding what is happening could lead to their demanding lower fees.

The uncertainty of turnover levels, which has a direct bearing on true costs, might be considered a defence by asset managers against the charge of inadequate fee disclosure. But they could at least have a stab at predicting turnover levels. A possible side effect is that the fund industry might have to answer searching questions requiring justification of these levels.

The nascent growth of robo-advisers is an incipient, albeit not immediate, danger. Inevitable consolidation, creating a few large groups with muscle instead of the current fragmented sector, could be more ominous for the fund industry.

So what might the next ten years bring? Compared with ten years ago, seven of the top ten global players have remained in the ranks, with the notable dropouts being the two Swiss giants, UBS and Credit Suisse. The forces currently at play might alter business models and fee structures beyond recognition. It would be surprising if as many as seven of the current top ten stay in the list.

Changes in the pecking order are more than likely, with Vanguard taking top spot. Other companies that show promise of climbing up the ranks include Amundi, PGIM and Goldman Sachs Asset Management. In its quiet way, Legal & General Investment Management has been producing very good growth on the back of its long-term investment philosophy, implemented outside the traditional areas, and it could be a star of the future. Fidelity, on the other hand, would do well to hold on to its current position, with its active assets draining away gradually under the onslaught of the passive movement.

To date, fund management has been spared the disruption that has hit several other industries, but this situation may not persist over the next decade. The long predicted consolidation of the asset management industry could be on the way and it is perhaps time for most fund companies, even BlackRock, to fasten their seat belts.

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A SNAPSHOT OF THIS ISSUE

REVIEWS OF WHAT OTHERS HAVE SAID

THREAT TO EUROPEAN ASSET MANAGEMENT FROM TOP US FUND HOUSE
An aggressive move by the top passive provider, Vanguard, into active fund management in Europe is set to squeeze the European asset industry further.

REGULATORS MIGHT RESHAPE ASSET MANAGEMENT (THREE RELATED ARTICLES AND EDITORIAL)

REGULATORY SPOTLIGHT ON ASSET MANAGEMENT FEES
Two different authorities, the European regulators and the Irish Central Bank, are potentially exerting downward pressure on European fund fees, considered too high by many.

UK REGULATOR THREATENS TO CAUSE UPHEAVALS IN ASSET MANAGEMENT
The UK’s Financial Conduct Authority has embarked on a sweeping study of asset management, causing alarm in the industry about serious threats to business models and profitability.

INVESTMENT CONSULTANTS UNDER THE MICROSCOPE
The Financial Conduct Authority has brought within its sights the workings of investment consultants who advise pension funds in the UK, a move widely welcomed by many in the industry concerned about their excessive power.

THREE NORTH AMERICAN HOUSES EXPANDING GLOBALLY
Three disparate North American fund management groups hitherto relatively obscure have every chance of reaching the very top ranks of the global industry.

LGIM STARS AMONG WINNERS AND LOSERS
Many leading companies close to the top ranks have mirrored 2015 market trends in their individual fortunes. Legal & General Investment Management (LGIM) stands out for its long-term philosophy, achieving good results and setting an example to the rest of the industry.

BLURRING BETWEEN DISTRIBUTOR AND FUND MANAGER ROLES
Edward Jones, a new entrant to the list of mutual fund families in the US, is making waves. In addition to the distinction of attracting higher recent inflows than most other fund groups, it is also remarkable for being neither distributor nor fund manager but effectively a hybrid.

FRENCH FUND MANAGEMENT BACK TO LIFE
Following seven years in the doldrums, the French market is in an expansionary mode, but the environment remains tough for asset managers.

HIGHER PROFILE FOR GERMAN BOUTIQUES
The investment boutique sector in Germany, while lacking the profile of its counterparts in London and Paris, is beginning to be taken more seriously. German investment firms have figured prominently in the list of the top 20 strongest boutique brands in Europe.

PRIVATE EQUITY BUZZING AROUND FOOTBALL HONEYPOT
Until recently, only the foolhardy or the super-rich would have considered backing UK football clubs, given their habitual tendency to make huge losses and even go bankrupt. Matters are now different, with a turnaround in their fortunes attracting hard-nosed private equity groups.

TOP INVESTORS SUING VOLKSWAGEN
Top investors and fund managers are in the process of going ahead with legal action against the leading car maker Volkswagen, following the scandal that emerged in 2015.

SHAREHOLDERS WRONGLY BELIEVED TO BE THE OWNERS OF COMPANIES
The generally accepted concept that shareholders should control companies and the idea of shareholder value are both undermined by eminent legal authorities asserting that the shareholders do not actually own companies.

A STEP CLOSER FOR THE FINANCIAL TRANSACTION TAX
A breakthrough in December by European finance ministers who support the financial transaction tax increases the likelihood of its implementation by June this year. Capital market players would be wise to prepare for it, though major obstacles remain.
**FUND MANAGERS ACCUSED OF YET MORE PRICE FIXING**

The competition between banks has been termed phony, with fund groups supposed to be influencing the banks not to compete on prices.

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**LEADING US WIRE HOUSES UNDERGOING TRAUMATIC TIMES (TWO RELATED ARTICLES)**

**ADVISERS DEPARTING WITH CLIENTS HITTING TOP US WEALTH MANAGERS**

The top brokerage houses in the US are approaching an important junction in the aftermath of the financial crisis, as they grapple with the risk of large numbers of their financial advisers departing to set up their own firms.

**BIG FOUR US WEALTH MANAGERS IN DECLINING TREND**

While the expiry of retention deals risks large outflows of client assets, the top four US wire houses have already been suffering a gradual erosion in their wealth management activities.

**MISUSE OF DISCOUNT RATES**

The valuation of future cash flows, implicitly or explicitly using discount rates, is a central aspect of much investor activity. Yet serious flaws are prevalent in the way discount rates are applied in financial markets, business projects and other areas.

**CHANGING OF THE GUARD AT THE TOP OF THE INDUSTRY**

In considering what might happen to the top ranks of the global industry in the next ten years, it might be worthwhile to consider what happened in the past ten.

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**CONTRIBUTIONS FROM INDUSTRY EXPERTS**

**REGULATORY SPOTLIGHT**

**REGULATORS TIGHTEN FIDUCIARY STANDARDS**

Dr Wolfgang Mansfeld, former President of the European Fund and Asset Management Association (EFAMA), outlines four different areas where regulators are likely to impose stricter fiduciary standards on the fund management industry.

**NEW FUNDS HELP REDEFINE ESG AND SUSTAINABLE INVESTING**

Jag Alexeyev, Founder of Impactvesting and former Head of Global Research at Strategic Insight, charts the growing involvement of fund managers in impact investment, pointing to several new products that have expanded the range of ‘sustainable’ fund management offerings by main stream financial providers. Previously, innovation had been carried out mainly by investment specialists and boutiques.

**RECORD INFLOWS FOR ALTERNATIVE INVESTMENT IN EUROPE AND CROSS-BORDER**

Bryan Liu, Managing Director, Global Research at Strategic Insight, details the growing popularity of alternative UCITS and Liquid-Alt mutual funds that mainly use hedge fund type strategies but are more liquid and transparent. Net sales of these products in Europe and cross-border during 2015 set a new record.

**INDUSTRY PERSPECTIVES IN FIGURES**

This section provides a statistical perspective on the key trends in important sectors of the asset management industry: mutual funds, pensions, insurance, exchange-traded funds, hedge funds and private equity. Figures in billions and trillions are bandied around. Comparisons put them into perspective.
BLURRING BETWEEN DISTRIBUTOR AND FUND MANAGER ROLES

Edward Jones, a new entrant to the list of mutual fund families in the US, is making waves. In addition to the distinction of attracting recent inflows higher than most other fund groups, it is also remarkable that this fund provider would not be classified as a proper fund management house. It is actually a chain of financial advisers. In introducing its Bridge Builder family of funds, it has blurred the boundaries between distributors and asset managers.

It is common for financial advisers to establish portfolios for their clients which are then invested in funds offered by the traditional fund provider groups. What is different is that the Bridge Builder funds do not invest in other funds but employ money managers directly as sub-advisers to manage their portfolios so that the brand name for fund management...
remains with Edward Jones. This makes the chain somewhat of a hybrid between a proper fund manager and a distributor, with the lines being blurred (see box).

In introducing its Bridge Builder family of funds, it has blurred the boundaries between distributors and asset managers.

Sub-advisers
Very few fund management groups possess expertise across all asset classes. It is common practice to subcontract the investment management of a portfolio in a sector where a fund manager lacks expertise to a third party fund manager who is able to handle the speciality sector. The original fund manager markets the fund under its own brand and the third party fund manager is only a subcontractor. There is a parallel here with supermarkets selling under their own brand the products of other suppliers.

A point that is salient to Edward Jones offering good value is that it is able to negotiate fees downwards by employing the fund managers directly rather than buying their mutual funds. There is another advantage in following this route. Previously, only fund groups that provided mutual funds could be accessed for their investment expertise. The Edward Jones hybrid model makes available the investment expertise to a third party fund manager who is able to handle the speciality sector. The original fund manager markets the fund under its own brand and the third party fund manager is only a subcontractor. This new entrant enjoyed more inflows in 2015 than much more well-known groups such as Fidelity, BlackRock and American Funds. The first fund was trialled by Edward Jones as recently as 2013. Since then it has launched seven more funds in fixed income and equity. Within months of launching these seven bond and equity vehicles it attracted more than $15bn, and only three other fund groups surpassed it in terms of net inflows in the first 11 months of 2015, according to Morningstar. These were Vanguard, the smart beta fund specialist Dimensional Fund Advisors, and MetWest, a fixed income manager that gained clients from Pimco on account of the latter’s travails.

These moves come at a time when advisers are shifting from commission payments to charging fees. There is increased regulatory pressure, such as the US Department of Labor’s new fiduciary standard for retirement savings advice. Jim Weddle, the managing partner of Edward Jones, feels that the curtailment of commission-based options because of the fiduciary standard will be more expensive for some clients. Referring to the much talked about threat from robo-advisers, he is not too concerned as long as the traditional intermediaries have technology of their own. An important development in the advisory industry is that American baby boomers are set to transfer $30tn to retirement savings advice. Jim Weddle, the managing partner of Edward Jones, feels that the curtailment of commission-based options because of the fiduciary standard will be more expensive for some clients. Referring to the much talked about threat from robo-advisers, he is not too concerned as long as the traditional intermediaries have technology of their own. An important development in the advisory industry is that American baby boomers are set to transfer $30tn to their offspring in the coming decades.

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Editor’s comment
Edward Jones is unusual in another respect. The US industry is relatively mature, and new entrants who are successful on the scale of Edward Jones are not around every corner. New successful fund groups are far more prone to arise in the newly developed markets of Europe and Asia, where the fund management industry is by and large no more than a decade or two old in their current form. These include even the large markets such as France and Italy.

This new entrant has enjoyed more inflows in 2015 than much more well-known groups such as Fidelity, BlackRock and American Funds.

Against a background of expected low returns for years to come, both fund managers and distributors will be subject to excruciatingly painful competitive forces, squeezing revenue and margins for different reasons. Fund managers are being hit by the move to passive and the downward pressure on fees. The world of distributors is being churned by several forces, including the need for more technology to fend off robo-advisers, the shift from commission to fees and increased regulatory oversight.

Under these conditions, any fund provider who follows a formula for reducing costs as Edward Jones has done is more likely than not to do well. The Edward Jones model represents a departure from the traditional fund type. It is working like a dream and many imitators can be expected.

‘Edward Jones shakes up US mutual funds industry’, Stephen Foley, Financial Times, 04.01.16
FRENCH FUND MANAGEMENT BACK TO LIFE

Following seven years in the doldrums, the French market is in an expansionary mode, in the view of key industry leaders such as Yves Perrier, Chief Executive of Amundi, the largest asset manager in France and the tenth largest globally. His opinion represents a turnaround for somebody who has downplayed the future importance of France to Amundi. Instead he has described Europe as the group’s domestic market, with Asia the all-important second front.

Though the atmosphere is positive, the French market remains very competitive. It is not surprising that two of its largest asset managers, Amundi and Natixis Global Asset Management (NGAM), have set their growth sights pointing firmly to outside France.

The problem for the smaller fund managers in the country is that distributors prefer to deal with larger groups. The solution that is suggested for the smaller specialist companies is to attach themselves to large multi-boutique houses, for which France is a major base. These include NGAM and BNP Paribas Asset Management.

While their specialist expertise is of value to the multi-boutique parent, the fledglings also gain from exposure to the distribution and global reach of the larger firms. In 2015, NGAM bought a 70% stake in DNCA Investments, which has €17bn assets under management (AUM), mainly in European equities. According to Pierre Servant, Chief Executive of NGAM, DNCA has a desirable feature of not being affected by the market going up or down. It has about 30% of its assets in Italy, and in receiving €5bn of inflows in 2014 was second only to Amundi.

Another acquisition by NGAM was Ossiam in 2011. This company is a pioneer in smart beta exchange-traded funds (ETFs) in France, having started in 2009. It is now diversifying away from the ETF sector and aiming at pension funds that want customised funds rather than ETFs. NGAM’s business is derived mostly from outside France, with a distribution network bought in the US having paid off. Servant shares Perrier’s bullishness on the outlook for the French retail market.

Amundi for its own part has been busy acquiring smaller groups in France. A notable purchase has been that of CPR Asset Management. This firm has taken over responsibility for operating Amundi’s thematic equity investments since September 2015, having made its name with Silver Age, a strategy based on the ageing of the population. Amundi’s support had played a vital role in its growth to €1.2bn AUM.

Amundi is expected to be in the market for many more acquisitions following the successful completion in November of its €1.5bn listing, the largest initial public offering on the Paris Stock Exchange for ten years (see box).

Extract from ‘Tales of asset managers with game-changing potential, Investment Management Review, October 2015

French giant preparing for a take-off
Amundi, one of the top ten global asset managers, will be floated off at the end of the year as an initial public offering (IPO), according to its two joint owners, the French banks Crédit Agricole and Société Générale, which currently hold 80% and 20% respectively of the shares …

The announcement stated that the offering will underpin Amundi’s continued development, which is being interpreted as providing the fund manager with public equity for both organic growth and acquisitions. The flotation will create the largest listed asset manager company in Europe.

Though Amundi is still largely owned by its parent, Crédit Agricole, it is expected to operate as an independent company. The cash actually received from the listing is not staying with Amundi but flowing back to its parents. Therefore, the money raised is not the source of its acquisition firepower. The additional muscle comes from the market valuation of its shares.
that enables the latter to be used as currency for takeovers. According to Perrier, €1.3bn cash on its balance sheet is promised to shareholders in three years, if not spent before.

Amundi has been a major success story in France since being launched by its two parents in 2009 with €650bn AUM. This reached €950bn at end June 2015. It has never been regarded by its two parent banks as a typical captive of a bank.

The group has much work to do in achieving its ambitions, with retail clients currently accounting for just €250bn, about a quarter of its AUM, and it is suggested that an acquisition in this area would be a good move.

Expanding in Asia also sounds promising. Asset growth in its joint-venture partners has been at 40% per annum since 2012, according to Piers Brown, an analyst in London of the Australian House Macquarie.

Amundi has a huge advantage over the rest of the asset management industry. Its cost-income ratio of 52% is the lowest in Europe and compares with BlackRock’s 60%, and 77% at the investment division of AXA.

The problem for the smaller fund managers in the country is that distributors prefer to deal with larger groups. The solution that is suggested for the smaller specialist companies is to attach themselves to large multi-boutique houses

Editor’s comment

The French retail market has been offering new cause for optimism, but too much should not be read into it. To see some recovery after seven bad years is not surprising, and the French economy still faces problems. But Amundi’s focus on Europe as a whole makes its growth plans more realistic. The Italian market, for instance, is growing rapidly and Amundi is considered to have a good chance there through a strategic acquisition.

