Global Asset Management
Phase 1 - US, UK and Germany
Insights Report
2015

nmg CONSULTING

Shape Your Thinking

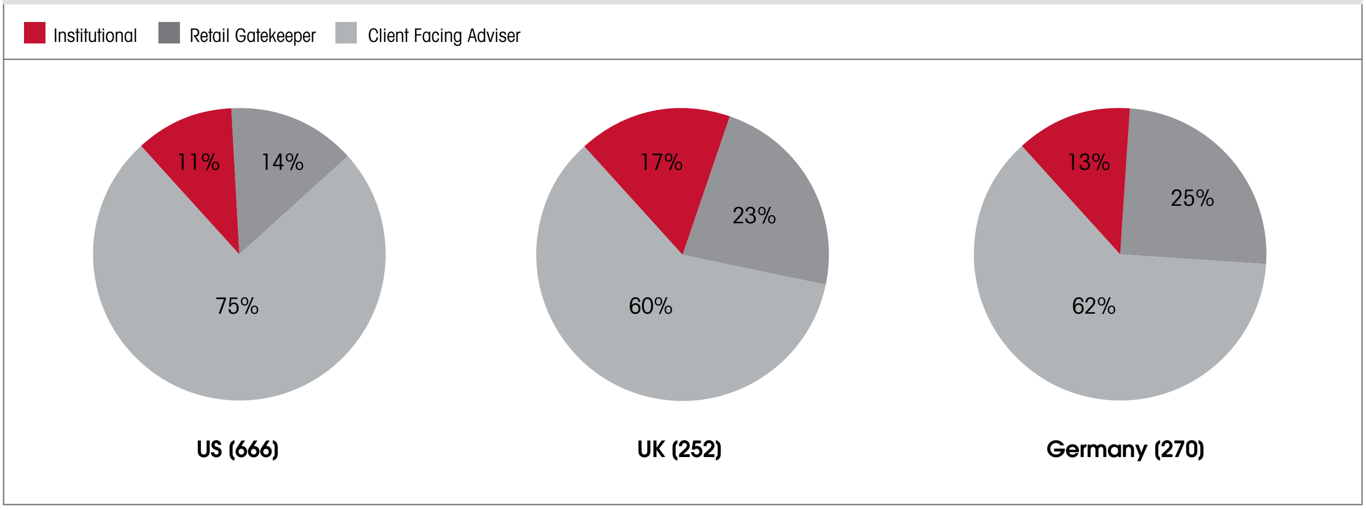
Introduction

Welcome to the phase 1 report of our annual global asset management study on the US, UK and Germany. This report covers the institutional, retail gatekeepers and client facing financial adviser segments in each market based on over 1,000 interviews in the second quarter of 2015. Institutional and gatekeeper interviews were completed in person or by phone while retail adviser interviews took place online. **Figure 1** sets out the underlying samples in each market.

Our objective is to develop the most consistent and comprehensive study of asset management buyers globally. The study explores key success factors and asset manager performance with a focus on managers with international aspirations and their marketing capabilities. The ultimate goal is to help asset managers better meet the needs of their clients, including asset consultants, DB and DC plan sponsors, insurers, endowments, family offices, private/retail banks, platforms, brokers and financial advisers.

This report shares key findings and feedback with participants in the US, UK and Germany who were interviewed during the second quarter of 2015. It will also provide context for potential research participants as we extend the study into our phase 2 markets that include Canada, France, Italy, Spain, Switzerland, Netherlands, Japan, Taiwan, Hong Kong, Singapore and Australia.

Figure 1 – NMG Global Asset Management Sample – Phase 1



Summary of Key Themes

This reports sets out the opportunities and challenges for asset managers with global aspirations based on end client interviews in the US, UK and Germany. We have summarised our findings into 5 themes below. Further insight and supporting evidence for these themes are included in the main body of the report.

1. **While institutional market structure varies by region, the in-scope markets are characterised by relatively low growth and declining contestability**. There are major differences in institutional market dynamics driven primarily by pensions regulation and product structures. However, each institutional market is relatively low growth which makes competitive dynamics tougher. Institutional clients want more strategic partnerships with managers but client feedback indicates that few asset managers have succeeded in developing these relationships.

2. **Understanding the evolution of retail investment propositions and dynamics between gatekeepers and client facing advisers is critical for success**. The US gatekeeper market adopts more qualitative/institutional behaviours relative to UK and Germany. However US gatekeepers are struggling most to increase their influence over asset placements relative to client facing advisers. Furthermore, few managers succeed with both client facing advisers and gatekeepers even in a single market.

3. **There are very few genuinely global active asset manager franchises**. While there are structural barriers to international expansion such as home-market bias, product differences and capacity constraints, this is only half the story. Client interviews indicate that certain managers with international aspirations have lacked Board commitment, investment and sufficiently diversified entry strategies.

4. **Weakening home market bias and robust demand for active are opportunities for global asset managers**. Institutional and retail investors across markets are seeking more global exposure. Despite evidence of barbelling and growing interest in indexing amongst certain asset classes, there is strong support for active management across segments. However, it will be challenging for new/global managers to exploit emerging product themes as part of their growth strategy.

5. **Marketing is increasingly important for international managers to compete with local champions with aligned distribution and time in market**. A range of thought leadership initiatives are critical for success in institutional and gatekeeper segments and align well to global manager capability. Client facing adviser marketing is the biggest challenge for global managers who often lack local distribution and product breadth and existing revenues and profit to justify the investment.

Theme 1: Institutional Market Structure

While institutional market structure varies by region, the in-scope markets are characterised by relatively low growth and declining contestability

The US, UK and German institutional markets are comprised of the same market participants (asset consultants, pension funds, insurers, endowments and charities) but the structure of each market is very different. As an example **Figure 2** shows the stark differences in the rate of migration from DB to DC in each market.

The UK is most weighted to defined benefit (DB) private sector assets accounting for 71% of total pension assets. Despite closure of most funds to new entrants and emergence of defined contribution schemes decades ago, existing assets have been sticky. Regulations have discouraged transfers out and DC assets continue to grow slowly. The phased roll out of auto enrolment and low contribution rates mean that UK DB assets will still comfortably outweigh DC assets in 2020. The key trend in the UK has been the shift from corporate to retail and from retail pensions to retail ISA and unwrapped savings. Corporate DC administration remains highly fragmented and low margin with new master trust structures emerging and limited integration between administration and asset management.

