Asset Management Sector Report

1. This is a report for the House of Commons Committee on Exiting the European Union following the motion passed at the Opposition Day debate on 1 November, which called on the Government to provide the Committee with impact assessments arising from the sectoral analysis it has conducted with regards to the list of 58 sectors referred to in the answer of 26 June 2017 to Question 239.

2. As the Government has already made clear, it is not the case that 58 sectoral impact assessments exist. The Government's sectoral analysis is a wide mix of qualitative and quantitative analysis contained in a range of documents developed at different times since the referendum. This report brings together information about the sector in a way that is accessible and informative. Some reports aggregate some sectors in order to either avoid repetition of information or because of the strong interlinkages between some of these sectors.

3. This report covers: a description of the sector, the current EU regulatory regime, existing frameworks for how trade is facilitated between countries in this sector, and sector views. It does not contain commercially, market or negotiation-sensitive information.

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Description of sector

4. The asset management sector links long-term savings to investments in the wider economy. There are currently £8.1 trillion assets under management (AuM) in the UK. Of that, approximately £2.6 trillion is managed on behalf of overseas investors, around half of which (£1.3 trillion) is from European Economic Area (EEA) investors.[1]

Asset managers

5. The UK asset management sector ranges from large institutions with billions of pounds of AuM to smaller boutique firms specialising in particular asset classes. In the UK, the top five asset management firms account for around 40% of AuM.[2]

6. These large asset managers can be independent entities or form part of wider financial services providers such as investment banks or insurance companies.

Clients and investors

7. The majority (79%)[3] of assets managed by UK asset managers are associated with institutional clients, including pension funds and insurance companies. Institutional

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[1] Asset Management in the UK 2016-2017, The Investment Association, September 2017.
[2] *Ibid.*

investors are very often acting on behalf of private individuals - households receive asset management services through, for example, insurance or private pension schemes. The remaining investments are directly from retail and private clients. Overall, more than a third of the funds managed in the UK come from overseas clients.[4]

8. Individuals' retirement savings can reach the asset management industry in a variety of ways. Large organisations will often contract directly with an asset manager to manage pooled occupational pension funds on a segregated account basis.

9. The UK asset management industry has expertise across the value chain, including in fund management and administration, custody of assets and marketing of funds and investment services.

10. UK authorised asset managers will often establish (or domicile) their international investment fund ranges in specialised international hubs to serve their non-UK clients. For those funds domiciled in an EU Member State, the firms use provisions under the relevant EU Directives – Undertakings for Collective Investment in Transferable Securities (UCITS) for funds available to retail investors and Alternative Investment Fund Management Directive (AIFMD) for professional investor funds - to delegate the portfolio management of the fund and other key services back to the UK. Where assets are not managed using a fund structure, investment services are provided using the cross-border passport under Markets in Financial Instruments Directive (MiFID).

Character and composition

11. The UK asset management industry is estimated to represent approximately 1% of GDP[5]. In 2016, UK asset managers generated fees amounting to £7.3 billion in gross exports[6] (£6.2 billion in net terms, once UK asset management service imports are subtracted).

12. By investing clients' money in debt and equity markets, asset managers provide financing to UK businesses. They purchase around 60-70% of new corporate bond issuances in the UK and provide around 40% of equity capital for initial public offerings. Debt financing is also important for infrastructure investment and in 2014-15, for example, capital markets accounted for approximately 60% of the £6.8 billion of new funding secured by housing associations.[7]

13. The asset management industry is a source of revenue for the UK's professional services sector and is an important service provider to other financial services firms, particularly insurance companies and pension funds that rely on the industry to manage

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[3] *Ibid.*
[4] *Ibid.*
[5] UK Fund Management, an attractive proposition for international funds, TheCityUK, November 2015
[6] '03 Trade in services, The Pink Book', ONS, October 2017.
[7] The contribution of asset management to the UK economy, Oxera, July 2016.

their funds. Asset managers are an important client group for investment banks and are also commercially connected to financial advisors, brokers and platforms (which connect asset managers to clients) and depositaries and custodians (which are appointed by funds to safeguard clients' assets).