The group has a long way to go before it gets near the giants BlackRock and Vanguard. But immediately above its number ten ranking in global terms is a cluster of rivals who are not all doing that brilliantly. Pimco, for instance, does not have a particular rosy outlook. Even Fidelity, at number four with just under $2tn of AUM, will be doing well if it merely protects its asset base, let alone grows, having suffered outflows from its actively managed funds.

‘Amundi gears up to rival BlackRock with listing’, Chris Flood, 09.11.15

‘IPO winning streak favours big deals’, Gavin Jackson and Michael Stothard, Financial Times, 14.11.15

‘Amundi’s IPO – supersize me’, The Economist, 14.11.15

‘Amundi used selective statistics in run-up to IPO’, Mike Foster, Financial News, 16.11.15

‘The French resistance’, David Stevenson, Funds Europe, November 2015
HIGHER PROFILE FOR GERMAN BOUTIQUES

The investment boutique sector in Germany, which lacks the profile of its counterparts in London and Paris, is beginning to be taken more seriously, with its quality strongly recognised outside the country. German investment firms have figured prominently in the list of the top 20 strongest boutique brands in Europe, according to a survey carried out over the past two years by the consultancy Fund Buyer Focus. Its Director, Diana Mackay, says: “The smaller guys have built quite a large presence in Germany.” She points out that they are very well managed and have performance that competes with the best, and that demand for their services is originating from markets outside Germany as well.

In the past, these small firms suffered from serious structural handicaps. Bank-owned fund managers, many of them making only their own funds available to retail investors, had dominated the investment scene.

**One of the advantages possessed by the boutiques is that the German asset management industry is relatively decentralised compared with that of other countries**

The conservatism of the German public has been another inhibition. Financial markets have been viewed with suspicion and the retail public’s preference is to keep its money in bank accounts or to invest in property. Loosening of regulatory requirements for start-ups has helped. Since the 2000s, the bank-owned managers’ move to open architecture models, whereby they offer to clients funds from other houses as well, has been another factor. Typically, the new boutiques have been founded by investment personnel leaving the larger bank organisations.

Lupus alpha, with €8bn of assets under management (AUM), was Germany’s first independent fund manager when it was set up in 2000, according to Michael Frick, its Managing Director.

Another such boutique is Assenagon, which was founded in 2007 by its Managing Director Vassilios Pappas and Hans Günther Bonk, who had previously been at UniCredit. This firm focuses on risk control strategies, and its AUM is currently €16bn and increasing by €2bn annually, according to Pappas. In 2015, it started up a Frankfurt office, already having bases in Zurich, Munich and Luxembourg. From two people in 2007 it has now expanded to 70.

One of the advantages possessed by the boutiques is that the German asset management industry is relatively decentralised compared with that of other countries. According to Harald Eggerstedt, a Frankfurt-based Senior Investment Consultant for Towers Watson, the absence of a dominant investment hub is a bonus. The bigger managers do not find it easy to have close personal relationships in the less well-serviced parts of the country.

A major problem faced by the boutiques is that they are not particularly strong in PR and marketing, and are thus at a serious disadvantage relative to the bigger players. Notwithstanding this, many of the new firms are planning expansion across Europe.

**Editor’s comment**

The dynamism of the asset management industry globally has historically been dependant on small enterprising firms starting up and flourishing, some eventually becoming giants. The progress of the German boutiques is a welcome development in this context. But the odds are stacked against them for expanding substantially under current industry trends.

The growing regulatory burden in recent years has been noted even by the UK’s Financial Conduct Authority as potentially militating against competition, by creating higher entry barriers. The shortcoming in PR and marketing among the newcomers is clearly another major handicap which alone could doom most of them to remain small-time players. But the most telling arguments in global terms are the two trends: the shift to passive and the growing popularity of investment solutions based on outcomes for the end investor. The traditional game of promising to beat the benchmark is now fast falling out of favour.

Many of the problems could potentially be overcome if, as in France, the small firms seek the shelter of a multi-boutique umbrella that can ease the regulatory burden and provide the marketing needed. The potential parent does not need to be exclusively multi-boutique, but must be open to owning or backing autonomous entities.

‘Fund boutiques look to expand their shops’, Andrew Pearce, Financial News, 09.11.15
PRIVATE EQUITY BUZZING AROUND FOOTBALL HONEYPOT

Until recently, only the foolhardy or the super-rich would have considered backing UK football clubs, given their habitual tendency to make huge losses and even go bankrupt. Matters are now different with a turnaround in their fortunes.

The ownership of the clubs in the top echelon, the Premier League, is now beginning to shift from billionaires, sheikhs and other super-rich people to a new breed of professional investors. Recently, PEAK6, an investment vehicle managed by financial veteran Matt Hulsizer in Chicago, bought a 25% stake in AFC Bournemouth. The club stated that Hulsizer would be providing not just the money but also a strategic insight and an international presence.

A few days after the Bournemouth deal, Crystal Palace FC sold minority stakes to Josh Harris and David Blitzer, US-based investors who have backed other sports ventures. Steve Parish, Co-Chairman of Crystal Palace, expressed his belief that the new investors and the current owners can work together. It was important that control remained with people who love the club.

Two factors underlie the motivation for professionals, including private equity types, to take football seriously: a dramatic rise in revenues and vastly improved cost control. Hitherto, the clubs had a proclivity to spend more than they earned, on expensive items such as footballers’ wages and transfer fees, often even borrowing to keep up with the best clubs’ outlays. But, recently, the new European Financial Fair Play Rule introduced in 2011 has imposed limits on what clubs can spend relative to their revenues, with sanctions should they overstep the mark. Now it is much more difficult for clubs to get into the sort of trouble that led to two former premier clubs, Leeds United and Portsmouth, going into administration. These two are now languishing in the lower leagues of English football.

With costs under control, clubs now keep more of their revenue, which has shot up dramatically in recent years. In the 2013/2014 season, Crystal Palace, for instance, in its first season after promotion to the Premier League, saw its wages bill double, but revenue from television prize money and sponsorship increased by more than 500%.

A new TV deal, finalised in February 2015 and due to come into effect in the 2016/2017 season, gives another lucrative boost to Premiership clubs. Even a club ending in the bottom position will receive prize money exceeding £100m, which is actually higher than currently received by champions.

The UK TV rights deal is worth £5bn, 70% higher than the previous agreement, and there are additional international rights. According to Trevor Watkins, Partner at Pinsent Masons, a typical Premiership club below the top four is now worth between £120–150m compared with £62m paid for Aston Villa back in 2006.

One of the driving forces is the increasing global popularity of the Premier League, making it especially attractive to those who have invested in sports teams elsewhere. Harris and Blitzer have stakes in the National Basketball Association’s Philadelphia 76ers and the National Hockey League’s (NHL’s) New Jersey Devils. Hulsizer has a minority share in Minnesota Wild, also in the NHL. Adding UK football to their investment portfolios allows them to work in new markets with partners they are comfortable with.

It is understandable why the Premier League is now a magnet for professional investors. The global audience enjoyed by the Premier League tournament can only grow as football continues to become a popular pastime in an increasing number of countries. With costs under control, the outlook for increasing profitability is very bright.

Now it is much more difficult for clubs to get into the sort of trouble that led to two former premier clubs, Leeds United and Portsmouth, going into administration.

But this is true only for the Premier League as a whole. Backing an individual club in the league is another matter. Its value will persist only as long as it survives in the top division. For the clubs at the very pinnacle, such as Manchester United (MU) and others, their current value and profitability can be sustained only if they remain at the top, something that cannot be taken for granted, as Liverpool FC has found and MU is experiencing now.

From a professional investment point of view, it makes more sense to hold shares in a number of clubs, but this goes counter to large stakes in single clubs held for emotional, prestige or business reasons.

‘Buyout groups eye football matchups’, Josh Noble, Financial Times, 26.11.15

Editor’s comment

Previously, massive infusions of money came from the super-rich who were content to treat their investment as status toys without bothering about making money. What attracted them was the global prestige of their ‘hobby’ club winning championships.
Top investors and fund managers are in the process of going ahead with legal action against the leading car maker Volkswagen, following the scandal that emerged in 2015 over its cheating on emission standards. The US’s Environmental Protection Agency (EPA) announced in September that the company had violated US emission tests by fitting vehicles with devices that enabled the bypassing of environmental rules.

Following the revelations, the share price of the auto company has fallen by about 40%, leading to many top investors collectively nursing billions of dollars in losses. Norway’s oil fund, the world’s largest sovereign wealth fund, had a 1.2% stake in the firm at the end of 2014 and was one of the worst affected.

Nordea Asset Management, the largest asset manager in the Nordic region, with €190bn of assets under management (AUM), has announced that it is evaluating various possibilities of joining class actions (collective lawsuits) in the UK and the US. Some 66 institutional investors have been planning to sue Volkswagen in its German home market.

Klaus Nieding, a lawyer at Nieding and Barth, the German law firm, stated that a capital market model claim, resembling a US collective lawsuit, would be filed in January on behalf of a US institutional investor with 65 others expected to join in the claim.

Nieding and Barth is working with MüllerSeidelVos, a fellow German firm, and Robbins Geller Rudman & Dowd, a US law firm, to represent investors that have contacted the German shareholder protection association DSW. The car firm, in addition to being sued in Germany, is also facing action elsewhere in countries such as the US, the UK and Australia.

The US Department of Justice has already filed a lawsuit on behalf of the EPA. The Dutch pension fund APG, with €400bn of AUM, is among leading pension funds that are involved in possible action. The Arkansas State Highway Employees Retirement System, a pension fund with $1.4bn of AUM, has already been named as the lead plaintiff in an action in the US. The City of Philadelphia Board of Pensions and Retirement, with $5.7bn of AUM, is also considering action.

The mechanisms for top investment management firms and institutional investors are well in place for pursuing legal claims against companies that breach environmental duties, particularly when cover-ups or dishonesty are involved.

Bentham Europe, a litigation finance group backed by the US hedge fund Elliot Management and IMF Bentham of Australia, announced that it is in talks with VW’s top 200 investors and plans to sue in 2016. DSW, with the support of European investor rights group Better Finance, has revealed that its discussions with private and institutional investors on both sides of the Atlantic on suing the car maker in Germany are at an advanced stage. In the UK, David Siedel, Chief Executive of the Institutional Investors Tort Recovery Association, has stated that law firms in the UK are also compiling cases.

VW is not the only large company that is subject to legal claims. The US fund house Dimensional Fund Advisors is suing Petrobras, a Brazilian company involved in a multi-billion-dollar corruption saga.

Editor’s comment

The mechanisms for top investment management firms and institutional investors are well in place for pursuing legal claims against companies that breach environmental duties, particularly when cover-ups or dishonesty are involved. With climate issues set to receive increasing prominence in the years to come, such legal action might become much more frequent.

‘Nordea to sue Volkswagen over emissions-linked losses’, Attracta Mooney, FTfm, 09.11.15

‘VW faces lawsuit from 66 investors’, Attracta Mooney, FTfm, 18.01.16
SHAREHOLDERS WRONGLY BELIEVED TO BE THE OWNERS OF COMPANIES

Many believe that shareholders own the companies in which they hold shares. This is wrong, as pointed out by Professor John Kay, Financial Times columnist and the author of the UK Government-mandated landmark study The Kay review of UK equity markets and long-term decision making.

This mistaken notion of ownership has serious implications for corporate governance, the demand for more shareholder engagement and the focus on shareholder value.

Kay cites eminent authorities in the UK and the US in asserting that the belief does not correspond to the law. This mistaken notion of ownership has serious implications for corporate governance, the demand for more shareholder engagement and the focus on shareholder value.

Shareholders have more rights with respect to companies in the UK than they do in the US, but these rights still do not amount to ownership. A 1948 declaration by the UK’s Court of Appeal clearly stated that “shareholders are not, in the eyes of the law, part owners of the company”, a ruling reiterated unambiguously by the House of Lords in 2003.

Concept of ownership

Ownership is a multi-faceted idea, just as the notion of friendship is. About 50 years ago, the eminent legal authority Tony Honoré outlined 11 types of legal relations that he considered to be the components of the full idea of ownership in capitalism (see box 1). His analysis stands out to date as a classic, defining the principles of the full liberal type of ownership in modern capitalism.

In practice, what many regard as ownership is a grey area not requiring all 11 of Honoré’s principles to hold, but a sufficient number of them need to be valid. In the case of shareholders and the companies they invest in, Kay points out that “only two of the 11 Honoré principles are satisfied and are minor at that, three are satisfied only in part and six not at all”.

Shareholder ownership wrong – the US legal situation

After analysing as above why shareholders owning the company is not valid in UK law, Kay asserts that it is certainly not correct in America either, citing Professor Lynn Stout of the Cornell Law School, an internationally recognised expert in corporate governance on the board of the CFA Institute and on an advisory committee of the US Treasury (see boxes 2 and 3).


11 types of legal relations

1. The right to possess – “having exclusive physical control”.

2. The right to use – “the owner’s personal use and enjoyment”.

3. The right to manage – “deciding how and by whom the thing owned shall be used”.

4. The right to income – reaping the benefits from “foregoing the personal use of a thing and allowing others to use it in return for a reward”.

5. The right to capital – “the power to alienate the thing, and the liberty to consume, waste, or destroy the whole part of it”, including the power to transfer the holder’s title to the object.

6. The right to security – “the ability to look forward to remaining owner indefinitely if he/she so chooses and if he/she remains solvent”, except for the state’s power to expropriate with compensation.

7. The incident of transmissibility – “the ability to transmit the interest to the holder’s successors, and so on ad infinitum”.

8. The incident of absence of term – ownership does not cease to be valid “at a future date or on the occurrence of a future event which is itself certain to occur”.

9. The duty to prevent harm – the owner’s liberty to use and manage the thing owned as he/she chooses is “subject to the condition that not only may he/she not use it to harm others, but he/she must prevent others from using the thing to harm other members of society”.

10. Liability to execution – the owned thing can be “taken away from him/her for debt, either by execution for a judgment debt or insolvency”.

11. Residuary character – “either immediately or ultimately, the extinction of other interests would inure to (the owner’s) benefit”.

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It has become routine for journalists, economists, and business observers to claim as undisputed fact that US law legally obligates the directors of corporations to maximise shareholder wealth. Business reporters blithely assert that “the law states that the duty of a business’s directors is to maximise profits for shareholders”.

The notion that corporate law requires directors, executives, and employees to maximise shareholder wealth simply is not true. There is no solid legal support for the claim that directors and executives in US public corporations have an enforceable legal duty to maximise shareholder wealth. The idea is a fable. And it is a fable that can be traced in large part to the oversized effects of a single outdated and widely misunderstood judicial opinion, the Michigan Supreme Court’s 1919 decision in Dodge v. Ford Motor Company.

In this legal tussle Henry Ford, the founder and majority shareholder of the giant car firm Ford Motor Company was being sued by Horace and John Dodge, who were minority shareholders and had started a rival car manufacturing company. They had relied on the dividends from the Ford Motor Company to expand their own business but Henry Ford started withholding dividends to discourage their business activities. The judge held on behalf of the Dodge Brothers in saying that they were entitled to a continuation of the dividends. The Michigan Supreme Court also made an offhand remark that is still cited today in favour of the idea that corporate law requires shareholder primacy.

In her analysis, Stout makes it clear that this case did not involve a public corporation but solely refers to controlling shareholder duties to minority shareholders. Shareholders in public corporations unlike the Dodge Brothers have no right to demand dividends.