Figure 2 – Corporate DB versus DC mix by market

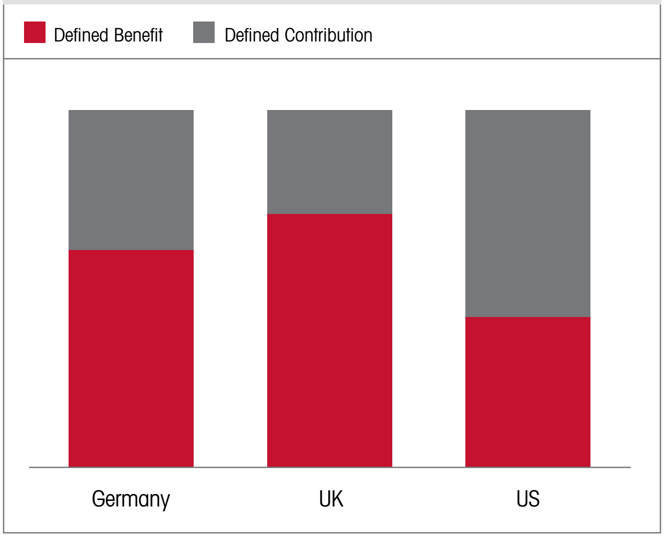


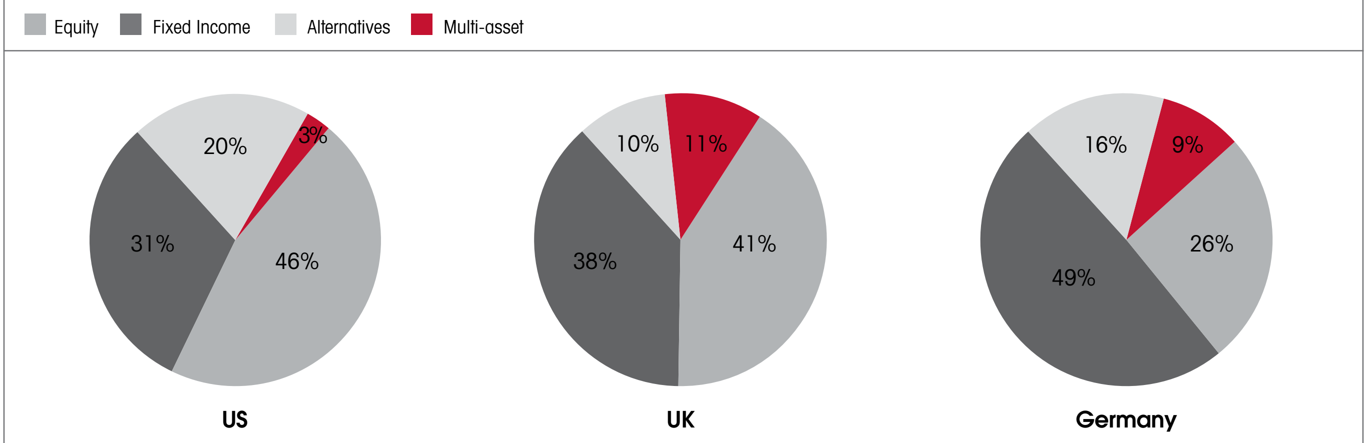
Figure 3 – Net product flows (inflows minus outflows) for wealth management products in the UK in 2014 (£ bn)

Product	Outflow	New Flow	Net Flow % of assets
Corporate DB			(5%)
Life Wrappers			(12%)
Direct Shares			(6%)
Annuities			(3%)
SS ISA			(1%)
Drawdown			(2%)
Personal Pension			1%
Cash ISA			3%
SIPP			5%
Corporate DC			2%
Direct Funds			9%
Total	(80)	–	80	(1%)

Sources: ABI, IMA, TISA, Annual Reports, NMG BQM Wealth Studies

In contrast, the US has seen faster migration from DB to DC structures with more active marketing of DB transfers to members. The move has been accompanied by vertical integration with asset managers dominating 401k record keeping and achieving high alignment of funds compared to international benchmarks. Respondent feedback also indicated higher levels of indexing in the US corporate DC segment relative to international peer markets. The US institutional market is also more diverse and complex. There is a large state pension fund segment many of which are running deficits. There is also a more established endowment sector and higher usage of asset consultants. Smaller plan sponsors especially were heavily reliant on third parties and these relationships often stretch beyond strategy into execution.

Figure 4 – Average asset allocations in the UK, US and German institutional market



Note: Cash and Money Market Funds excluded

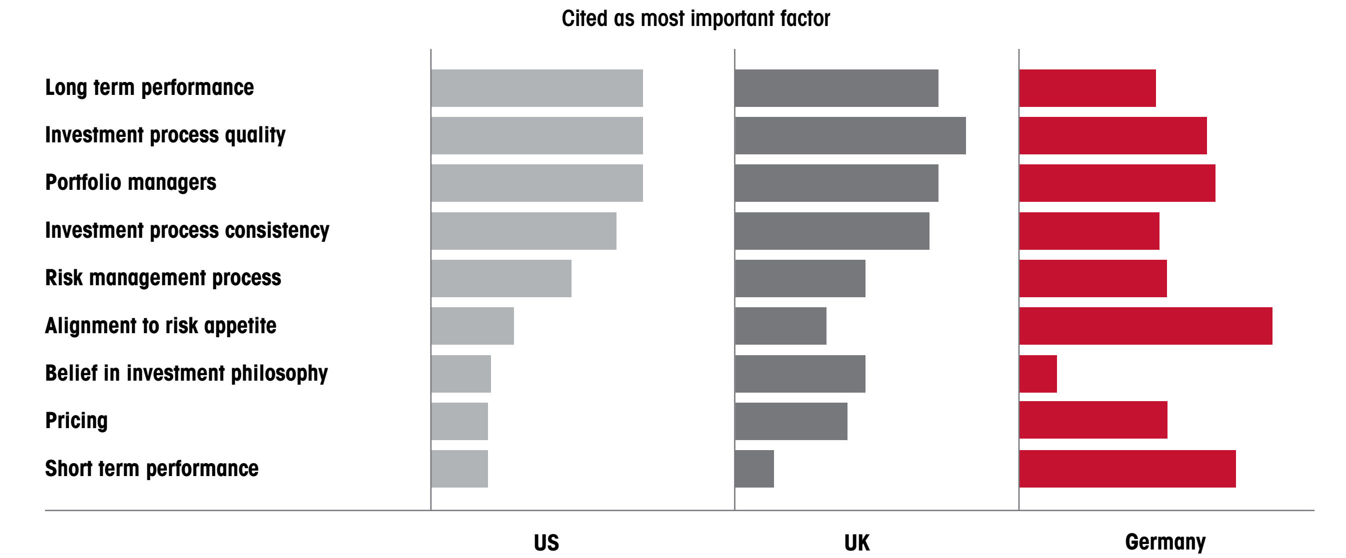
Germany is different to the US and UK. The pace of migration from DB to DC varies between the UK and the US, but for Germany the nature of DC assets is distinct. Return of premium guarantees create liabilities within DC driving much higher allocations to fixed income and greater outsourcing of pension assets to insurers. **Figure 4** sets out high level asset allocation from institutional participants in our study validating higher allocations to fixed income in the German market.

In Germany structural differences drive different buyer values. More balance sheet insurance assets and pension guarantees coupled with recent local regulation on capital, reporting and surplus distribution have increased the use of tactical asset allocation and focused the German institutional market on shorter term performance (defined as 1 and 3 year metrics). **Figure 5** highlights the difference between German, UK and US institutional buyer values for active asset management.

Despite structural differences, there are common themes. First, all these markets are large both in the context of global active assets and their adjacent retail market. Second each market faces a growth challenge as assets migrate from DB to DC pensions and from insurer balance sheets to unit-linked products. Employers are not only seeking to outsource liabilities but they are also less willing to contribute in a world where employee/employer engagement is weaker and employees want more choice over their benefits. Meanwhile insurers are struggling to manufacture balance sheet (general account) products in a low return investment environment with tougher capital requirements and more fee-based financial advisers.

From an asset management perspective, less new flow makes it more important to displace competitors or direct/internal substitutes. However, there was consensus that few managers really understand institutional client business models and the nature of their investment objectives and liabilities. Few managers were cited as leaders across institutional client segments and markets despite high levels of penetration from global asset consultants and strong demand for more strategic relationships with asset managers from institutions. We will explore the performance and challenges for international managers in more detail in subsequent themes.

Figure 5 – Institutional investment drivers for US, UK and Germany



Theme 2: Retail Market Structure

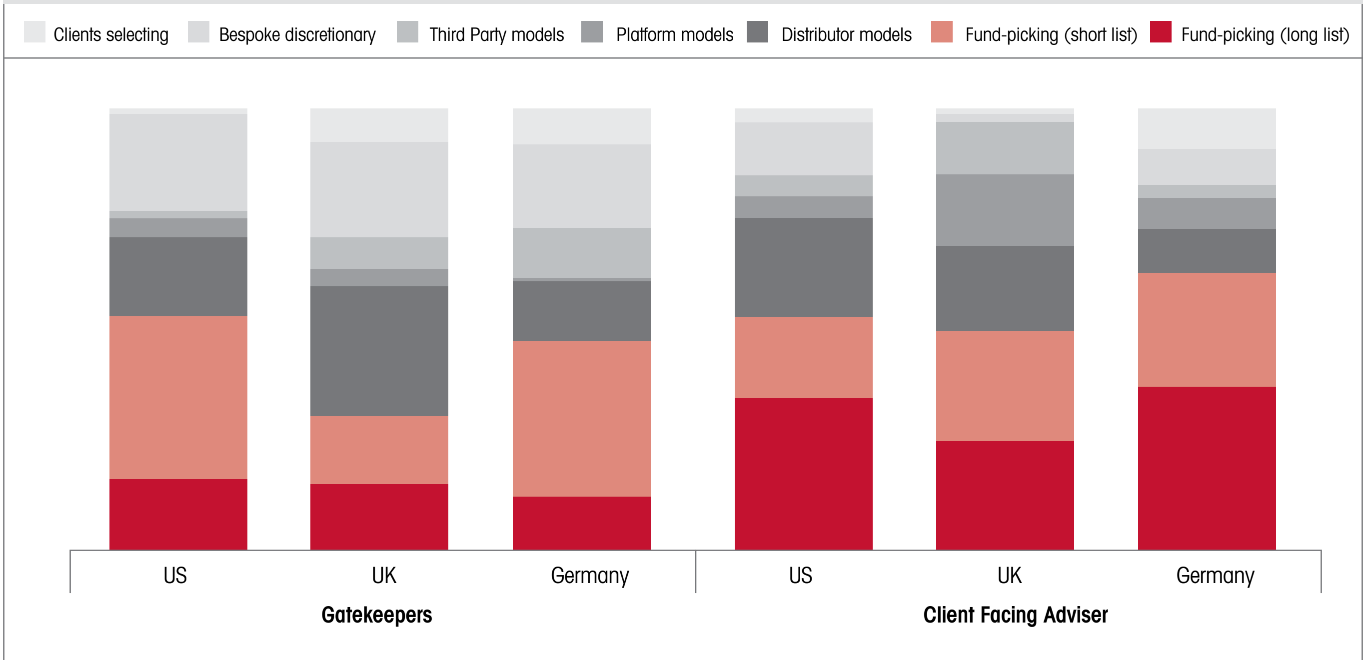
Understanding retail investment propositions and dynamics between gatekeepers and client facing advisers is critical for success

The retail asset management market requires an understanding of product, administration and advisory parts of the retail value chain. The key participants in this value chain vary by market. In the US the majority of assets are controlled by wirehouses, broker dealers and RIAs while in the UK financial advisers serviced by platforms and discretionary fund managers control most assets. Germany is different again with retail banks and traditional life insurers exerting more influence.

While the type of retail firm is important (e.g. retail bank, wirehouse or broker), our primary retail segmentation for asset management is driven by the relative importance of gatekeepers and client facing advisers in selecting asset managers and funds. Gatekeepers are head office based investment specialists with responsibility for fund manager due diligence, approved fund lists and model portfolio development. Gatekeepers could exist within any of the firms above. In contrast, client facing advisers manage retail client relationships as their primary objective.

The relative role and influence between gatekeepers and client facing advisers is important for asset managers. This dynamic is strongly influenced by the investment proposition design: model portfolios are controlled by gatekeepers while fund selection from panels or lists gives advisers significant influence. Our analysis in **Figure 6** suggests that model usage and the influence of gatekeepers is highest in the UK, while German gatekeepers have least control. **Figure 6** also shows reasonable consistency between gatekeepers and client facing adviser responses, indicating limited conflict between the two groups.

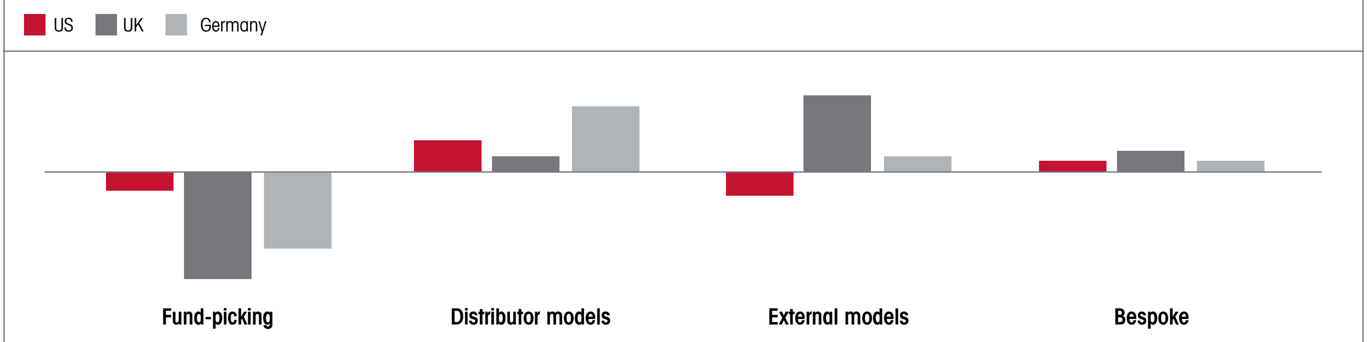
Figure 6 – Split of assets by investment proposition for gatekeepers and client facing advisers by market



The direction of travel is also important with **Figure 7** highlighting a divergence between US and European models. In the UK and Germany there was consensus that gatekeeper influence was increasing. More advisers recognise they struggle to successfully pick funds and institutions want to increase value chain participation in response to regulatory driven economic pressures. In the US respondents explained that RIA was the growth segment and these models often involved greater adviser autonomy on fund selection than in broker dealer or wirehouse models.