**Ownership is a multifaceted idea, just as the notion of friendship is**

Kay’s opinion is that there is a stronger case for a company to be considered as owned by its directors rather than its shareholders. A hypothetical Martian would point to the executive suite as the true owners. In response to the question of who does own the company, the answer is that no one does, just as publicly accessible assets, such as the River Thames, the streets, the atmosphere, and the National Gallery are not owned by anybody. Several different types of claim exist against these assets and only in some cases does the word ‘ownership’ describe them.

Kay extends the principle of non-ownership of the company even to non-ownership of the shares which people hold. A particular name may be on the share register, but often a different entity has the power to buy and sell and yet others to decide how to vote on corporate issues. The actual beneficiary of the investment returns may be somebody else again. Kay quotes Charles Handy, the legendary management guru, who has written that “the myth of ownership gets in the way” as a warning that clear thinking about businesses would be enhanced if the word ‘ownership’ were dropped.

The notion that corporate law requires directors, executives, and employees to maximise shareholder wealth simply is not true

Stout points out that by the end of the 20th century, a broad consensus had emerged that corporations should be governed by shareholder primacy, but this consensus is now crumbling, with several prominent thinkers challenging it. As it is becoming clear, shareholder value does not work, even for most shareholders.
lie behind the exhortations and pressures for investors to intervene with companies in which they own shares. Clearly there is no basis in law for this, but governments have other tools at their disposal. Large companies are subject to governance codes that are effectively binding, but pressure on investors to engage is another matter.

Kay’s opinion is that there is a stronger case for a company to be considered as owned by its directors rather than its shareholders.

In practice, the law is not the only arbiter of the relations between shareholders and companies. By and large, many companies are not totally indifferent to the views and attitudes of the shareholders. There are other forces at work here, some historic, some cultural and others representing various unseen pressures.

What emerges is that the general approach of focusing on shareholders as the group which should control companies needs a rethink. Not only is it wrong in law, but also in practice, as argued by Stout.

In theory it is possible that governments might change the law to make shareholders supreme, but this will be dubious, given the large number of stakeholders of these companies who would vigorously object.

‘Bodily rights and property rights’, B Bjorkman and S O Hansson, Journal of Medical Ethics, April 2006


The shareholder value myth, Lynn A. Stout, The European Financial Review, 30.04.13

‘Shareholders think they own the company – they are wrong’, John Kay, Financial Times, 11.11.15

A STEP CLOSER FOR THE FINANCIAL TRANSACTION TAX

Mixed signals have emerged in recent months for the prospects of the financial transaction tax (FTT) to be introduced by end June 2016, the latest deadline. This controversial tax, if implemented, is widely predicted to inflict economic damage on an already stagnant Europe. Despite the 30 June deadline, it is not among the topics scheduled for political agreement in the European Council, which came under the presidency of the Netherlands for six months from 1 January 2016 to 30 June 2016.

Some observers attach significance to the Netherlands not being one of the states supporting the tax for this omission on the Council’s agenda, which is at variance with the debate that has been planned for 25 May in the Economic and Financial Affairs Council (ECOFIN). However, the Netherlands is downplaying its apparent unwillingness to cover the FTT by stating that, if the group of countries that are behind the tax agree on a proposal for a directive, then the FTT can still be discussed.

An EU official has also emphasised that the deadline commits the ten member states that support the FTT to reach agreement independently of the Council, and has suggested that too much importance should not be attributed to the presidency schedule.

Achieving such an agreement is easier said than done, with some sticking points still being effective obstacles (see box). A few years have passed since the tax was first mooted, and a number of previous deadlines have come and gone since it was originally planned to be implemented in 2014. A January 2016 deadline was the latest to be missed. The key question
remains as to whether the political will to reach agreement will be found.

**Extract from ‘The financial transaction tax refuses to die’, Investment Management Review, April 2015**

The proposals encompass a levy of 0.1% on share and bond transactions and 0.01% on derivatives transactions. It is believed that the actual effective tax could be a multiple of these figures, as the tax is levied at every stage in the chain, between seller and broker, broker and market maker, and so on. While those in favour of the tax claim that it will be a levy on banks, the culprits behind the financial crisis, the widely recognised reality is that it will be the end investor who will pick up the tab, with the intermediary institutions passing on the cost.

The real sticking points preventing agreement among the 11 pro-FTT states lie elsewhere, and cover several complex issues. One is how derivatives are to be taxed, and another is the extra-territorial scope of the levy. How revenues are to be allocated, and designing a system to collect the tax are also headaches.

On the derivatives front, two approaches are reportedly being considered. The first is to base the tax on derivative contracts’ notional value, which is objected to by some states on the grounds that it would favour some derivatives and penalise others. The second approach is to link the tax in some way to the premium paid for the contract.

The question of extra-territorial coverage is governed by two principles. The first is ‘issuance’, where the entity issuing the contract is in one of the FTT states, and the other is ‘residence’, which applies if one of the parties to the transaction is located in the FTT zone.

However, a breakthrough of sorts occurred in early December when the European countries in support of the tax reached a compromise on some aspects of the FTT. EU officials expressed some optimism about the result. Hans Jörg Schelling, the Austrian finance minister who presided over the meeting, said: “FTT is still alive, we have a technical compromise on what for, where and what is taxed.”

A breakthrough of sorts occurred in early December when the European countries in support of the tax reached a compromise on some aspects of the FTT.

The finance ministers of the countries in support of the tax gave themselves six months prior to the latest end-June 2016 deadline to agree on the remaining issues, including tax rates and how the proceeds were to be disbursed. But what was achieved in December did not address several major issues, emphasising that there are still massive differences.

In another serious setback, of the 11 countries that have been pushing for the FTT, Estonia refused to sign up to the agreement, expressing concern that it might lose out by hardly getting any revenue, and fearing that its traders would move business elsewhere.

There is also concern among the 11 that the cost of collecting the tax could exceed the proceeds. The finance ministers additionally agreed to further analyse the impact of the tax on the real economy and pension schemes as well as the financial viability of the tax for each country.

David Hillman, a spokesman for the Robin Hood Tax Campaign, which supports its introduction, strongly feels that the process is on track and that the ten countries in support cannot back out at this late stage.

The International Capital Markets Association says there are doubts about the legality of any agreement unless at least nine of the remaining ten member states seek fresh authorisation.

By not scheduling the topic in the Council, the Dutch may not be deliberately sabotaging the topic, but at the least might be signalling considerable scepticism at the prospect of an agreement being reached before the June deadline.

It is tempting, in view of the long duration of the saga, for capital market players to switch off. But it would be wise, in spite of the dragging out of the story, for them to monitor matters closely, given the potential impact on European financial markets and the economy.

‘The financial transaction tax refuses to die’, Investment Management Review, October 15

‘FTT slips off the EU agenda’, James Rundle, Financial News, 18.01.16

‘Ten EU countries agree on some aspects of financial transactions tax’, wsj.com

‘Ten EU countries agree on aspects of a financial-transaction tax’, reuters.com
THREAT TO EUROPEAN ASSET MANAGEMENT FROM TOP US FUND HOUSE

Editor’s introduction
An aggressive move by the top passive provider, Vanguard, into active fund management in Europe is set to squeeze the European asset industry further, as if the latter had not already had sufficient cause for alarm from potential regulatory pressure on fees. Vanguard’s European announcement in December followed a fierce price war between two of the top US exchange-traded fund (ETF) providers, BlackRock and Charles Schwab.

The ETF sector went from strength to strength in 2015, but the market mayhem of 24 August continues to pose serious questions as to its safety under extreme crisis conditions. The Securities and Exchange Commission (SEC) has come up with a preliminary analysis of what went wrong, pending a definitive diagnosis and remedial measures.

Actively managed ETFs have been one of the most prolific areas of innovation, spurred by the rapid growth of smart beta strategies.

- Vanguard extends its invasion of Europe. Vanguard launched in December a new range of low-cost actively managed ETFs in Europe, with its fees designed to undercut traditional managers such as Schroders. John James, Managing Director of Vanguard in Europe, asserted that it can drive down costs a lot, giving the average investor a much better chance of success. Vanguard already has $1tn in actively managed assets.

- Cut-throat price war among top US ETF providers. In November, BlackRock and Charles Schwab embarked on fierce fee reductions. BlackRock is attempting to protect its market share in mainstream equity
ETFs. It reduced annual management fees on its iShares Core S&P, its US stock market ETF by three basis points (bps) to seven bps, undercutting Vanguard's total stock market ETF expense ratio of five bps. Charles Schwab also cut the expense ratio on its US large-cap ETF from four to three bps and is considering other reductions. Vanguard charges average ETF fees of ten bps, compared with Charles Schwab's nine bps and BlackRock's 28 bps, according to ETFGI, a London-based consultancy co-founded by the well-known ETF expert Deborah Fuhr. ('BlackRock and Charles Schwab in ETF price war', Chris Flood, Financial Times, 16.11.15; ‘A year to remember’, David Stevenson, Funds Europe, 12.01.16)

- The SEC pronounces on the ETF panic of August 2015. A bout of market mayhem that halted trading in hundreds of ETFs in August was exacerbated by stock exchange rules intended to limit extreme price movements, according to the SEC’s report released in December (see box).

The 88-page study, which was issued by the SEC’s staff, did not propose any policy fixes, but gives the agency’s commissioners and industry groups a blueprint for debating structural changes to stock and ETF trading.

The brief introduction and subsequent withdrawal of trading halts in China early this year has intensified debate within the global industry as to the type of market controls that needs to be in place to stop future panics.

Regulators and stock exchange officials continue to discuss changes that could minimise the likelihood of another event like the August 2015 turmoil, which caused more than 1,000 trading halts in 327 exchange-traded products. The focus is on how to tweak safeguards put in place after the May 2010 flash crash, when price fluctuations for more than 300 securities exceeded 60% within a specified time period. The protections, known as ‘limit-up, limit-down’, cause trading to be halted when prices increase or decrease by a certain threshold.

In the meantime, the brief introduction and subsequent withdrawal of trading halts in China early this year has intensified debate within the global industry as to the type of market controls that needs to be in place to stop future panics. (‘NYSE Arca rules partly responsible for August ETF rout, SEC says’, bloomberg.com, 29.12.15; ‘Beijing U-turn reignites circuit-breakers debate’, Philip Stafford and Gabriel Wildau, Financial Times, 12.01.16)

- Adverse ETF effects on top fund managers. While groups such as Vanguard and BlackRock have been thriving on the growth of the ETF industry, State Street has been a notable casualty. This house was the only one of the top 20 ETF managers to register outflows in 2015, raising questions about its ability to compete with its main ETF rivals. Investors withdrew $19bn from State Street’s ETFs in 2015, in contrast to BlackRock and Vanguard attracting $139bn and $84bn respectively, according to ETFGI. State Street had been the largest ETF manager until 2003, and in January 2015 it suffered the further indignity of losing its second place to Vanguard. State Street is not the only top fund manager to be concerned about the march of ETFs. Goldman Sachs Asset Management, Franklin Templeton and Legg Mason are other leading managers that have been forced to join the ETF bandwagon.

Editor’s comment

The ETF sector has grown to a point where it poses threats to the industry on several fronts. Until the SEC comes up with remedial measures in response to the August panic, ETFs exacerabing a market crisis cannot be ruled out.

On an individual company basis, ETF growth is pressuring many fund management houses, as already demonstrated by some of the traditional groups risking cannibalisation of their asset base in joining the ETF bandwagon. Over the next few years, ETFs have the potential to change the shape of fund management, with Vanguard leading the way.

State Street is not the only top fund manager to be concerned about the march of ETFs.

Goldman Sachs Asset Management, Franklin Templeton and Legg Mason are other leading managers that have been forced to join the ETF bandwagon.
REGULATORY SPOTLIGHT ON ASSET MANAGEMENT FEES

Editor’s introduction

The European asset management industry is coming under scrutiny from three different regulators, causing much concern in the industry that its profitability will be seriously dented. European financial regulators are planning new rules from January 2017 focusing on fee disclosure. These have now been produced in draft form.

The Irish Central Bank has got into the game. It has launched the largest ever investigation in Europe into the fees that fund managers charge their clients. The UK’s Financial Conduct Authority (FCA) has embarked on a review on a wider front of the domestic asset management industry. This review not only covers the workings of the asset managers, but also looks at the role of consultants to pension funds and how they influence the selection of fund managers. The FCA review is covered in the next two articles.

European focus on hidden charges

The European Union financial regulator has drafted rules that will put pressure on fund managers to disclose all the fees that they charge, amidst widespread concern about the lack of fee transparency within the industry. The European authorities are demanding that the costs of managing funds are clearly stated up front. Currently the managers of these funds typically levy between 1.25–1.75%, according to the Investment Association in the UK. But the real cost of running a fund that is passed on to the client is much higher. When fund managers buy and sell shares on behalf of a client, they have to pay charges to an intermediary. These charges are not explicitly disclosed to the client but are included in the total amounts involved in the purchases and sales. So these charges are effectively hidden and if they are added to the 1.25–1.75% as above, the overall cost can double the disclosed amount of 1.25–1.75%, according to a study by the Financial Services Consumer Panel in November 2014.

David Pitts-Watson, a former fund manager and currently an academic at the London Business School, likened the situation to a house that was promised to be built for £20,000, but in the end the customer was presented with a bill for £100,000.

Martyn Hopper, a Linklaters’ Partner and former Head of Department at the Financial Services Authority, says that the whole area of transaction costs needed further debate, and that the new draft rules have drawn attention to the issue.

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The draft rules issued by the regulators specify that, on the sale of retail investment products, fund costs should be disclosed in total in a standardised format that allows easy comparison. However, it is not just retail investors who are unable to calculate costs. Even pension funds suffer from the same problem. In defence, UK asset managers say that they cannot predict some of the costs of running their funds that are variable, including commission, stamp duty and investment research.

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The new rules expected to be in place at the beginning of 2017 are likely to give the UK authorities some discretion on how to enforce them, but the FCA seems generally happy with the direction the European authorities are taking. David Geale, Head of Policy at the FCA, said that it will not demand anything on this front from fund managers until the European legislation is finalised. Daniel Godfrey told the Financial Times in November that the fee structure is very complicated and causes confusion, though he does not suggest that this is actually designed to confuse the consumer.

Editor’s comment
The fund manager’s defence that some costs cannot be predicted is technically true in that these depend on the turnover of the fund. But, surely, estimates can be given based on the specimen turnover figures, including likely ranges of this variable. Furthermore, investment research should not be very turnover-dependent.

A recent spat led to leading fund managers, such as Schroder’s and M&G, departing from the Investment Association in a flurry of negative publicity on account of Daniel Godfrey, then Chief Executive of the association, advocating more disclosure. This dispute does suggest that there is widespread industry opposition to more transparency on the fees front.

A higher degree of disclosure could lead to downward pressure on fees, as clients will be enabled to compare the overall expenses of different fund providers.

‘Fund managers face pressure on hidden fees’, Naomi Rovnick, Financial Times, 17.11.15

Irish authorities examine fund fee levels
The Irish Central Bank is undertaking the largest ever investigation in Europe into the fee levels currently prevailing in asset management. This regulator, overseeing more than 6,000 funds, including 3,725 major funds, is looking into whether investment products represent value, against the background of widespread concern that fee levels are too high.

The regulator is already believed to be reviewing closet trackers, a breed of funds that are accused of hugging the relevant benchmark closely, but charging fees that can only be justified by more active management.