Gatekeeper and client facing advisers chose funds in different ways. Our analysis in **Figure 8** shows that advisers focus heavily on long term performance with 79% of advisers across our study citing long term performance as a top 5 factor and 50% as the lead factor. In contrast, gatekeepers consider a much broader range of factors including investment process quality and consistency as well as the quality and profile of the underlying fund manager. Long term performance is important but citations as the lead factor drop from 50% in adviser to 32% for gatekeeper.

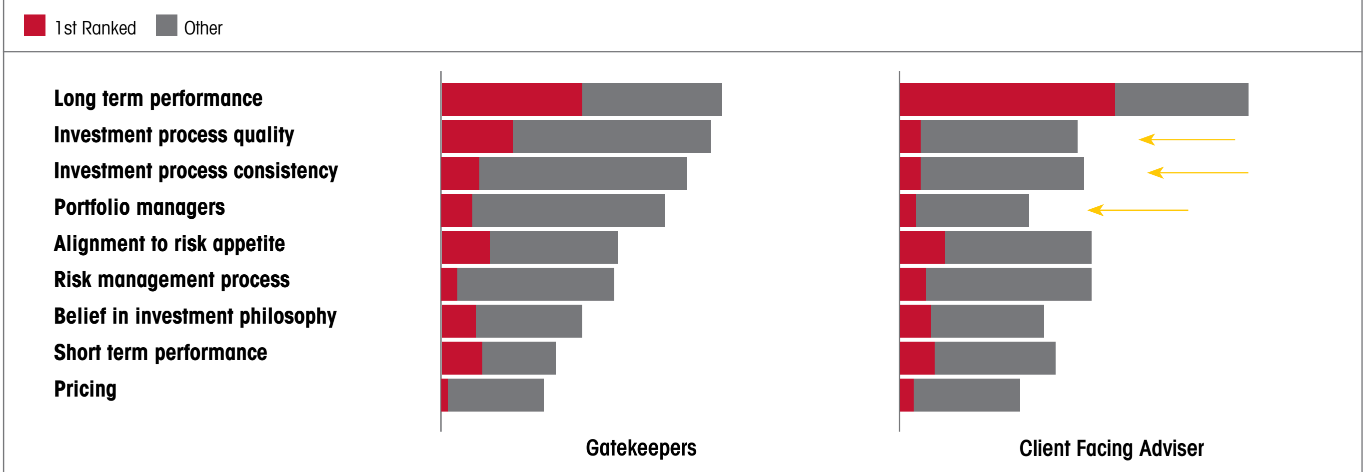
Figure 7 – Future expected growth by investment proposition by market (aggregate gatekeeper and client facing adviser)



Note: The above graph represents net respondent view (% citing increase less % citing decrease)

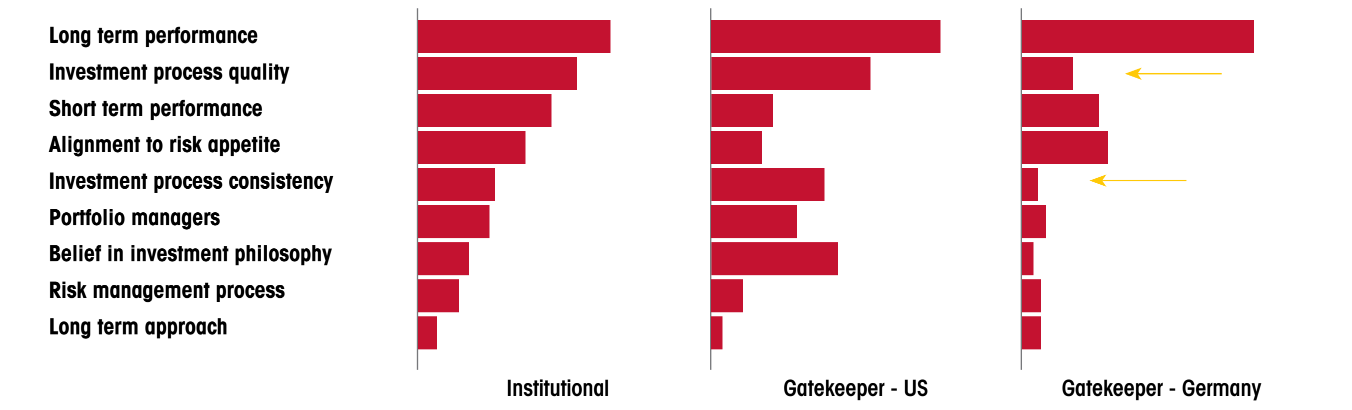
There are also important differences by market. The US has the largest and most sophisticated gatekeeper segment, for example investment teams in wirehouses are comparable to a mid-sized asset consultant servicing the institutional market. **Figure 9** shows that the importance of qualitative factors on process and managers in the US is comparable to institutional. Germany sits at the other end of the spectrum with smaller gatekeeper teams and more reliance on tools and quantitative models for screening and model development.

Figure 8 – Summary of gatekeeper versus client facing adviser selection factors for asset managers



One of the key findings from our study was that in many cases fund managers struggle to meet the needs of both gatekeepers and client facing advisers. In the US, UK and Germany the leading manager with client facing advisers has significantly weaker citations amongst gatekeepers. Delivering different propositions and messages to different parts of the same value chain (and often the same organisation) is clearly a challenge.

Figure 9 – First ranked selection factors for overall institutional and gatekeepers in the US and Germany

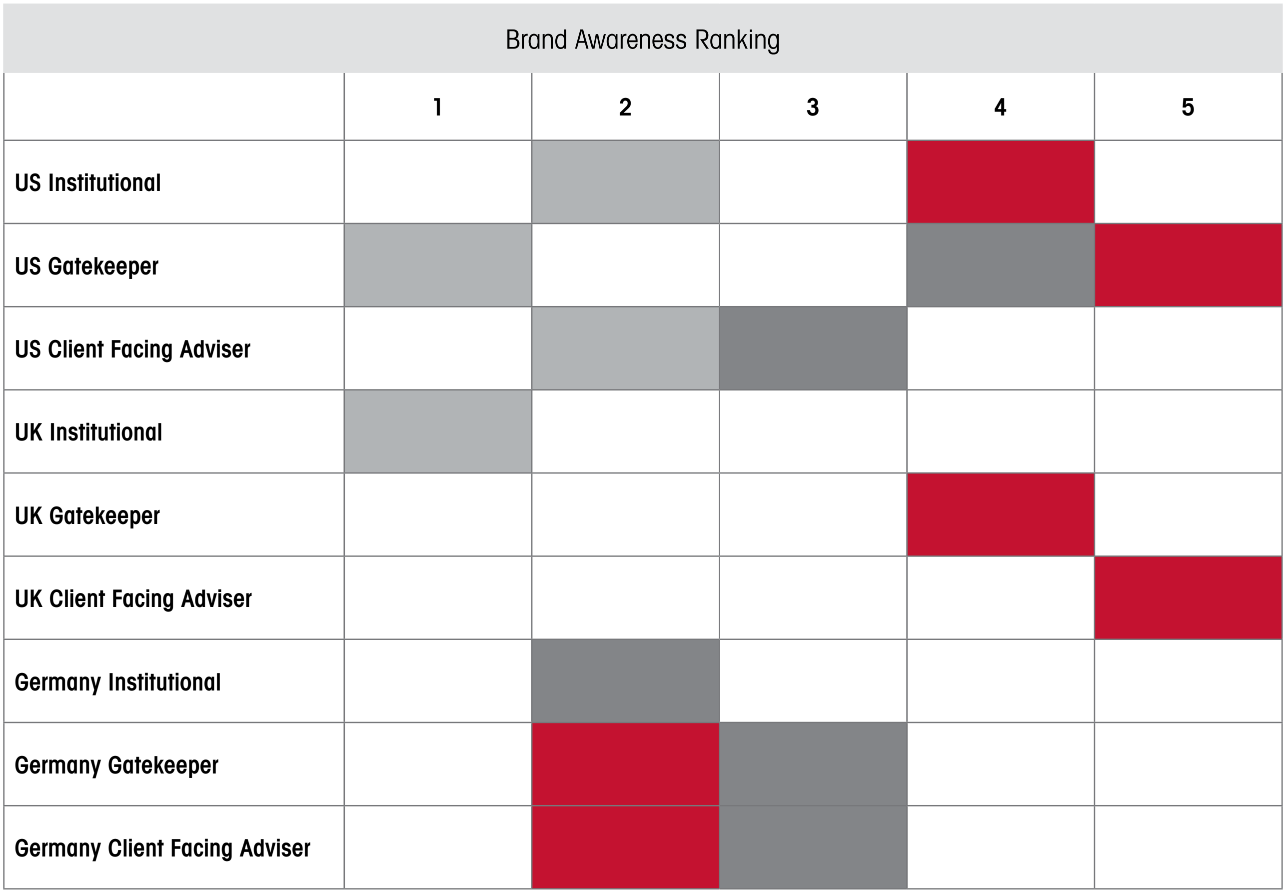


Theme 3: Asset Manager Franchises

There are very few successful global active asset manager franchises

There are very few genuinely global active asset managers and compared to banking, insurance or reinsurance the industry remains fragmented. There is not a single manager which is cited as a top 5 brand in each of the 9 market segments we have covered in phase 1 of our study. **Figure 10** shows that only 3 global managers were cited in more than 3 of the 9 segments and even these leaders have relatively fragmented positioning.

Figure 10 – Top of mind awareness of active asset managers by market segment (Top 5 managers)



Note: Managers with at least 4 citations are shown. Top 3 managers by citations have been colour coded

Home market bias to domestic equity and fixed income is one challenge. In Germany global or emerging market equity and fixed income propositions account for less than 40% of assets so it is hard for global managers to be relevant without domestic manufacturing capabilities. There are also formidable domestic champions with strong citations across institutional, gatekeeper and client facing advisers in domestic equities and fixed income.

Product differences create further complexity for international managers. For example global equities in the US is international ex-US while UK is global including UK so managers cannot directly passport global products between markets. Only 2 managers appear in the top-10 brands for global equities in the UK and US institutional markets.

However, home market bias, product complexity and capacity constraints are only part of the story. **Figure 11** shows the leading brand based on unprompted awareness by asset class in the 9 market segments covered in our study. Again few managers perform across regions while domestic champions frequently dominate across asset classes, especially amongst client facing retail advisers. Even in global asset classes like emerging market equity or fixed income, domestic champions often outperform global managers. The analysis also highlights highly contested segments such as global equities in the US where the leader only received 9% citations.

Figure 11 – Lead asset manager brands by asset class by market segment (% citations by segment)

	Domestic Equity	Global Equity	Emerging Market Equity	Domestic Fixed Income	Global Fixed Income	Emerging Market Debt	Multi-Asset	Liquid Alternatives	Illiquid Alternatives
US Institutional		9%	11%	54%	24%	21%	36%		
US Gatekeeper				40%	33%	29%	24%		
US Client Facing Adviser	43%	41%	33%	21%	20%	34%	43%	31%	35%
UK Institutional		18%			26%				
UK Gatekeeper									
UK Client Facing Adviser	56%	46%	29%	34%			20%	40%	24%
Germany Institutional	41%	22%	7%		17%				
Germany Gatekeeper	55%	21%			17%	12%		8%	
Germany Client Facing Adviser	45%	40%	36%	31%	28%	29%	41%	47%	42%

Note 1: Managers with at least 5 citations are shown. Cells are shaded consistently by manager
Note 2: Numbers in cells indicate % citations

Respondents explained that international managers have struggled to invest and commit long term to new markets. The reputation of global managers in the UK is mixed with participants citing numerous examples of managers entering and exiting the market. In all markets respondents explained that global asset managers see new market entry as an extension of an existing distribution strategy for existing funds. Localisation, tailored product structures, multiple share classes, local marketing and a deep understanding of different market segments were cited as hygiene factors to compete.

Some respondents went further, challenging the traditional market entry model focused on institutional clients. Some of the most successful international managers have succeeded via acquisitions and in Germany there was a belief that the retail market is an easier start point than institutional for new entrants. However, these perspectives are based on 3 markets. We look forward to reviewing these findings after phase 2 of this study which covers a further 11 major asset management markets.

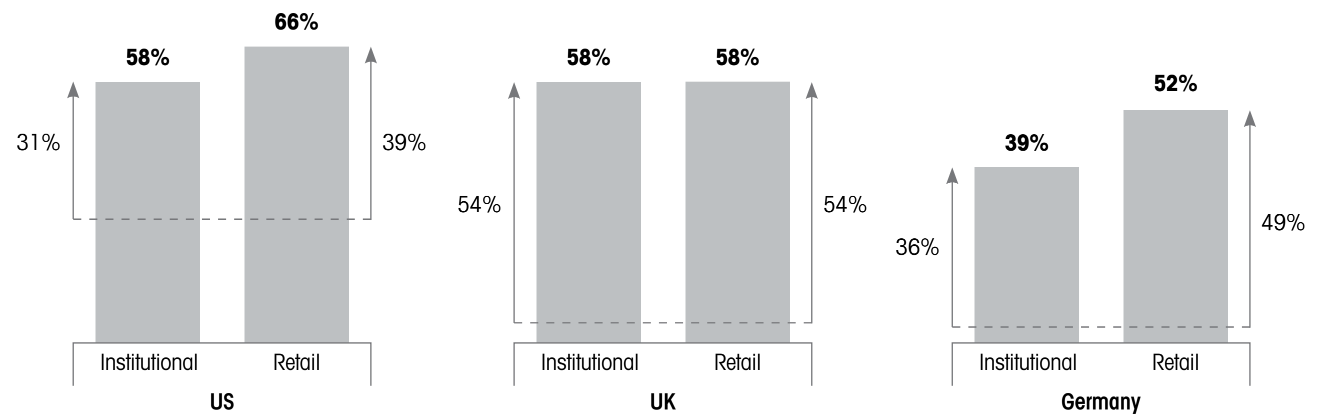
Theme 4: Investment Trends

Weakening home market bias and robust demand for active are opportunities for global asset managers

Globally (including the US, UK and Germany) there has been a reversion to developed markets, interest in outcome based solutions and a shift to alternatives to capture risk adjusted returns in the current low return environment. These trends are well documented and supported to varying degrees in our study. This theme focuses on trends in home-market bias and indexing which drive contestability for international active managers.