However, the enquiry into fund fees will be much broader. The investigation will embrace fees charged by Irish-domiciled funds. It will initially concentrate on total expense ratios, which represent the full cost of a fund to the investor. This includes the manager’s annual charge as well as the cost of other services paid for by the fund, such as those involving custodians and auditors. Particular attention will be paid to the vehicles that have high total expense ratios. The duration of the enquiry is not certain.

Guillaume Prache, Managing Director of Better Finance, a consumer lobby group, commented that fees are too high in Europe and not always transparent

Fund industry figures in Ireland were critical of the enquiry, with comments such as that it was unnecessary, representing interference with the free market, and that it may not be up to the regulator to pronounce on what is good value. Guillaume Prache, Managing Director of Better Finance, a consumer lobby group, commented that fees are too high in Europe and not always transparent. This sentiment was echoed by Mick McAteer, Director of the think tank, the Financial Inclusion Centre, who felt that EU investors ‘pay far too much for inferior performance’.

The regulator in Luxembourg, the largest domicile of funds in Europe, did not respond to the query whether it planned to follow in the wake of Dublin, its rival centre for administering funds.

Editor’s comment
It is well known that fee levels are higher in Europe than for equivalent funds in the US. However, this is partly for an innocent reason. The European market is fragmented and lacks the same economies of scale as in the US. But even so, there is room to believe that there is a culture of fund managers not competing on fees in Europe.

‘Ireland launches fund fee probe’, Attracta Mooney, Financial Times, 14.12.15

This is the first of a group of related articles. Please see the next two on ‘UK regulator threatens to cause upheavals in asset management’ and ‘Investment consultants under the microscope’.
UK REGULATOR THREATENS TO CAUSE UPHEAVALS IN ASSET MANAGEMENT

The UK’s Financial Conduct Authority (FCA) has embarked on a sweeping study of asset management, causing alarm in the industry about serious threats to business models and profitability. On the other hand, some leading industry commentators are concerned that the FCA investigation might not reach far enough and have a sufficient impact.

The central theme of the study is to examine the effectiveness of competition in the industry, so far as it delivers value for money to end investors.

The FCA identified three main areas for investigation:

• how competitive forces work to deliver value
• willingness and ability of fund managers to control cost and quality along the value chain
• impact of investment consultants on competition for institutional asset management.

The FCA is also concerned about potential barriers to innovation and market competition. Christopher Woolard, the Director of Strategy and Competition at the FCA, emphasised that the UK is a world leader in asset management and the market study aims to ensure that both retail and institutional investors can get value for money.

In 2013 the UK asset management industry earned around £15bn in revenue and generated about 1% of UK GDP.

The size and global importance of the UK market

In terms of assets under management (AUM), the UK asset management industry is the largest in Europe and second to the US globally. According to Investment Association (IA) figures, the UK industry manages around £6.6tn of assets (see table).

UK funds under management as at end 2014 £tn
Pension funds 2.1
Non-traditional asset classes 1.1
Insurance 1.0
Retail & private clients 1.2
Other 0.9
Public sector and non-profit 0.4

The IA estimates that nearly 40% of assets managed in the UK are for overseas clients, which makes investment management a successful export. The asset management sector is also a significant contributor to the UK economy in terms of both employment and tax revenue. In 2013 the UK asset management industry earned around £15bn in revenue and generated about 1% of UK GDP.

Some of the assets managed in the UK for overseas clients are in pooled funds domiciled overseas. The CityUK estimates that £775bn of UK-managed assets were for overseas pooled funds at the end of 2013, around three-quarters
of which were for funds domiciled in Luxembourg and Dublin.

According to Lipper, the leading data provider, there were over 35,000 European funds at the end of 2013. Of those, over 7,000 were available to buy in the UK (of which 3,500 were equity funds). The UK is the fifth-largest centre in Europe in terms of fund domicile, with 11.6% of European investment funds domiciled in the UK. The largest centre is Luxembourg, where over 27% of funds are domiciled, followed by Ireland (15%), France (14%) and Germany (14%). The FCA’s internal analysis (based on IA data) suggests that offshore funds have been increasing their share of UK retail investor money, from 4% in 2007 to 9% by September 2015.

As many as 14.2 million pension savers and 11 million retail investors could benefit from improvements in competition at the institutional and retail levels respectively.

The asset management industry does not appear to be particularly concentrated, with the top ten asset managers accounting for around 55% of AUM. On the face of it, this might allay concerns about lack of competition. However, the FCA document points out that a large number of competitors does not necessarily guarantee effective competition. The latter requires firms to have sufficient incentives to satisfy client demand as best as they can and to try to win customers from their arrivals.

Despite the higher annual management charge for active management (an average 1.2% compared to 0.5% for passive), the majority of the UK market still favours it (78% compared to 22% for passive). This ratio is lower for institutional clients (68% for active) than for the market overall.

As many as 14.2 million pension savers and 11 million retail investors could benefit from improvements in competition at the institutional and retail levels respectively.

Platforms have become an important part of the investment market, with over three million customers using them to hold assets or invest.

### Topics covered by the FCA

Within the three main areas of the investigation, the FCA places importance on some specific topics:

- impact of platforms on competition between asset managers seeming to compete more on future performance, though unpredictable, than on price, which is an important component of net performance
- switching costs (entry and exit charges) inhibiting retail investors from moving between funds
- how the structure of the industry affects the incentive and ability to compete
- entry barriers for fund managers and new funds, including regulatory barriers and the extent to which these barriers reduce the incentive for effective competition and provide value for money
- potential conflicts of interest arising from vertical integration, such as fund managers and platforms coming under one entity and insurance companies owning fund managers
- understanding price and costs along the value chain (advice and distribution to fund managers and ancillary third-party products) and the difficulties of finding the data that will allow estimation of these costs
- understanding why the profitability of asset management, high both for the UK and on a global basis, persists though competitive forces in general might be expected to reduce it to more normal rates of return related to the cost of capital for the industry
- the incentive for asset managers to look after the interests of their investors when purchasing services charged to the latter. The danger of the classic principal-agency conflict of interests arises here
- fee structures and the potential implications for effective competition of active management fees herding around 1.5%
- investigation of closet indexing, where many fund managers are running near-passive indices while charging fees that are justifiable only for more active management, and in some cases are effectively promising investors more active management than they deliver.

### What the FCA will not cover

- financial advisers
- wealth managers
- stockbrokers
- private equity and venture capital
- the use of dealing commissions to pay for research charge to clients.

These areas are excluded as the FCA considers that they have been dealt with elsewhere.

### Potential FCA action

After studying all the submissions received from the industry stakeholders and other interested parties, the FCA aims to publish an interim report setting out these analyses and preliminary conclusions in the summer of 2016 and, after receiving the feedback of stakeholders, to publish its final report in early 2017. As the study progresses, the regulator might expand the scope in some areas and narrow it in others, depending on the evidence.

If the FCA concludes that the competition is not working very well, it could introduce a number of possible measures to promote effective competition, including:

- market-wide remedies, such as rule-making (changing or potentially withdrawing existing rules), publishing general guidance, and proposing enhanced industry self-regulation

The FCA places importance on entry barriers for fund managers and new funds, including regulatory barriers and the extent to which these barriers reduce the incentive for effective competition and provide value for money.

- firm-specific remedies, such as using own-initiative variation powers or own-initiative requirement powers, cancelling permissions, public censure, imposing financial penalties, as well as filing for injunction orders or restitution orders. If the FCA...
identifies potential infringements of other laws, such as competition law, it may open an investigation accordingly, or refer the matter to other enforcement agencies.

- making a market investigation reference to the Competition and Markets Authority.

Alternatively, the FCA may decide to take no further action for the time being. This could be because any issues it may identify are likely to be satisfied by upcoming legislative measures, action by the relevant firms or other circumstances. The FCA may continue to monitor the market in case its concerns are not addressed.

Comments, criticisms and forebodings

Some leading industry commentators have expressed concern about shortcomings in the FCA’s study. Glen Miller, co-founder of investment boutique SCM Private, a group that has been a long-running campaigner against hidden fees and mis-selling in the industry, has stated: “I would not hold my breath on the FCA taking a tough stance.” She is severely critical of the FCA considering enhanced industry self-regulation, saying: “When will they learn that self-regulation does not work?” A senior industry figure told the Financial Times anonymously that the FCA will do a quick investigation representing a light touch, and aim to reduce costs by five basis points, which he castigates as not good enough.

Saker Nusseibeh, the Chief Executive of the UK fund manager Hermes, said that the study is clearly a move towards compelling the industry to lower its high profit margins of 35–45%.

Notwithstanding all these criticisms of the FCA’s study, the general consensus in the industry is that the downward pressure on fees will intensify. Business models of fund management companies are considered to be at risk.

Saker Nusseibeh, the Chief Executive of the UK fund manager Hermes, said that the study is clearly a move towards compelling the industry to lower its high profit margins of 35–45%. Lora Froud, partner in the investment management group at Macfarlanes, states that the FCA is intending to promote competition and thereby reduce prices.

Editor’s comment

The FSCP may well be justified in asking for fund managers to be prevented from overcharging, though what exactly amounts to overcharging can be a contentious issue, given the judgment brought to bear in investment decisions and portfolios. However, the panel is likely to be on shakier ground in demanding legal constraints against short-termism, as this term is even more difficult to pin down in practice.

The open-mindedness of the FCA in recognising the possibility of regulation inhibiting competition is a welcome development. During the financial crisis, regulators were widely criticised for a narrow view of the role of rules in avoiding financial risks, which in practice actually led to creating risk to the economy in terms of lower growth, reduced competition and liquidity.

Even after allowing for considerable overlap, 11 million retail investors and 14 million pension savers amount to a substantial penetration of the UK’s population of about 60 million. The mind boggles at the potential size of the global industry if similar proportions take hold in the rest of the world. But to achieve this position the industry needs to woo savers worldwide with something more than investments based on the same tired looking security-market vehicles. Currently there is a shift towards outcome-based investment solutions, but even these are based largely on traditional securities.

The FCA study may well be a damp squib, or at the other extreme provoke revolutionary industry changes. But, at the least, it promises to be an important study throwing much light on the workings of asset management, which is likely to be valued worldwide. The industry and regulators everywhere might draw many insights that can be adapted locally.

‘Asset managers face fee scrutiny’, Caroline Binham, Financial Times, 19.11.15

‘UK puts focus on fund managers’, Juliet Samuel, The Wall Street Journal 19.11.15

‘Nervous fund managers braced for hit to business models after FCA review’, Madison Marriage and Chris Newlands, Financial Times, 19.11.15

‘City watchdog sets out buyside probe’, Andrew Pearce, Financial News, 21.11.15

‘Asset management market study – terms of reference’, Financial Conduct Authority, November 2015

‘Fund management study must look in the right places’, Richard Saunders, Financial News, 18.01.16

This is the second of a group of related articles. Please see the previous one on ‘Regulatory spotlight on asset management fees’ and the next one on ‘Investment consultants under the microscope’.

The FCA places importance on understanding why the profitability of asset management, high both for the UK and on a global basis, persists though competitive forces in general might be expected to reduce it to more normal rates of return related to the cost of capital for the industry.

Others have attacked the length of time it has taken the regulator to address issues raised by investor rights groups and academics as well as by previous regulatory investigations.

A year has passed since the Financial Services Consumer Panel (FSCP), an independent body that was set up to provide policy advice to the UK regulator, urged the latter to overhaul the fee structure of fund managers and strengthen their legal duties to prevent overcharging and short-termism.

Richard Saunders, a former Chief Executive of IA, feels that the FCA’s review will be seriously flawed unless it takes into account the role of investment advisers. His opinion is that what the FCA has in mind is the robo-adviser model, whereas in today’s world financial advice is mainly coming from human beings.

The industry and regulators on a global basis, persists though competitive forces in general might be expected to reduce it to more normal rates of return related to the cost of capital for the industry.
INVESTMENT CONSULTANTS UNDER THE MICROSCOPE

In investigating the asset management industry, the Financial Conduct Authority (FCA) has also brought within its sights the workings of investment consultants who advise pension funds in the UK. The FCA’s main focus is the impact of these consultants on competition for institutional asset management.

The inclusion of consultants in the FCA’s enquiry is widely welcomed by many in the industry who are concerned about what is believed to be their excessive power in the selection of asset managers for their institutional clients. Because many of these asset managers are beholden to the consultants for putting pension funds business their way – or at least hoping for it – it is understandable that asset managers are generally reticent about voicing their reservations in public. But their unease is certainly prevalent behind the scenes.

In recent years, the big consultancies have been shifting from their low-margin advisory business to the higher-margin activity of making investment decisions, the traditional preserves of fund managers.

The concerns are particularly acute because of the large concentration of the consultancy sector within the big three: AON Hewitt, Mercer and Towers Watson. The FCA recognises this, but also points to the presence of many smaller boutiques in the market. Three specific aspects of the overall theme of how consultants affect competition are considered by the regulator:

- How does advice given by investment consultants affect competition for asset management?
- How are conflicts within the business model of investment consultants managed?
- Can clients monitor the services provided by investment consultants?

The FCA has paid particular attention to the advice given by the consultants to their institutional clients on the selection of asset managers to run their money, and has mentioned the metrics chosen by the consultants to rate the asset managers. These often ignore fee levels and performance and instead focus on matters such as governance. The concern of the FCA is whether these criteria lead to entry barriers for funds seeking the custom of the institutional
Conflict of interests

In recent years, the big consultancies have been shifting from their low-marginal advisory business to the higher-margin activity of making investment decisions, the traditional preserves of fund managers (see box 2).


Investment consultants who advise on pension funds are not adding value, according to a new research study, Picking winners? Investment consultants’ recommendations of fund managers, by Tim Jenkinson, Howard Jones and Jose Vicente Martinez of Oxford University’s Said Business School. Using Greenwich Associates data, the authors find that the portfolio of products recommended by investment consultants since 2000 has produced a performance of 7.13% annually on an equally weighted basis, exactly 1% less than a portfolio of products not recommended by the consultants. Both portfolios were US equity based. The analysis covered 29 consultancies that accounted for more than 90% of the market and poses serious questions for the pensions industry.

Consultants remain important. Some 82% of US public pension funds and half of corporate sponsors use investment consultants, who advise on approximately $13tn of assets. In another paper, How institutional investors ignore and inform their own expectations, two of the above authors, Jones and Martinez, found in August 2013 that institutional investors tend to listen to consultants even if it is against advice of their in-house staff. In the US, consultants’ recommendations have a crucial impact, with any fund chosen by the latter typically receiving an extra flow of $2.4bn. One of the reasons for the consultants’ poor performance was that they tend to recommend the larger funds, which suffer from diseconomies of scale.


Mercer, one of the best known and most powerful investment consultants in the world, and voted by an international financial news panel as Europe’s top consultant every year in the past ten years, is now turning itself into more of an asset manager and making investment judgments. In doing so, the group stands to multiply its fee base many times, by actually managing money rather than providing advisory services charged by the hour. Another motivation for heading in this direction is the decline of defined benefit pension schemes, with the consequence that Mercer’s clients in the UK and US are maturing fast and offering little growth.

The group is now moving to a hands-on approach of providing multi-manager and fiduciary products, where investment judgment is involved. This move is seen as risky, in that Mercer’s illustrious brand will be tarnished if performance is not delivered or if serious problems arise with its products. In fact, several senior consultants have left the group, missing the earlier days of not having been involved in investment products.

This move towards competing with asset managers has exposed the investment consultants to the charge of conflict of interests. The FCA refers to consultants offering their own multi-manager funds and funds of funds to clients, and has decided to explore how the potential conflict of interests in offering advice as well as products is being managed.

Fiduciary management is another area involving possible conflicts introduced to the UK in 2007. This activity now amounts to about £72bn, according to the research firm Spence Johnson. Both within fund management and among regulators there is worry that some pension funds do not operate a public tender when selecting a fiduciary manager, but just hand over the job to their consultants. A KPMG survey published last October tends to confirm these fears by suggesting that as many as a third of pension funds might not be using the public tender approach. But the consultancies offering fiduciary services, such as the big three, refute this allegation by saying that most funds do actually adopt public tenders.

The relationship between consultants and the many fund managers whom they recommend to their clients comprises yet another area of potential abuse (see box 3).


Many consultants, who are supposed to assess investment managers impartially for the benefit of the institutional clients whom they advise, in many cases actually derive benefits themselves from these fund managers. Explicitly recommending particular fund managers in exchange for revenue violates the Employee Retirement Income Securities Act, and is an imprisonable criminal offence, but this rule seems legally to be sidestepped.

Some of the consultants have fund managers as clients, supplying them with services such as research or charging for access to events where the consultancy and its other clients are present. For example, Mercer levies a fee of $35,000 from fund managers attending its global investment forum events, but effectively say that all three of the big three consultants can be trusted because they have internal controls.

The evidence in box 3 pertains to the US, but the big three in the UK are leaders in the US as well and so this issue cannot be ignored in the UK. It does not take much for top UK fund managers to fly to US-based forums or to receive research from the consultants.

Editor’s comment

The issue of consultants charging for services to fund managers has not been mentioned by the FCA, but given its prevalence in the US, its possible transatlantic applicability should not be excluded. The big three asserting that they can be trusted because of internal controls needs to be examined. Top lawyers and top doctors are largely high quality professionals who can claim the trust of their clients. The same used to apply to actuaries at all levels in the consultancies.
The game has changed, however, since the consultants, in pursuit of more revenue, diversified into areas that were previously fund manager territory. Furthermore, in deriving revenue from the latter, potential conflicts of interest have come into play. It is, therefore, not at all clear whether the top consultancy firms can demand trust as a matter of right, rather than having to demonstrate anew that they deserve it. When there is room to suspect conflicts of interest, these should not only be avoided, but should also be clearly seen to have been avoided, with full transparency.

The relationship between consultants and the many fund managers whom they recommend to their clients comprises yet another area of potential abuse

As well as conflicts of interest, there are other good reasons why consultants’ advice may not represent good quality. In general, they play safe and recommend only the tried and tested among fund managers. In doing so, the consultants are effectively driving by looking just in the rear view mirror. Their clients are in the same boat. Trustees of pension funds also have to be cautious and hence prefer to seek conventional advice from the big firms. Thus, the consultants and pension funds are locked together in a mutual dance that focuses on hugging safety and avoiding criticism.

Moreover, consultants suffer from an endemic problem. They do not have the brand in fund manager terms to attract the best quality investment personnel who have the capacity to make forward looking judgments. For their part, regulators will find it very difficult to enforce rules that pressure both consultants and their clients to depart from the safety-first approach in favour of theoretically riskier decisions that might provide better value to end investors.

‘Asset management market study – terms of reference’, Financial Conduct Authority, November 2015

This is the third of a group of related articles. Please see the previous two on ‘Regulatory spotlight on asset management fees’ and ‘UK regulator threatens to cause upheavals in asset management’.
It’s not just what you know.

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name of Pramerica internationally. The new brand name PGIM was the first step in the investment company embarking on a global expansionary path, according to its Chief Executive David Hunt.

There has already been significant growth in the company’s move towards a more global presence. Non-US clients now account for 25% of its customers, compared with 15% three years ago. Areas where it is particularly targeting growth include South East Asia, India and Malaysia.

The group’s fixed income funds account for more than half of its assets under management (AUM) and have benefited from Pimco’s problems around the world in the past 18 months. The group currently has around $1tn of AUM and has recently been ranked at number nine in the world, though the competition in this part of the league table is such that its position may change quite rapidly.

The company is taking other steps in its quest for growth. It has supplied seed capital of more than $350m to new funds, which is $100m more than usual, and it expects to repeat the same amount in 2016.

Editor’s comment
From one point of view, why should PGIM now take off from the obscurity that it enjoyed for many decades? A change of name does not in itself mean too much, but the growth in its non-US presence is more impressive. A key question is whether it is aiming to grow organically or through acquisitions.

The group’s fixed income funds account for more than half of its assets under management (AUM) and have benefited from Pimco’s problems around the world in the past 18 months

For organic growth, just a brand name change is not enough. It has to deliver results that are meaningful, with either investment returns or strong distribution arrangements, or both. The current trend towards outcome-orientated investment results will probably stand the group in good stead. Attracting clients into this type of investment will be easier with the solidity of its parent.

‘Investment group takes the ‘America’ out of its brand name,’ Stephen Foley, Financial Times, 11.11.15

F&C brand name abandoned by BMO Global Asset Management

Having been an obscure Canadian name, BMO Global Asset Management (BMO GAM), owned by the Bank of Montreal, grabbed the world’s attention in 2014 when the Canadian firm acquired the UK’s F&C Asset Management. The latter is one of the most venerable names in the industry, with over 140 years of history as the oldest investment trust and collective investment vehicle in the world.

Interestingly, BMO GAM is abandoning the much better known brand name of its acquisition in favour of its own relatively unknown name. Why is it doing this? The reason lies in its global ambitions. In worldwide terms, it is a relative minnow, with $254bn AUM. This is small in relation to its rivals in North America, but certainly of a respectable size in Europe.

Editor’s comment
BMO GAM’s current size is about that of Aberdeen’s before it took over Scottish Widows Investment Partnership. Though the F&C name is iconic, it had not been expanding. Unifying all its assets under the BMO GAM flag signals its intention to become a serious global player.

Canadian asset management has achieved global respect in the past few years through the pioneering activities of its top pension funds, which have treaded new investment paths, such as co-investment with private equity and infrastructure

Goldman Sachs remains arguably the most powerful investment bank in the world, but its asset management arm GSAM is widely considered to be much stodgier. The group is trying to overcome this image, given its position near the top ten global companies and its steady growth prospects.

All in all, the three groups PGIM, BMO GAM and GSAM have every chance of utilising their parents’ power to climb up the ranks and become more notable.

‘Goldman Sachs’s ‘second class’ fund arm fights dull label,’ Andrew Wilson, FTfm, 09.11.2015

Funds Europe, winter 2015
LGIM STARS AMONG WINNERS AND LOSERS

Editor’s introduction

Last year was marked by the inexorable upward progress of passive funds, while emerging markets and fixed income investments have had a bad year. Many leading companies close to the top rank have mirrored these trends in their individual fortunes.

Legal & General Investment Management (LGIM) stands out for its long-term philosophy, achieving good results and setting an example to the rest of the industry.

The victims of the passive fund onslaught

The advance of the passive sector and emerging markets turmoil hit some of the most prominent names in global fund management in 2015, notably Pimco, Franklin Templeton, M&G and Aberdeen. Pimco, the top bond house, had already been damaged severely by the acrimonious exit of its founder Bill Gross in 2014. It suffered the heaviest outflows of any fund company in 2015. Investors withdrew $79bn in the first 11 months of 2015, compared with $176bn in 2014, and $34bn in 2013, according to the top research house Morningstar. Franklin Templeton was the next worst hit (outflows of $42bn). The most seriously affected in Europe were M&G and Aberdeen (with net withdrawals of $16bn each). In contrast, the leading passive groups, Vanguard and BlackRock, received $223bn and $124bn respectively over the same 11-month period. Other bestselling fund firms of 2015 were the Japanese house Nomura and Amundi. Both have significant exchange-traded fund businesses.

‘2015 worst-selling fund houses,’ Madison Marriage, FTfm, 04.01.2016

LGIM in unorthodox investments

LGIM increased its assets under management (AUM) by 8% to £17bn in the 12 months to end September 2015. It has clearly shrugged off the negative impact of the UK’s pension shake-up. The effect of this has been a drop of three-quarters in sales from this source, from the time the changes to the retirement system were announced. LGIM has been expanding in Asia and the US, and is now looking at openings in other areas, including America and Australia. In the 12 months to September 2015, it ventured outside traditional investment vehicles into assets including housing schemes in Walthamstow and Salford. It has also announced a £400m regeneration scheme in Cardiff and backed a Leeds-based project of £162m.

Anthony Hilton, the well-known veteran Evening Standard columnist, wrote enthusiastically about LGIM’S investment philosophy and its positive impact on the business. It is about half as big again as five years ago. Hilton attributes this to a decision made then to focus on five long-term themes: ageing populations, the globalisation of asset markets, the creation of real physical assets, welfare reform and the digital revolution.

Its Chief Executive, Nigel Wilson, has been articulating the need to cope with the housing shortage, infrastructure investment and urban regeneration. LGIM has been implementing these ideas and themes in practice by going outside the traditional areas of securities investments, in favour of long-term investments, as above with the life of 50 years or more.

‘L&G brushes off pension annuity changes with 8% jump in assets under management’, Alistair Gray and Naomi Rovnick, Financial Times, 05.11.15

‘Legal & General profits by planning for the long term’, Anthony Hilton, Evening Standard, 15.03.16

M&G reversal continues

M&G reported net outflows of £2.7bn in the third quarter of 2015, which followed a negative second quarter. Previously, the group had enjoyed 14 successive quarters of net retail inflows. M&G had been badly hit by investors fleeing from bond funds in general, because of fears of the Fed raising interest rates.
Indifferent performance also contributed, with flagship funds underperforming their benchmarks. The Barclays Global Aggregate increased by 0.41% during the 12 months to 31 October 2015, whereas M&G’s Optimal Income fund fell by 0.73%. Its peer group in the Investment Associations sector classification enjoyed a positive return of 1.45%, according to FE Trustnet. In recent years, M&G has been a top-selling group in the retail sector. This adds some long-term perspective. Its highly respected skills should allow it to bounce back.

‘Pru hit by M&G outflow and concerns over some Asia markets’, Alistair Gray, Financial Times, 11.11.15

Franklin Templeton going downhill

Franklin Templeton has undergone a torrid year, having suffered $33.4bn of net outflows from January 2015 to end October, according to the research house Morningstar.

LGIM is a cut above the typical captive investment arm of European insurance groups in that it has an adventurous approach towards investments

A combination of heavy exposure to depressed emerging markets, indifferent investment performance and bad bets on energy prices contributed. Its AUM dropping by 11% in the third quarter of 2015 has led to the group, with $771bn AUM, falling below the top 20 rank for the first time in five years.

It is now suffering the double whammy of sales falling and top level staff leaving the company. However, the company has a long-term philosophy and is widely expected to bounce back in due course.

Among the clouds, a ray of sunshine has emerged. A mid-cap UK equities fund from the group has achieved top place among the most consistently outperforming UK equity funds in the past 16 years, according to FE Analytics. In the 16 years ending 30 September 2015, the Franklin UK Mid Cap Fund, managed by Paul Spencer, had a total return of about 520%, compared with 110% for the average peer fund. The top ranking accorded to Franklin arises not just from performance, but also from consistency. FE Analytics has adopted a scoring system which rewards funds that have shown consistency over the period with extra points.

‘Franklin’s ‘perfect storm’ drives senior staff away’, Madison Marriage, FTfm, 09.11.15

‘Franklin Templeton tops ranking’, Mark Cobley, Financial News, 23.11.15

Vanguard’s record breaking goes on

For the fourth year in succession, Vanguard received a record amount of inflows of new money in 2015. The total of $236bn was 5.3% higher than the previous year. Vanguard’s continued success, based on its low fees, is putting pressure on rivals with more expensive products. In the past five years, the total net inflow from investors has reached nearly $1tn, a figure more than double that attracted by the hedge fund industry.

‘Vanguard attracts record cash for fourth year running’, Chris Flood, Financial News, 18.01.16

Editor’s comment

LGIM is a cut above the typical captive investment arm of European insurance groups in that it has an adventurous approach towards investments. Its AUM puts it not far below the ranks of the top ten in the world. Though, lacking the profile of many other fund management groups, it has every likelihood of getting into the top ten in the next ten years. As long argued by the Investment Management Review, the asset management industry, if it follows LGIM’s example, stands a much better chance of becoming more important and respected in the real world.

Vanguard’s name fits very well with its current status of being the vanguard of the global shift from active to passive management. At some point, the shift will decrease in intensity, and it is possible that passive funds will fall out of favour. At the moment, this does not seem likely to occur any time soon. In the meantime, Vanguard motoring ahead is likely to leave many battered active fund managers in its wake. Single-handedly, the group might be the instrument for a much needed consolidation in the oversupplied active management sector.

FUND MANAGERS ACCUSED OF YET MORE PRICE FIXING

The competition between banks has been termed phony, with fund managers accused of pressurising banks to keep charges high. An academic paper has found that banks are charging more than they should because of ownership by big asset management firms through their large holdings in many of these competing banks. The fund groups are supposed to be influencing the banks not to compete on prices as expected. The theory is that investors owning shares in rival banks would not be pleased at their competing away profits through price reductions and the banks would be keen not to upset their larger shareholders.

As an example, it is pointed out that in the frenetic Manhattan district of New York City, where bank branches are plentiful, charges are actually higher than in sleepy Kansas, whereas the greater competition in the centre of New York should have the opposite effect. The airline industry was singled out by the author of the same paper,
Martin Schmalz, in 2014 as being subject to the same anti-competitive pressures from large fund managers owning shares in several banks. The Department of Justice (DOJ) started an antitrust enquiry into these findings and the effect on other industries as well on 1 July 2015 (see box 1).


The US Department of Justice (DOJ) is looking into price fixing by the four largest airlines in the US, and seeking information regarding the potential involvement of leading fund managers in the process.

The four airlines are Delta, American, Southwest and United. The fund managers brought into this investigation are those holding more than 2% of the shares of at least two of these big four carriers. They include BlackRock, JPMorgan Chase, Primecap, State Street, Vanguard Group and Capital Group.

Editor’s comment

Despite the DOJ taking the issue seriously and Bloomberg Businessweek having devoted almost two pages to the topic back in September, the idea of price fixing by fund managers is not that plausible and any official action against them could have unintended consequences (see box 2).

While the idea of price fixing by top fund managers in banks seems much more farfetched than with airlines, The Economist magazine has this time lent credence by its coverage. The example of Manhattan vs Kansas ignores the well-known fact that costs in Manhattan are generally much higher in most activities owing to the demand for space and services. Furthermore, banks are in a different league from airlines in being much larger relative to the asset management groups. Multifarious factors influence bank charges. There is a danger that the well-known statistical trap of confusing causation and correlation is applicable here.

‘Blunt elbows’, The Economist, 09.01.16


The relationship between common ownership and ticket prices is fascinating. It is difficult to imagine the fund managers participating in any secretive collusion, as they have too much to lose if it comes out ...

What is possible is that the fund managers, concerned about the profitability of such a cyclical industry, may have expressed opinions that price cutting by any of the companies would be futile since the others would follow. Expressing such a view would not be illegall ... If the competitors are likely to be in the same stock market index, and if an investor genuinely wants exposure to a sector to spread the holding within it, either because of uncertainty or to avoid too large a holding in a single company, then any constraint could have a severe impact.
The top brokerage houses in the US are approaching an important junction in the aftermath of the financial crisis, as they grapple with the risk of large numbers of their financial advisers departing to set up their own firms. The danger is that these advisers might take their clients with them.

Such a large scale loss of clients would be a big blow to the big banks that have come to rely on the revenue from their wealth management division. The situation is arising because of the approaching expiry of retention agreements in the next several years.

Typically, when advisers move from one bank to another, they are accompanied by 80% of their clients. Banks are taking steps, firstly, to inhibit the departure of their advisers and, secondly, to minimise the number of clients that go with them should they actually depart.