Home market bias (HMB) is defined as higher allocations to the local assets over international assets relative to their weighted market capitalisation in a global index of equity and fixed income. HMB is a challenge for international asset managers seeking to deploy global capabilities. HMB can be rationally driven by the need to match asset and liabilities e.g. currencies or a belief that asset owners or advisers are more likely to outperform in their local market. However, many respondents cited historic or irrational behaviours as contributing factors. **Figure 12** shows HMB for institutional and retail segments in the US, UK and Germany. The presence of significant home-market bias is a key driver behind the strong performance of local champions in our study.

Figure 12 – Domestic allocations (in bold) and home-market bias (arrows) for institutional and retail segments in the US, UK and Germany



Note 1: Dotted line indicates allocation from Global Index
Note 2: Global Index - NMG analysis of Global AUM across retail and institutional segments

However, in the US there appears to be a strong trend towards greater internationalisation and declining HMB. Respondents in institutional and retail markets cited US equities and fixed income as the only declining asset classes on a net respondent view basis (see **Figure 13**). Global equities (as well as alternatives) are expected to be the major beneficiaries.

Figure 13 – Internationalisation trends in the US and Germany

In Germany, both domestic and global equities are expected to rise as high allocations to domestic fixed income decline. More limited access to attractive alternative investments means that retail investors are more likely to increase equity or multi-asset exposure relative to institutions. In each market, retail respondents expect multi-asset (often outcome based solutions) to grow faster than any other asset class (**Figure 14**).

Despite evidence of barbelling in certain institutional segments, demand for active management remains relatively robust. In the US institutional market there is growing demand for indexing for domestic large caps and a broadly neutral outlook for other asset classes. There is growing demand for indexing and ETFs amongst German institutions; this links to interest in tactical asset allocation and historically low allocations to indexing relative to the US. In contrast we are seeing a reversion to active in the UK institutional market notably in fixed income.

Figure 14 – Multi-asset allocations and forecast growth in the US, UK and Germany

	Germany	UK	US
Future growth expectations (net respondent view basis)	39%	42%	40%

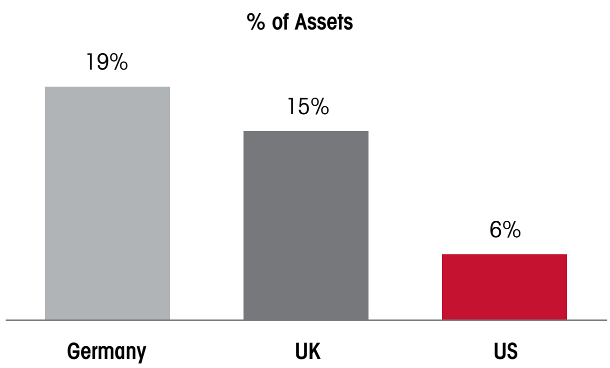
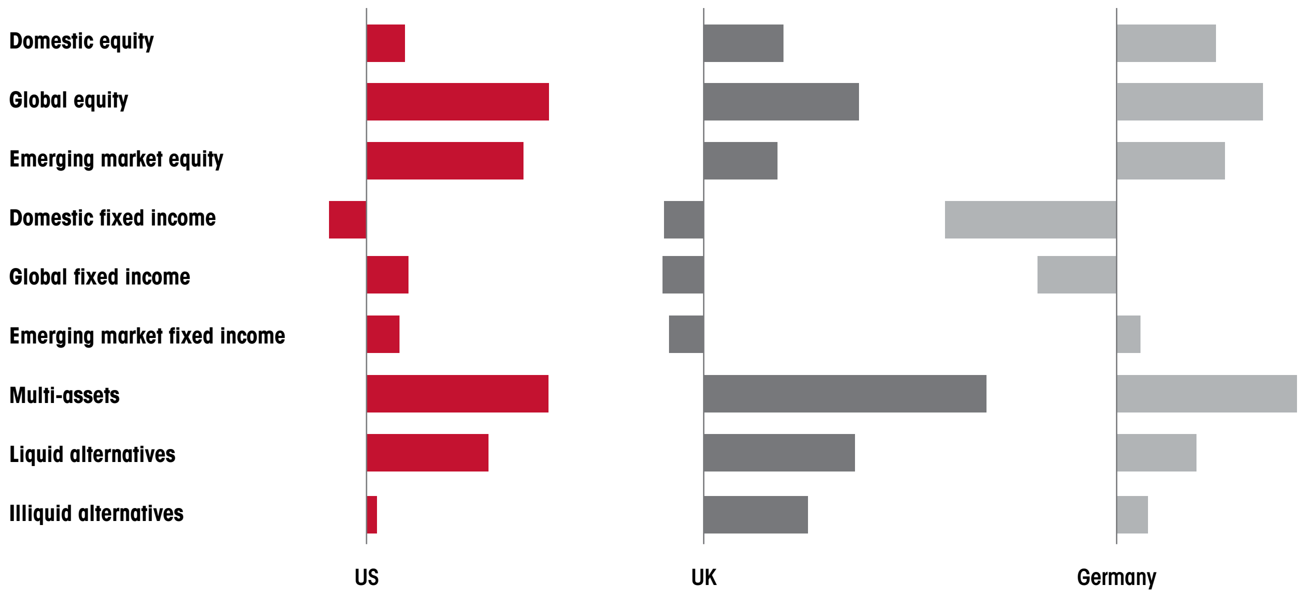


Figure 15 – Respondent views on outlook for external active management allocations, retail market



Note 1: Bar represents net respondent view. Right is positive
Note 2: Cash and Money Market Funds excluded

The US and UK retail markets are positive on active management in equities. Both markets have observed recent growth in ETFs and indexing as the UK market (or a segment of the US market) moves to fees. However, **Figure 15** shows relative demand for active external management by asset class in each retail market and indicates that active management is now back on the front foot for equities. In the UK the segment of independent holistic financial planners which use indexing is not growing as quickly as tied/aligned advice models which promote active management. In the US, a number of fee based RIAs continue to promote active management while revenue sharing continues to be important for broker dealers and wirehouses.

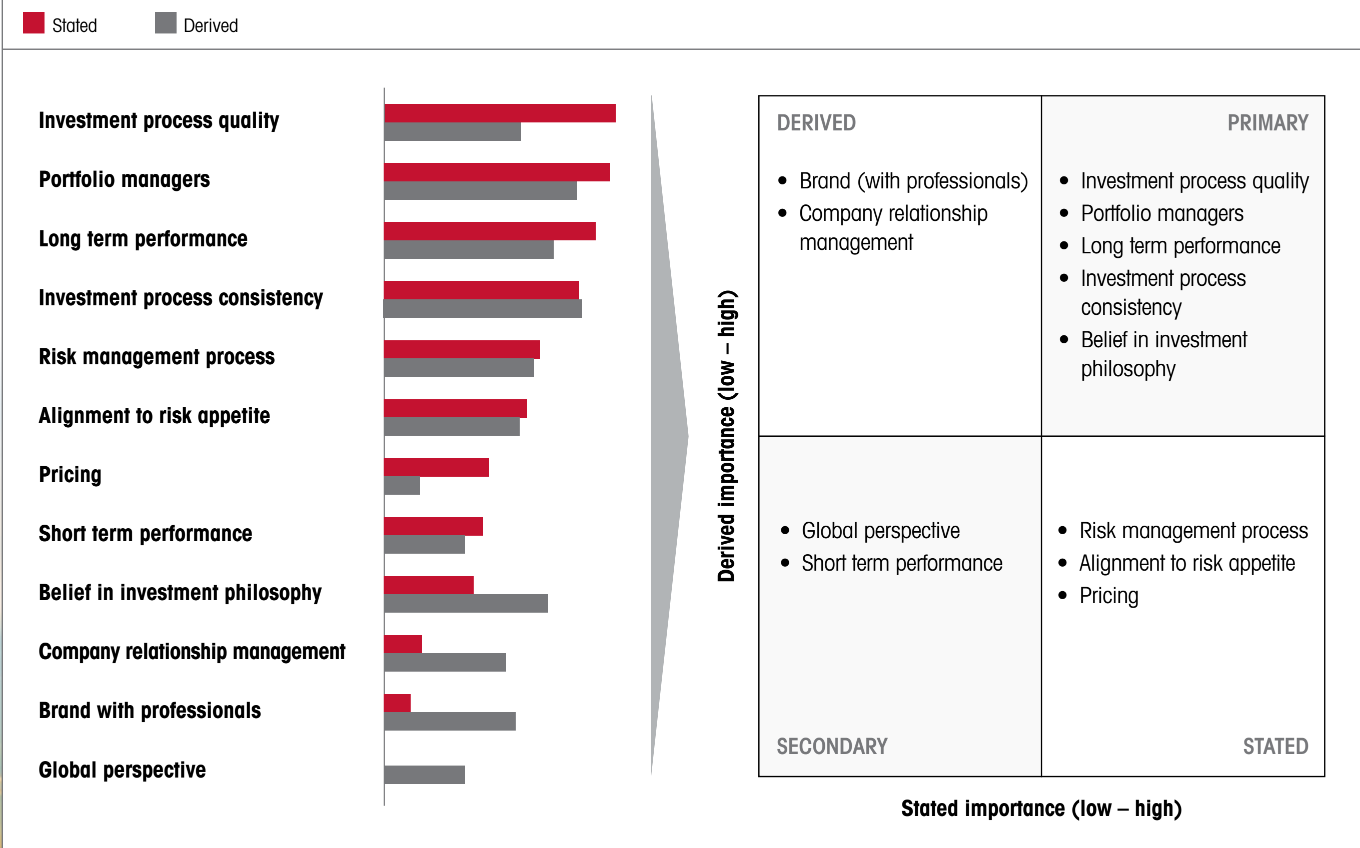
While internationalisation and robust demand for active management are positive for international managers, challenges remain. New managers are keen to exploit new or emerging products and asset classes so they can capture new flows rather than grow via direct substitution of existing managers. While there are new product themes, notably alternatives in institutional and multi-asset in corporate DC and retail, participation for most traditional long only managers is challenging. Few managers have a credible proposition in alternatives and institutional investors are increasingly building direct capability. Furthermore, effective participation in multi-asset fund solutions increasingly requires participation in administration (record keeping) and few managers have the appetite or expertise in this space.

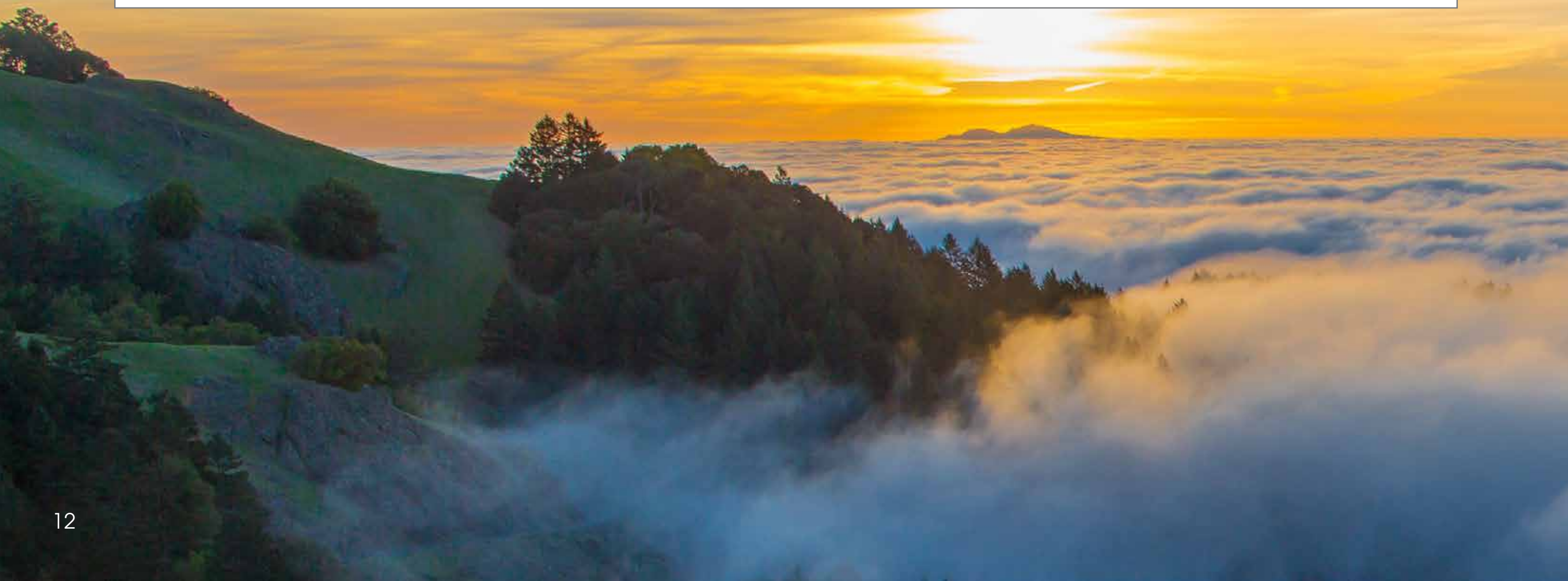
Theme 5: Marketing

Marketing is increasingly important for international managers to compete with local champions with aligned distribution and time in market

In every market we study, there are differences between what buyers say and what buyers actually do. In asset management, buyers focus on investment factors and do not call out the role of relationship management and marketing. In institutional segments the strength of company level relationships was not cited as a selection factor but derived analysis (based on the attributes of lead asset managers) in **Figure 16** indicates it is important. The derived analysis resonates with qualitative feedback from our study highlighting the importance of understanding individual context, objectives and liabilities. We also note the importance of 'brand with investment professionals' on a derived basis, especially amongst smaller plan sponsors in the US who are reliant on consultants.