On average, an adviser at one of the top four brokerages (wire houses), Bank of America Merrill Lynch, Morgan Stanley Smith Barney, UBS Wealth Management and Wells Fargo Advisors, manages $122m of clients’ money and produces revenues just exceeding $1m. Top advisers are responsible for much more.

These problems are arising at a time when the top four wire houses are already losing market share to the independents.

The deals with the advisers were introduced at the onset of the financial crisis, when there was a wave of consolidation and the big banks took steps to retain their advisory teams. These deals are now beginning to expire. Bank of America’s advisers can start to leave from this year, while Morgan Stanley’s in 2019.

While the banks save money in terms of commitments made during the tenure of the agreements, they stand to lose revenue should clients accompany the departures. Naturally, steps are being taken to retain as many clients as possible when somebody departs. A client can always move with the adviser when the latter shifts from one brokerage house to another. But the key debate surrounds the extent to which the departing adviser actively persuades the client to move.

The big brokerages are now declaring some clients off limits when the advisers leave. For instance, in the case of Bank of America, the 14,000 Merrill Lynch brokers cannot touch their clients who came through referrals from its branches. In many cases, the advisers inherited clients from others who had retired. These clients are also off limits.

The banks are planning more scrutiny of the client lists of the departing advisers and the steps they take to persuade clients to move with them.

These problems are arising at a time when the top four wire houses are already losing market share to the independents. Before the financial crisis, the big four had about 50% of retail client assets, according to the leading research house Cerulli Associates. By the end of 2014, their share had fallen to 38%, compared with 36% for independent advisers.

Cerulli’s prediction is that this narrow gap will disappear in 2016, with the independent firms going ahead slightly.

Merrill Lynch, in particular, might be in the process of losing its pre-eminent status. Decades ago, the Merrill’s ‘thundering herd’, as applied to its army of advisers, was a byword across the world. Hence, it is easy to understand why it was considered the jewel in the acquisition when it was taken over by Bank of America. But now it is believed by many that Merrill advisers have been relegated to becoming merely cogs in a machine. The feeling is that the old distinctive Merrill culture has disappeared. Over much of the past ten years, Merrill has occupied the number one spot on the big four, but now it is in danger of slipping to second position behind Morgan Stanley.

Editor’s comment

Conflicting forces are at work. It will be interesting to monitor how many advisers will actually depart. Many of the more talented might feel that they can do better on their own, particularly if their clients go with them.

But wider industry trends cannot be ignored. The shift from commission to fee-based remuneration demands economies of scale, with one-man bands finding it more difficult to survive.

The ongoing march of robo-advisers is another threat to intermediaries who are too small. Now it is recognised that the traditional advisory sector needs to counter the automated platforms with technology of their own. This again puts a small individual adviser at a disadvantage.

However, if the clients accompanying the departing broker are predominantly of the older generation, then these new forces, more relevant to the younger age groups, may not impact the new small businesses too much. Furthermore, the departing brokers need not set up on their own. They could well join sizeable but still entrepreneurial firms.

‘Brokers set to turn free agents’, Michael Wursthorn, The Wall Street Journal, 12.01.16

‘Merrill hits turning point’, Christina Rexrode and Michael Wursthorn, The Wall Street Journal, 19.01.16

‘Merrill Lynch’s brokers in search of greener pastures’, Christina Rexrode and Michael Wursthorn, Financial News, 25.01.16

This is the first of two related articles. Please see the next one on ‘Big four US wealth managers in declining trend’.
BIG FOUR US WEALTH MANAGERS IN DECLINING TREND

While the expiry of retention deals risks large outflows of client assets in the next few years, the top four US wire houses have already been suffering a gradual erosion in their wealth management activities. This situation is likely to continue without root-and-branch changes in their business practices.

Reflecting the loss of market share by the big US brokerages to independent wealth managers, the research firm Cerulli Associates expects the number of wire house advisers to decrease from approximately 48,000 in 2014 to 41,000 by 2017, with many of the departing advisers taking their clients with them.

There has been a corresponding increase in the number of advisers starting up their own firms, having departed from the big brokerages, according to the annual Evolution/Revolution study by the Investment Adviser Association and National Regulatory Services. Since 2014, the number of these firms has risen by 5.3% to about 12,000.

Some of the advisers have been drawn to larger independent firms, such as HighTower Advisers, Dynasty Financial Partners and XY Planning Network, which have attracted billions of dollars in client assets.

The difficult conditions are not affecting just the big four. Many international firms operating in the US have already thrown in the towel. In October, Deutsche Bank was reportedly trying to sell its US private-client brokerage. Around the same time, Credit Suisse disposed of its US brokers to Wells Fargo. Barclays had already sold in June its US private client business that was mostly inherited from Lehman Brothers.

The research firm Cerulli Associates expects the number of wire house advisers to decrease from approximately 48,000 in 2014 to 41,000 by 2017.

A number of structural reasons underlie adviser exits from the big four. They have frequently been tinkering with compensation structures...
and the complications have led to dissatisfaction. Furthermore, the large wire houses are burdened with cumbersome and archaic technology.

From the perspective of the wire houses, their advisers have become increasingly expensive, following a bidding competition among the four to attract them along with their valued client relationships. Consequently, adviser remuneration has been eating a large chunk of the revenues that the wealth managers receive. For instance, in the third quarter of 2015, Morgan Stanley paid out about 58% of its revenue to advisers, and UBS 51.5%, compared with the industry average of 44%.

The existing business model of the top four is not functioning and the market is becoming increasingly fragmented

The existing business model of the top four is not functioning and the market is becoming increasingly fragmented, according to Liz Nesvold, Managing Partner of Silver Lane Advisors, an M&A advisory firm in the financial services sector. The big brokerages are responding to the squeeze on revenues resulting from high adviser awards by devising other ways of making profits. For instance, Morgan Stanley has gone into consumer banking products such as lending, and has doubled its product development team in the past four years. In contrast, Wells Fargo, already strong on the consumer side, has expanded the availability of its investment banking services to its wealthier clients.

The new model adding extra services has another potential advantage. A client of the big brokerages will no longer deal with just one adviser, but with a team operating in different product areas, which makes it more difficult for any member of the team to depart with the client. The client will also find it more cumbersome to move away. This holistic approach represents a shift towards the European private banking model, according to Brent Beardsley, a global leader in the wealth and asset management practice at the Boston Consulting Group.

However, this new approach of offering different services is being countered by developments on the independent side. The multi-product approach can create conflicts of interest, with the bank offering its in-house services regardless of whether an outside supplier could provide better value.

As a result, many clients and their advisers are actually leaving. This process has been facilitated by new platforms. According to Michael Parker, its Chief Development Officer, HighTower Advisers offers a service to senior advisers seeking independence, freeing them of conflicts of interest. Since 2008, his firm has forged relationships with 120 advisers who have responsibility for $31bn in client assets. Under this new umbrella, the advisers are free to access the best products and services for their clients. Thus, just as big brokerages are moving towards the holistic approach, clients are shifting away from the one-stop shop and are more comfortable with selecting their own team of providers to get the best service in every area.

The rise of the robo-advisers is an important development. But many of these newcomers, lacking the scale to survive, are expected to be acquired by the bigger platforms and the wire houses. Some of the larger players look likely to follow in the footsteps of Charles Schwab and Vanguard, and either set up their own low-cost semi-automated services or take over robo-advisers.

Just as big brokerages are moving towards the holistic approach, clients are shifting away from the one-stop shop

The growth of registered investment advisers (RIAs) is making them increasingly attractive as acquisition targets to bigger players such as banks, financial intermediaries and private equity groups, who are lining up for this purpose. The number of RIA mergers and acquisitions in the first half of 2015 was 61, compared with 38 in the corresponding half of 2014, according to DeVoe & Co, a San Francisco-based RIA industry advisory firm. RIAs, for their part, value the extra firepower that their new partners bring for more takeovers and much-valued increased scale.

Business model decay is not the only problem besetting the brokerages. The Financial Industry Regulatory Authority (FINRA) is embarking on an investigation of the practices of brokerages, particularly how they interact with customers. One of the areas that will come under attention is how the firms avoid conflicts of interest when selling some investment products.

FINRA’s Chief Executive Richard Ketchum said: “You cannot effectively manage your conflicts of interest if you are not focused on your culture.”

The big four wire houses have a mountain to climb in order to stop the rot in their current business model. An overhaul of business structure, adviser rewards as well as transparency for clients, in addition to enhancing technology, are prerequisites for turning around the decline in their market share.

Editor’s comment

Perhaps, irrespective of their internal business problems, the erosion of the top four’s market share has always been inevitable. The convergence to private banking is an indication. Just as with fund managers, size is the enemy of effectiveness in private banking and wealth management. Swiss private banks have prospered globally for decades and even centuries while resisting the temptation to become too big.

Wealth managers share other features with fund houses. Being too small puts them at a disadvantage with respect to technology, marketing, administration and regulation. On the other hand, being too big endangers the quality of the services to clients. An optimal size lies in-between. Big bureaucracy vs personal service is the issue here. Perhaps the balance is shifting in favour of the ability to remain small with the support of platforms such as HighTower, which can provide umbrella services similar to what multi boutiques do for their component firms.

‘US wirehouses feel the pressure’, Helen Avery, Euromoney, December 2015


‘Eying brokerage culture’, Anna Prior, The Wall Street Journal, 06.01.16

This is the second of two related articles. Please see the previous one on ‘Advisers departing with clients hitting top US wealth managers’.
MISUSE OF DISCOUNT RATES

The valuation of future cash flows, implicitly or explicitly using discount rates, is a central aspect of much investor activity. Yet serious flaws are prevalent in practice in the way discount rates are applied in financial markets, business projects and other areas.

Referring to the prize-winning book The price of fish: a new approach to wicked economics and better decisions, co-authored by him, he pointed out that the implicit use of high discount rates contributes to the depletion of fishing stocks worldwide.

A seminar at Gresham College in London explored many weaknesses in the usage of discount rates. The starting point was the paper Uses and abuses of discount rates: a primer for the wary by Nick Goddard, a leading member of the think-tank Z/Yen. The paper covered basic concepts of discounting theory. The speakers at the seminar expanded on the subject, dealing with issues where discount rates are used either wrongly or in a controversial manner.

Professor Michael Mainelli, Chairman of Z/Yen and Professor Emeritus of Gresham College, opened the discussion by focusing on some long-term issues. He explained how the inappropriate use of discount rates can lead to misallocation of assets across generations. Referring to the prize-winning book The price of fish: a new approach to wicked economics and better decisions co-authored by him, he pointed out that the implicit use of high discount rates contributes to the depletion of fishing stocks worldwide.

Mainelli stated that in business the current discount rate is not always obvious and can cause heated discussion. He went on to outline various preconditions for the use of discount rates. Only after agreeing priorities and relative ranking of goals, discount analysis can be used to choose options within each goal, in his view.

Goddard drew upon his experiences at BP, followed by a stint evaluating power stations and later at an investment bank where he encountered some of the more dubious instances of discounted cash flow (DCF) analysis.

Often, an arbitrary hurdle rate of, say, 10% is used, regardless of whether or not it relates to the actual market ruling rates. He has seen three types of models. The first was very helpful in supporting business decisions. The second seemed to be just window dressing for a decision that was independently obvious, a reverse of common sense, and the third came across as disingenuous, serving just the interest of those presenting them. Goddard hoped that his paper would help others to distinguish when DCF models are useful or not, and even when they are dangerous.

There were many criticisms of the alternative market-based approach that ignores ethics

Goddard reiterated the famous acronym GIGO (garbage in, garbage out) as particularly applicable to discount rate analysis. Too many analysts excessively emphasise the level of discount rates, rather than the more important accuracy of the cash flows that are being valued.

The main speaker of the day, Professor Mark Freeman of Loughborough University, dwelt mostly on the social time preference rate (STPR) used for valuing long-term assets and liabilities, going even as far forward into the future as hundreds of years. This analysis has some relevance to the topics of impact and social investing and climate change, all of which are increasingly capturing the attention of fund managers.

Freeman did not dwell on what he thought the long-term STPR should be, but focused on controversies surrounding its estimation. A major thrust of his talk was based on surveys of expert academic opinion as to the level of this social discount rate.

Two surveys of expert academic opinion were analysed:
- Martin Weitzman (Harvard, 2001) received over 2,000 responses from PhD-level economists.
- Three co-authors and Freeman received around 180 responses from international experts, as defined by their academic publications on social discounting.

After outlining the different distribution of responses to the two surveys, both centring around 2%, Freeman went on to demonstrate the sensitivity of long-term valuation to seemingly small discount rate differences. At discount rates of 3.5% and 1.4%, the present value of a £1m outlay in 400 years would be a miniscule £1 and a much larger £3,844 respectively.

The central issue that is much debated concerns intergenerational justice. The Stern Review, of climate change fame, had argued that ethical issues are important in the choice of intergenerational discount rates. Various equations that incorporated ethical judgments as to the appropriate long-term discount rate were then presented. There were many criticisms of the alternative market-based approach that ignores ethics. These criticisms were:
- approach driven by personal considerations, not intergenerational justice
- markets influenced by the wealthy
- future generations having no say
- market frictions and imperfections.

Freeman said that markets may not resolve the problems, quoting Stern: “There is no market-determined rate that we can read off to sidestep an ethical discussion.”

Freeman concluded that there is little consensus, either in academia or among policy makers, as to whether the rate should be driven by ethics or markets, and whether it should reflect risk.

A key finding on how the discount rate should change in the long term was that any uncertainty should reduce the discount rate used. Freeman concluded that there is little consensus, either in academia or among policy makers, as to whether the rate should be driven by ethics or markets, and whether it should reflect risk. These policy issues are important because the attractiveness of intergenerational projects is hypersensitive to the discount rate chosen.

The next speaker, Matthew Rees, referred to the differences between the cost of capital in the public and private sectors, with the private sector level being generally higher. This has a bearing on whether the UK Government decides to retain or privatise a public asset. He stated that the Government is sometimes selective in whether to apply discount rates, citing the Lloyds Banking Group shares held by it. He concluded that reducing the risk of bias or error will require the avoidance of political estimates for the justification of an outcome that is already chosen.

Con Keating emphasised that uncertainty of any form lowers the discount rate. He quoted from the UK Government Green Book Appraisal and evaluation in central Government that the real rate to be used was 3.5% up to 30 years, going down to 1% after 300 years. He then touched on discount rates used for funded pensions, a topic on which he has written several papers for the Z/Yen think-tank.

Editor’s comment

The misuse of discount rates is just one aspect of the misuse of the mathematics in finance and investment, when used in a context that is not justified. This is the background to the misapplication of models, which were partly blamed for some of the worst aspects of the recent financial crisis that started with the subprime debacle.

‘Uses and abuses of discount rates: a primer for the wary’, Nick Goddard, September 2015

‘Why a primer?’, Nick Goddard, March 2016

‘Long-term discounting: ethics or markets?’, Mark Freeman, March 2016

‘Are you interested or discounted?’, Matthew Rees, March 2016

‘The folly of discount based valuations’, Con Keating, March 2016
CHANGING OF THE GUARD AT THE TOP OF THE INDUSTRY

In considering what might happen to the top ranks of the global industry in the next ten years, it might be worthwhile to consider what happened in the past ten. Tables 1 and 2 below list the top ten as published in *IMR*, ten years apart, in April 2006 and April 2016.

Five of the initial top ten still figure: State Street, Fidelity, Capital Group, Vanguard and J.P. Morgan. Barclays Global Investors reappears indirectly as part of BlackRock, its new parent. The Allianz Group has been replaced by Pimco, which is only a superficial change, as it is owned by Pimco and comprises its major part. So only three, UBS, AXA and Credit Suisse, have dropped out.