Figure 16 – Stated and derived selection factors for asset managers, all institutional markets





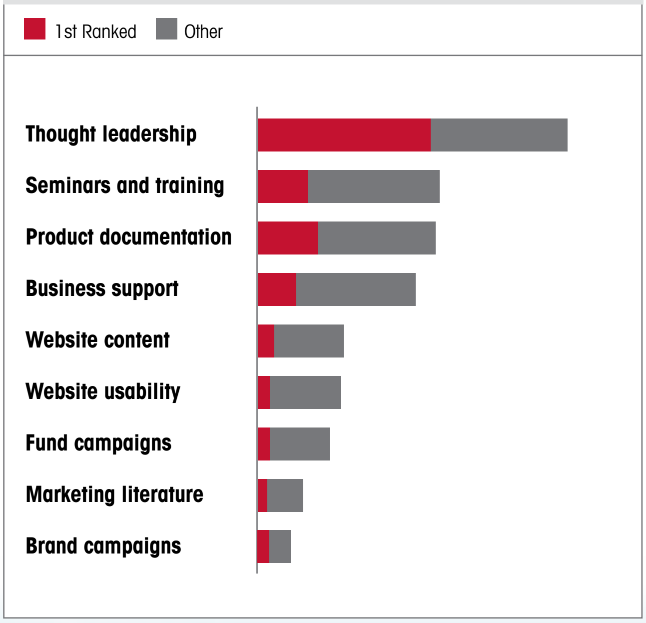
This theme explores the role of marketing in asset management. We will compare different markets and segments as well as stated and derived preferences. In all institutional markets the importance of marketing focused on thought leadership. **Figure 17** shows that 4 in 5 institutions rate thought leadership as a key service while very few respondents valued conventional brand and fund campaigns or digital services. Product documentation was also important in response to growing internal and regulatory requirements to understand exposures.

In the institutional market respondents classified 3 types of asset management thought leadership:

1. **Client**: demonstrating that managers understand institutional businesses and their investment priorities/challenges
2. **Investment**: supporting asset owners in understanding emerging investment themes and concepts
3. **Manager**: facilitating effective communication between portfolio managers and asset owners

Generally, institutions with more complex liabilities (DB plans, insurers, US state pension funds) placed greatest emphasis on client thought leadership while investment focused organisations such as endowments placed most emphasis on investment led thought leadership and portfolio manager communications.

Figure 17 – Stated importance of different marketing factors, all institutional markets



The role of marketing becomes much broader in the retail market. **Figure 18** shows that gatekeepers also value thought leadership, especially in the US given their institutional attributes. However seminars and training are cited as the number one marketing factor and there is greater interest in brand and fund campaigns, especially for new managers who need to demonstrate their commitment to the retail market.

Figure 18 – Stated importance of different marketing factors, gatekeeper versus client facing adviser

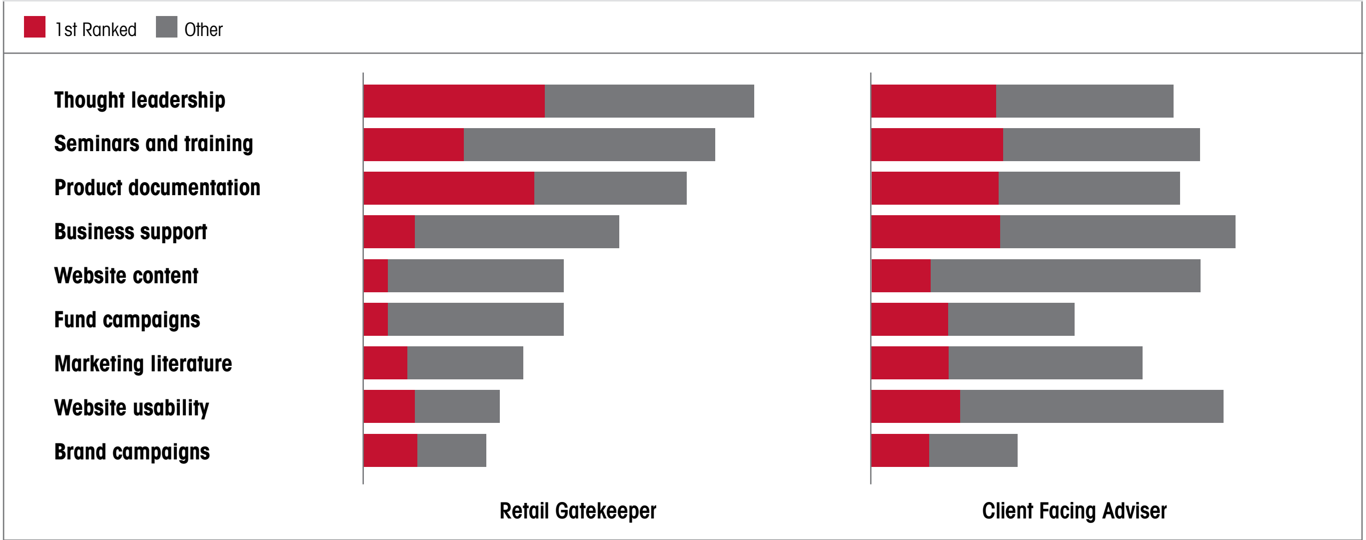


Figure 18 demonstrates the growing role of brand and fund campaigns, business support and digital services for client facing advisers. Business support is defined as asset manager services focused on helping the adviser's business while seminars and training focus on asset manager products and services. US advisers stand out in terms of their strong demand for business support and digital services. This finding is driven by growth in the RIA segment and higher penetration of in-house administration platforms shifting demand for support from platforms to asset managers.

Across our study, there was strong feedback that marketing was becoming more important in supporting sales and operational efficiency. In the institutional and gatekeeper segments, thought leadership gives the sales team an ability to open doors and create more strategic partnerships.

In the retail market, campaigns and conferences are important to demonstrate commitment to the market and deliver the value proposition to large retail adviser communities who still influence a significant percentage of fund flow.

Global managers are well placed to exploit institutional and gatekeeper demand. Thought leadership often involves insights from other markets and enables managers to invest in local research. Client facing adviser marketing is more complex. Global managers often lack product breadth and existing revenues and profit to justify the investment required in brand and fund campaigns and face-to-face adviser support.

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