The next ten years is likely to bring about bigger changes (see editorial on inside front cover).

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<th>Rank</th>
<th>Manager</th>
<th>Total assets ($tn)</th>
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<tr>
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<td>UBS</td>
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<td>2</td>
<td>Allianz Group</td>
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<td>3</td>
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<td>5</td>
<td>Fidelity Investments</td>
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Table 1. The top ten global players published in *Investment Management Review*, April 2006

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<td>5</td>
<td>BNY Mellon Investment Management</td>
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Table 2. The top ten global players published in *Investment Management Review*, April 2016

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REGULATORY SPOTLIGHT

REGULATORS TIGHTEN FIDUCIARY STANDARDS

Dr Wolfgang Mansfeld

According to traditional economic thinking, the pursuit of commercial interests by product providers will not hurt the interests of customers. Effective competition will force companies to satisfy the customers better than rivals do in order to achieve commercial success, ie, profits.

If competition is not effective, regulation may impose rules on companies, to ensure they serve the needs of the customers. At best, these rules are a result of self-regulation. A forward looking company may abstain from seeking short-term benefits at the expense of consumers, because the long-term damage from this may be higher. In reality, effective self-regulating behaviour is seldom achieved. So the public regulator will step in and define and enforce the necessary rules.

It is extremely difficult for investors to fully understand the value that the fund manager delivers for them and to compare it with alternative products and providers

The fund management industry follows this general logic. Effective competition, according to the textbook, should force managers to behave as if they were obliged to assume a fiduciary responsibility for investors (which in strict legal terms is not the case). Whether competition works that way in reality is questionable. The main problem is the well-known information asymmetry between managers and clients. It is extremely difficult for investors to fully understand the value that the fund manager delivers for them and to compare it with alternative products and providers.

That is apparently true even for professional investors; recent evidence indicates that even leading pension funds do not have transparency on total fees retained by private equity managers from fund holdings. Effective self-regulatory steps by the fund industry are unlikely, as has been pointed out in this column recently.1 Therefore, the fund industry is being subject to comprehensive regulation. Since the financial crisis, the focus has shifted to rules regarding the conduct of providers, in order to strengthen the fiduciary standards applied by the industry. Satisfactory fiduciary standards require that fund managers act in the best interests of the client.

when they have discretion in handling client money. Independent experts support that regulatory focus.²

At EU level, a first set of such standards came with the Commission Directive for Undertakings for Collective Investments in Transferable Securities (UCITS) 2007, followed in 2011 by the Alternative Investment Fund Manager Directive. But the process does not stop here. I see at least four areas where a shift to stricter fiduciary standards is under way or – at least – under discussion:

1. paying for research (part of the recently approved Markets in Financial Instruments Directive (MiFID) II)
2. fund manager remuneration (part of the recently approved UCITS V Directive)
3. closet index-tracking (under scrutiny by European Securities and Markets Authority (ESMA) and some national regulators)
4. sales commissions paid by fund managers (part of the MiFID Directive).

European regulatory authorities intend to extend the bonus cap for banks – 200% of fixed salary – to those asset management companies that are bank subsidiaries. The fund industry, which strongly opposes such a move, is correct to argue that risks in asset management are different from those in banks.

Paying for research. Paying for research with soft commissions (which are not disclosed to investors) provides little incentive for fund managers to minimise the costs and optimise the use of research. Under provisions of the EU Financial Markets Directive, from 2017 on, fund managers will have to unbundle payments for execution and research. Research will have to be paid for explicitly by the fund manager – either out of the general management fee or via an explicit and transparent extra charge raised from the investors. Fund managers can be expected to press for lower transaction fees and buy research in a considered way.

The problem is not illiquid strategies as such (which have their merits) but that they are packaged into open end retail funds with an obligation to accept ongoing redemptions.

Fund manager remuneration. Remuneration rules, in particular those regarding variable pay, are extremely important to align the interests of managers and investors and discourage excessive risk taking. European regulatory authorities intend to extend the bonus cap for banks – 200% of fixed salary – to those asset management companies that are bank subsidiaries. The fund industry, which strongly opposes such a move, is correct to argue that risks in asset management are different from those in banks.

Closet index-tracking. ESMA recently analysed ‘closet indexing’ by investment funds – a practice where fund managers stay close to a benchmark. Closet indexing has already been subject to regulatory scrutiny in some EU member states. A preliminary quantitative analysis conducted by ESMA concluded that closet indexing might apply in the case of up to 15% of EU equity funds. As the management fees of such funds are normally comparable with those of truly actively managed funds, this practice raises questions. ESMA reminds that fund managers are required to provide clear and not misleading information to investors, and that this would include the duty to indicate the freedom to deviate from a benchmark.

Sales commissions: Under the EU MiFID Directive, fund managers and other product providers are permitted to pay commissions to distributors who sell their products. The current revision of the Directive (the secondary regulation is not yet finished) puts some restrictions on such rebates, but does not ban them completely. Advice will continue to be commission-based in most cases. But doubts will remain about whether a distributor accepting rebates can ever fully “act in the best interest of the client” as the Directive requires. I expect the discussion to carry on.

The FCA fund study

The projects mentioned above are not necessarily the end of the story. Opinions are divided on whether the current level of regulation is sufficient to ensure that fiduciary standards are met. The underlying question is whether the industry all in all delivers an appropriate level of benefits for investors. To clarify this, the UK Financial Conduct Authority (FCA) has recently announced a market study “to understand whether competition is working effectively to enable both institutional and retail investors to get value for money when purchasing asset management services.”³

The FCA has laid down a detailed proposal regarding the design of this study. It intends to research, among others, the following issues:

Value added. The incentives for asset managers to compete to provide value for money, and how asset managers and investors identify future performance.

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² An example is The Kay review of UK equity markets and long-term decision making, July 2012. Recommendation 7 of the review says: “Regulatory authorities at EU and domestic level should apply fiduciary standards to all relationships in the investment chain which involve discretion over the investments of others, or advice on investment decisions.”

³ The Financial Conduct Authority, Asset management market study, Terms of Reference, November 2015
Costs. Charging structures and underlying costs for providing asset management services; the extent to which investors are able and willing to compare different products and choose or switch to the one that represents the best value for them; the extent to which asset managers are willing and able to control and scrutinise costs when purchasing services on behalf of the fund.

Conflicts of interest. Whether vertical integration along different parts of the asset management value chain can lead to conflicts of interest and whether these are being managed appropriately; the role of investment consultants and the impact that they have on the purchase of asset management services by institutional investors.

This agenda looks ambitious. Whether it can provide new answers to old questions remains to be seen. If not, it could trigger further regulatory steps regarding rules of conduct and fiduciary standards.

Liquidity risk – an update

In my previous ‘Regulatory spotlight’ column, I highlighted the liquidity risk management challenges for the fund industry, given the deteriorating market environment and the fact that a number of funds apply less liquid investment strategies.

Shortly afterwards, Third Avenue Focused Credit, a US high-yield mutual fund, suspended redemptions and announced its liquidation. According to analysts, Third Avenue’s portfolio was far riskier, more concentrated and less liquid than those of comparable funds. Remarkably, a Morningstar analyst was cited as follows: “In hindsight, the strategy probably shouldn’t have been in a mutual fund wrapper.”

In my eyes, this is a key issue. The problem is not illiquid strategies as such (which have their merits) but that they are packaged into open end retail funds with an obligation to accept ongoing redemptions. Such funds – labelled ‘Newcits’ in Europe and ‘Liquid Alts’ in the US – carry an enhanced risk of product failure. Third Avenue’s failure is a signal that these funds will face tough challenges in times of market stress.

Dr Wolfgang Mansfeld, from 2002 to 2005, was the President of EFAMA. Until June 2011, he was on the Executive Board of Union Asset Management Holding, the holding company of Union Investment Group, Frankfurt am Main. From 2007 to 2010, Dr Mansfeld was the President of BVI (German Investment Funds Association). From 2004 to 2011, he was a member of ESMA (European Securities and Markets Authority) Consultative Working Group on Investment Management.

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NEW FUNDS HELP REDEFINE ESG AND SUSTAINABLE INVESTING

Jag Alexeyev

No longer our grandmother’s version of ‘responsible’ and ‘ethical’ funds

The world of sustainable and impact investing has changed dramatically since the days of our grandmother’s version of ‘socially responsible’ or ‘ethical’ investing. It is no longer about equity funds with simple exclusions of tobacco, alcohol or weapons producers. Now it is more about actively incorporating environmental, social and governance (ESG) risks, positive ‘best-in-class’ security selection across multi-asset classes, managing climate and ‘stranded asset’ risks throughout the supply chain, and achieving measurable positive impact in addition to a competitive financial return.

Several new products in recent months have expanded the range of sustainable fund management offerings, while evolving the scope and definition of ‘responsible’ investing. Importantly, some of the larger mainstream financial providers are now innovating in a segment that previously was served by investment specialists and boutiques. Over time this broadening of industry participation will mean a greater range of sustainable investment options for financial advisers and investors.

A retail impact fund built on a ‘big data’ quant engine

BlackRock last summer launched its first suite of retail ‘impact investment’ funds in Europe, in Japan, and in the US. The products invest in public equity securities, and thus represent a different approach from other impact investment funds that are mostly private equity and venture capital type offerings.

In addition, the approach is tied to existing ‘data science’ driven quantitative investment strategies run by BlackRock’s Scientific Active Equity (SAE) team. The team had already run long/short mutual funds alongside institutional quant strategies.

BlackRock Impact US Equity, the ‘40 Act mutual fund version, invests in equities of companies with ‘positive aggregate societal impact outcomes’, using the BlackRock SAE Impact Methodology and systematic, quantitative security selection models. Borrowing from our grandmother’s responsibility legacy, the fund will screen out certain companies or industries, including those in the tobacco, alcohol, and weapons sectors. But the rest of the strategy is distinctly modern. Securities are selected and weightings are allocated based on the issuer’s measurable societal impact outcomes, along with financial criteria.

The principal societal impact outcomes that are currently measured include green innovation, corporate culture, high impact disease research, and ethics controversies (eg, misuse of company funds, falsification of company records and other illegal activities, as well as factors in the areas of diversity, labour rights, health and safety, and the environment).

An Undertakings for Collective Investments in Transferable Securities (UCITS) sub-fund of Luxembourg-domiciled BlackRock Strategic Funds, Impact World Equity follows an impact methodology that is also managed by BlackRock’s SAE team. It has collected around $200m in assets. The fund aims at “identifying agenda-setters across the globe”, looking for companies with products, technologies and ways of doing business that have a positive impact in society. To find them, BlackRock scores 8,000 companies daily across three key impacts – health, environment, and corporate citizenship – before building a portfolio that aims to outperform on impact.

BlackRock’s retail fund in Japan, named Big Impact, feeds into the UCITS.
Aspiration Redwood – ‘Pay what you wish’ for sustainability

Less visible than the BlackRock offerings, the UBS-advised Aspiration Redwood fund nonetheless represents innovation across multiple fronts, merging sustainability with the robo-adviser/finTech (financial technology) revolution and a unique pricing approach.

Aspiration, a Los Angeles based online financial firm with a focus on sustainability, seeks to bring a ‘conscious consumer’ approach to investing that combines social and financial goals. Its Redwood fund is based on a strategy made available by UBS to institutional and private wealth clients.

Less visible than the BlackRock offerings, the UBS-advised Aspiration Redwood fund nonetheless represents innovation across multiple fronts, merging sustainability with the robo-adviser/finTech (financial technology) revolution and a unique pricing approach.

Interestingly, Aspiration pursues a ‘pay what is fair’ business model that allows customers to choose their fee, ranging from zero to 2%. Other fund expenses have been capped at 0.5%. The firm also donates 10% of revenue to microloans and mentoring for low-income Americans. UBS joined Aspiration in being compensated on a ‘pay what is fair’ basis and donating 10% of their revenue in this fund.

Other new funds worth tracking

Several fund managers have introduced new sustainability themed products recently that are worth tracking. These include:

- Resonance Bristol Social Investment Tax Relief Fund (developed with UBS)
- Mirova Core Infrastructure
- AXA Planet Bonds (Green Bond)
- Tera Neva

These products reflect a range of strategies and structures that have so far been uncommon in the fund industry. Resonance Bristol Social Investment Tax Relief Fund, developed in collaboration with UBS, invests in social enterprises helping to tackle poverty. It takes advantage of tax relief measures that provide incentives for investment in charities, community interest companies and community benefit societies. The UK Government introduced the Social Investment Tax Relief in April 2014 to encourage investment into social enterprises.

AXA Planet Bonds meanwhile is a play on the growing universe of Green Bonds, whose proceeds are invested in environmental projects. Before the launch of the fund, AXA Investment Management had already invested €1bn in the green bond market.

Worth noting in this segment is Tera Neva, a €500m capital guaranteed equity index-linked green structured product developed by BNP Paribas, European Investment Bank (EIB) and Vigeo. It was built around the EIB’s Climate Awareness Bond format, which dedicates proceeds to renewable energy and energy efficiency projects. The transaction, arranged by BNP Paribas, is 100% capital guaranteed. The payoff is linked to the performance of the ‘Ethical Europe Climate Care Index’ over the life of the bond, floored at zero and paid at maturity. The Index consists of 30 European equities selected on financial and sustainability criteria based on Vigeo and Solactive’s filters. Institutions investing in Tera Neva have included Aviva, BNP Paribas Cardif, ERAFP, Generali, Groupama, HSBC Assurances, and Natixis Assurances among others.

Sustainable investing may actually enhance investment outcomes in some cases

Mirova Core Infrastructure Fund, introduced by Natixis subsidiary Mirova, is a €600m ‘brownfield’ infrastructure fund. Brownfield projects relate to the operation or expansion of existing infrastructure assets, in contrast to greenfield projects that relate to the development of new facilities. The capital for the fund was raised from European investors including pension funds, insurance companies and funds of funds.

Other sustainability themed products recently introduced in Europe include Generali SRI Ageing Population, TiAA Global Equity ESG/US Bond ESG UCITS, and Deka Oekom Euro Sustainability UCITS ETF.

Looking to the future

Product innovation around sustainability will become an increasingly important element of the fund management industry in coming years. In part it will be driven by client demand and changing investor demographics. In particular, addressing the values, concerns, and extra-financial objectives of younger investors, including the millennial generation, will be important for fund managers and wealth advisers hoping to attract and retain their assets in the future.

Greater access to information, facilitated by technology, is also raising awareness of corporate governance matters and the financial risks associated with poor ESG performance. Meanwhile, fund track records and other evidence suggest that sustainable investing does not involve a trade-off in financial performance, and may actually enhance investment outcomes in some cases.

Regulatory changes will also help. In the US, for example, a milestone for sustainable investing was reached in October when the US Department of Labor clarified how fiduciaries may consider ESG factors or ‘economically targeted investments’ in retirement plan choices. As the demographic profile of plan participants shifts to younger investors and the millennial generation, who place a higher value on values-based investing, employers will recognise the benefit of including a broader range of ESG investment options to help attract and retain talent.

Jag Alexeyev is Founder of Impactvesting, a research and consulting firm that helps asset managers create climate resilient and sustainable investment solutions. He advised more than 100 asset managers as Head of Global Research at Strategic Insight, a leading provider of fund intelligence. He established Strategic Insight’s international operations in 2001 and led the group until 2014.
RECORD INFLOWS FOR ALTERNATIVE INVESTMENT IN EUROPE AND CROSS-BORDER

Bryan Liu

The net sales of alternative investment products (excluding funds of hedged funds), most of which are alternative Undertakings for Collective Investments in Transferable Securities (UCITS) and ‘Liquid Alts’, set a new record at €67bn during 2015 in Europe and cross-border, an increase of 60% from the previous year. The total assets under management (AUM) of alternative funds in the region reached nearly €280bn, more than doubling the amount five years ago. Notably, non-UCITS products in 2015 accounted for about 10% of total AUM of alternative funds tracked in Simfund Global, a sharp decline from a 50% share in 2007, reflecting a rapid growth of alternative products in the retail space since the 2008 financial crisis, as both traditional fund firms and hedge fund boutiques have actively entered the arena by wrapping alternative investment strategies in a UCITS format.

The demand among retail investors for alternative products, often through financial advisors, is growing in volatile markets under a prolonged low-interest environment. The alternative strategies provide new options to investors seeking to protect and diversify their assets amid market uncertainties. Compared to hedge funds, alternative UCITS and Liquid Alts mutual funds are more liquid and transparent, and are thus also attractive to many institutional investors, such as pension funds. In response to the strong demand, both traditional asset managers and hedge fund specialists are accelerating the launch of new products. Notably, alternative funds represented one of the bestselling categories for new fund launches during 2015 in Europe and cross-border, collecting nearly €17bn of net new money.

Among all the alternative strategies, multi-strategy led the way, gathering €21bn during 2015, almost double the amount of 2014 and nearly four times as high as that of 2013. The two notable multi-asset strategies, Alt-Multistrategy and Absolute Return Multi Asset, defined as Strategic Insight Simfund investment objectives, share some similar characteristics, particularly for recent launches. In fact, many recently launched alternative funds aim to achieve positive absolute returns over the long run, and have a low correlation to traditional equity and bond indices, and lower volatility than traditional equity markets. They usually pay attention to protect downside risks and actively pursue either single or a combination of well-defined hedge fund strategies, including long/short, market neutral, managed futures, arbitrage, volatility and global macro.

However, we believe that many absolute return products are substantially different from the various alternative strategies primarily based on hedge fund styles – the former

![Alternative investment strategies in Europe and cross-border, 2015 (€bn)](image-url)

*Note: Excludes funds of hedge funds. Source: Strategic Insight Simfund Global*
tend to focus more on traditional assets to achieve core returns, and use alternative strategies for risk management and additional returns, while the latter mainly use those well-defined hedge fund strategies to achieve their investment objective.

In 2015, DWS Concept Kaldemorgen topped the Alt-Multistrategy category with €2.4bn in net flows from both retail and institutional investors. The veteran fund manager Klaus Kaldemorgen pursues a total return strategy by investing in different traditional and alternative assets and strategies (eg, long/short, currency and futures), aiming to achieve two-thirds of the gains of any market upside, while being subject to only one third of downside risks.

Among other bestselling alt multistrategy funds, Mercer Flexible LDI Sterling Fixed Enhanced Matching fund, managed by the UK-based wealth management specialist Mercer, garnered €0.9bn in net flows in 2015. The fund invests through BlackRock Liability Matching Funds (Dublin) to gain general leveraged exposure to movements in real rates. Another product from the same firm, Mercer Multi-Asset Credit fund, added €0.8bn, investing in a group of funds managed by selected specialist investment managers. Franklin K2 Alternative Strategies also uses a multi-manager approach to utilise the expertise of each manager. As of January 2016, the fund was advised by 12 managers, including Lazard and Loomis Sayles, across four main alternative strategies. Lona/Short funds raised about €17bn in net flows during 2015. Roughly €10bn of net flows went to Market Neutral products in 2015, more than five times higher than in the prior year. Credit/Debit strategy garnered around €8bn in net flows, with BSF Fixed Income Strategy collecting €3.5bn alone (see table below).

Managed Futures was also a popular strategy, generating nearly €4bn of inflows in 2015, with the majority of flows going to German managers. Union Investment’s Unikonzept: Portfolio invests mainly in assets with less value fluctuations through an intensive use of derivatives/futures, focusing on allocation of risk (risk parity) rather than allocation of capital. DB Platinum IV Systematic Alpha (not in the top 15 list) uses a computer-based trading strategy designed by Winton Capital Management and invests in derivatives and transferable securities, with Winton advising the former and State Street Global Advisors managing the latter.

Amid increased market volatility and uncertainties, the demand for alternative UCITS focusing on achieving a total return/absolute return is likely to continue in 2016 in Europe and beyond. In Asia, for example in Singapore, more managers are offering Liquid Alts products to cater to needs of private bank clients, more affluent retail investors, and of course institutional investors, as part of their portfolios to protect downside risks. In Taiwan, the Luxembourg-domiciled JPMorgan Global Macro Opportunities fund, which invests more than 40% of its assets in derivatives, was approved for sale at the end of 2015, indicating the increasing but still cautious acceptance of the use of derivatives by Asian regulators.

However, high expenses (sometimes including performance fees), complexity of the products, relatively short track records as well as wide variations in outcomes among individual funds and some regulatory concerns, remain as main barriers for the distribution of alternative UCITS and Liquid Alts products to broader retail investors. In fact, alternative mutual funds suffered $13bn in net redemptions in the US during 2015, the first occurrence of outflows on an annual basis since the rise in interest in Liquid Alts products post financial crisis. After a strong growth in 2015, we might see some pull-backs of alternative UCITS in the European markets in the coming months or years.

Nevertheless, as Managed Futures funds in the US still attracted $8.2bn in net flows in 2015, excellent managers and funds (such as AQR) are continuing to gain investor and advisor attention and assets. This trend perhaps will be increasingly more visible during a longer and heavier market downturn.

Bryan Liu, Managing Director, Global Research
Strategic Insight, an Asset International company, is a research and consulting firm, which supports over 250 companies around the world with analysis, perspective and data on the fund industry. Its Simfund Global databases track monthly flows, assets, performance, ratings and other intelligence on more than 60,000 portfolios and many more fund share classes globally, totalling $23tn in assets.

Bestselling alternative funds in Europe and cross-border, 2015 (€bn)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Fund Name</th>
<th>Manager</th>
<th>Objective</th>
<th>Launch</th>
<th>AuM (Dec 15)</th>
<th>Net Flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>BSF Fixed Income Strategy</td>
<td>Blackrock</td>
<td>Alt - Credit/Debit</td>
<td>Sep-09</td>
<td>5.5</td>
<td>3.5</td>
</tr>
<tr>
<td>2</td>
<td>DWS Concept Kaldemorgen</td>
<td>Deutsche AWM</td>
<td>Alt - Multistrategy</td>
<td>May-11</td>
<td>4.1</td>
<td>2.4</td>
</tr>
<tr>
<td>3</td>
<td>Old Mutual Global Equity Absolute Return</td>
<td>GAM</td>
<td>Alt - Market Neutral</td>
<td>Jun-09</td>
<td>4.8</td>
<td>3.1</td>
</tr>
<tr>
<td>4</td>
<td>Julius Baer ER Absolute Return Europe Equity</td>
<td>SGI</td>
<td>Long - Short</td>
<td>Mar-05</td>
<td>3.0</td>
<td>2.0</td>
</tr>
<tr>
<td>5</td>
<td>Henderson Gartmore UK Absolute Return</td>
<td>Parkers</td>
<td>Alt - Multi-Asset</td>
<td>Dec-15</td>
<td>4.6</td>
<td>3.1</td>
</tr>
<tr>
<td>6</td>
<td>G/M Global Real Return</td>
<td>G/M</td>
<td>Alt - Multi-Asset</td>
<td>Dec-15</td>
<td>4.1</td>
<td>1.7</td>
</tr>
<tr>
<td>7</td>
<td>DWSCA Invest Multi</td>
<td>DWS</td>
<td>Alt - Multi-Asset</td>
<td>Jun-13</td>
<td>4.9</td>
<td>3.2</td>
</tr>
<tr>
<td>8</td>
<td>Legg Mason WA Macro Opportunities Bond</td>
<td>GAM</td>
<td>Alt - Multi-Asset</td>
<td>Jul-13</td>
<td>3.9</td>
<td>2.1</td>
</tr>
<tr>
<td>9</td>
<td>BSF European Absolute Return</td>
<td>BSF</td>
<td>Alt - Multi-Asset</td>
<td>Nov-12</td>
<td>2.3</td>
<td>1.1</td>
</tr>
<tr>
<td>10</td>
<td>AZ Fund 1 Arbitrage A-AZ Fund</td>
<td>AZ Fund</td>
<td>Alt - Multi-Asset</td>
<td>Jun-15</td>
<td>1.1</td>
<td>0.5</td>
</tr>
<tr>
<td>11</td>
<td>Morgan Stanley Global Balanced Risk Control</td>
<td>Morgan Stanley</td>
<td>Alt - Multi-Asset</td>
<td>Jul-14</td>
<td>2.2</td>
<td>1.0</td>
</tr>
<tr>
<td>12</td>
<td>P/F Agora P</td>
<td>P/F Agora</td>
<td>Alt - Multi-Asset</td>
<td>Dec-15</td>
<td>1.1</td>
<td>0.5</td>
</tr>
<tr>
<td>13</td>
<td>Mercer Flex LDI ER Fixed Enhanced Matching 2 M-5</td>
<td>Mercer</td>
<td>Alt - Multi-Asset</td>
<td>Mar-15</td>
<td>1.1</td>
<td>0.5</td>
</tr>
<tr>
<td>14</td>
<td>Unikonzept: Portfolio A</td>
<td>Kaldemorgen</td>
<td>Alt - Multi-Asset</td>
<td>Jan-15</td>
<td>1.1</td>
<td>0.5</td>
</tr>
<tr>
<td>15</td>
<td>Franklin K2 Alternative Strategies</td>
<td>Franklin</td>
<td>Alt - Multi-Asset</td>
<td>Aug-15</td>
<td>1.1</td>
<td>0.5</td>
</tr>
</tbody>
</table>

Total Above: 41.1 24.5

Note: Excludes money market funds, internal funds of funds and funds of hedge funds Source: Strategic Insight Simfund Global
Global managed assets

In isolation, it is difficult to interpret what amounts and growth rates mean. Figures in billions and trillions are bandied around and it is useful to assess how the numbers for each sector relate to the whole.

Estimated global managed assets at end 2015 reached $105.6tn, representing an increase of 0.9%, compared with the corresponding end 2014 figure.

Although hedge funds, exchange-traded funds and private equity are much talked about and receive prolific coverage in the media, it is interesting that they are all (still) small in total relative to mutual funds. The other big asset pools include pension funds, insurance and sovereign wealth funds.

Two new categories appear in the table on the left and elsewhere in this section: Regulated open end funds and Private capital. The first category includes mutual funds and exchange trade funds. The second is a broader category of private close end funds with the actual figures very close to private equity (please see notes 2 for details of these changes).

Regulated open end funds (see notes 2) achieved inflows of $1.4tn globally in the first three quarters of 2015.
Balanced funds received the strongest inflows. Regulated open end fund assets were $36.2tn at the end of September 2015, slightly below the end 2014 level.

Exchange-traded products (ETPs)

<table>
<thead>
<tr>
<th>End of period</th>
<th>Net flows ($bn)</th>
<th>Assets ($bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>331</td>
<td>2,778</td>
</tr>
<tr>
<td>2015</td>
<td>351</td>
<td>2,959</td>
</tr>
<tr>
<td>Global industry</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Private capital fundraising was again strong in 2015, although below the 2014 level, with more than $550bn of capital raised and assets reaching $4.2tn mid 2015, according to Preqin research.

Top ten asset managers

<table>
<thead>
<tr>
<th>Rank</th>
<th>Manager</th>
<th>Total assets ($tn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>BlackRock</td>
<td>4.7</td>
</tr>
<tr>
<td>2</td>
<td>Vanguard Asset Management</td>
<td>3.1</td>
</tr>
<tr>
<td>3</td>
<td>State Street Global Advisors</td>
<td>2.5</td>
</tr>
<tr>
<td>4</td>
<td>Fidelity Investments</td>
<td>1.9</td>
</tr>
<tr>
<td>5</td>
<td>BNY Mellon Investment Management</td>
<td>1.7</td>
</tr>
<tr>
<td>6</td>
<td>J.P. Morgan Asset Management</td>
<td>1.5</td>
</tr>
<tr>
<td>7</td>
<td>Capital Group</td>
<td>1.4</td>
</tr>
<tr>
<td>8</td>
<td>PIMCO</td>
<td>1.4</td>
</tr>
<tr>
<td>9</td>
<td>Pramerica Investment Management</td>
<td>1.2</td>
</tr>
<tr>
<td>10</td>
<td>Amundi</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Notes 1

The Investment Management Review (IMR) calculated the statistical figures based on publications of the following institutions: ICI, EFAMA, BlackRock International, Hedge Fund Research, IPE, OECD, Preqin, Statista and Towers Watson.

Regular, systematic and authoritative statistics across all sectors are hard to come by in the fund management industry. Given that the statistics are from different sources, there may be some incompatibility in the definitions and assumptions underlying the figures. Hence, the figures reported should be treated as approximate and designed only to give a feel for relative orders of magnitude.

IMR cannot accept responsibility for the accuracy of the figures cited, as they are not based on our primary research and are meant to help our readers to identify the broad trends in the industry across different sectors and their relative importance to the whole.

Notes 2 (Changes in the asset management perspectives, IMR April 2016)

The ‘Perspectives’ column for IMR April 2016 contains some changes in the categories, figures and sources for the statistics.

Mutual funds

The mutual fund statistics are based on the statistics of ICI, EFAMA and IIFA (which among them are consistent).

Since 2015, these statistics have been broadened. They include now all substantively regulated, open end investment funds. The broadened coverage has been applied backdated, starting with the first quarter 2014. The figures in IMR April 2016 reflect the new format, also for the 2014 figures. Therefore, the 2014 figures in IMR April 2016 are not the same as the 2014 figures in the previous IMR issues.

Furthermore, the category has been renamed from ‘Mutual funds’ to ‘Regulated open end investment funds’. The new category comprises the total of exchange-traded funds (which was not the case before).

A detailed description of the new collection can be found in EFAMA’s International statistical release 2015, Q1, p.8.

The first table in this section – titled ‘Global managed assets’, is an estimation. The official end 2015 figure, based on the official IIFA statistics, will be published in IMR July 2016.
Hedge funds

So far the hedge fund statistics had been based on monthly public press releases by Eurekahedge. In the course of 2015, Eurekahedge has stopped the press releases in the usual format.

Therefore, IMR has switched to Hedge Fund Research (HFR) as a source. HFR is the leading provider of hedge fund analysis worldwide.

HFR issued press releases on 20 January 2015 and 20 January 2016, which contain figures both for investor net inflows of the year before, and the AUM year end. The figures in IMR April 2016 for 2014 are higher than the 2014 figures in previous issues, because HFR covers a broader fund universe than Eurekahedge does.

Private equity

Private equity (PE) figures have been based on Preqin press releases or free publications for years. Preqin has now announced an "updated terminology" for the fund categories covered. From now on:

- ‘Private equity’ will be narrowed and refer to buyout and VC only.
- A new broader category – ‘Private capital’ – will refer to a broader spectrum of private closed-end funds, including PE, Private Real Estate, Infrastructure and Natural Resources.

Figures are also published for 2014, according to the updated classification.

The new category ‘Private capital’ is, with reference to the figures, very close to the former PE category. Therefore IMR decided not to stick with the PE category – which would have meant to work with much lower figures from now on – but to apply the new ‘Private capital’ category. Figures for this new category are available for 2014 and 2015, and there is little change regarding the 2014 figures used up to now.