14. Direct employment in the asset management industry in the UK in 2016 was estimated to be approximately 38,000[8]. Indirect employment – i.e. through services such as auditing, fund administration and custody management – is estimated at an additional 56,000[9]. A large proportion of jobs are in London, which has a share of approximately 59% of asset management jobs, but Scotland is also an important centre with 13% of asset management employment, including indirect jobs.[10] 10% of jobs are in the South East (ex. London) and 3% in the North West.[11]

15. Tax revenues flowing from the asset management industry primarily derive from the income tax paid by the managers employed in the sector, as well as the tax (be it income or capital gains, or corporation tax) on the fees generated by the services that they provide, rather than taxes raised on the funds themselves. It is, therefore, difficult to quantify, but on one estimate the sector generates £5-7bn tax revenues annually.[12]

The current EU regulatory regime

16. The three main pieces of EU legislation that have an impact on asset managers are the Alternative Investment Fund Managers Directive (AIFMD), the Undertakings for Collective Investment in Transferrable Securities (UCITS) Directive, and the Markets in Financial Instruments Directive (MiFID).

Alternative Investment Fund Managers Directive (AIFMD)

17. AIFMD sets rules for the authorisation, operations, transparency and marketing by fund managers that manage and/or market so-called Alternative Investment Funds (AIFs). AIFs are funds that aimed at professional and institutional investors, and include hedge funds property funds and private equity funds. Many of these are domiciled for tax reasons in third countries, which is why the focus of the AIFMD is on the managers of the funds. The main provisions include:
    i. a ***marketing passport*** allowing management companies authorised in the EEA to market their funds to customers elsewhere in the EEA;

[8] Asset Management in the UK 2016-2017, The Investment Association, September 2017.
[9] *Ibid*.
[10] Asset Management in the UK 2016-2017, The Investment Association, September 2017.
[11] *Ibid*.
[12] The Impact of the UK's Exit from the EU on the UK-based Financial Services Sector, Oliver Wyman, 2016. (Taxes borne and collected including employment tax, NI, income tax, irrecoverable VAT, bank levy and other taxes)

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ii. a ***management passport*** allowing EEA based management companies to manage AIFs domiciled elsewhere in the EEA;
iii. provisions enabling management companies to ***delegate portfolio management*** to non-EEA firms provided certain safeguards are met (e.g. cooperation arrangements are in place between the national competent authority of the AIF manager's home Member state and the national competent authority in the relevant third country); and
iv. a ***third country passport regime***, allowing non-EEA managers to market non-EEA domiciled funds in the EEA. These passports are awarded through an assessment by the European Securities and Markets Authority (ESMA), which is then followed by a further Commission assessment. To date, no AIFMD third country passport has as yet been awarded[13].

Undertakings for Collective Investment in Transferable Securities Directive (UCITS)

18. UCITS sets out a regulatory framework for retail investment funds with extensive provisions on the type of assets that UCITS may invest in, as well as a number of requirements covering managers of the funds, in areas such as remuneration. Once a UCITS fund has been authorised by its home state, it may be marketed to the general public in any Member State. The UCITS regime is recognised internationally as a gold standard and while it constitutes a set of rules governing retail investment funds, it also attracts a significant amount of institutional investment from the EU and third countries.

19. Like AIFMD, the UCITS Directive includes marketing and management passports for EEA-based asset managers that manage and market funds on a cross border basis. It also contains provisions enabling UCITS management companies to delegate portfolio management of the fund to non-EEA providers. All these provisions operate in a similar way to those under AIFMD. However, unlike AIFMD the UCITS Directive does not include a third country passport regime.

Markets in Financial Instruments Directive (MiFID)

20. MiFID includes rules that apply to asset managers that sell investment services (principally portfolio management) across the EEA. It also provides a passport enabling investment managers to sell their investment management services not only to AIFMD and UCITS management companies in other Member States, but also to firms that hold their client assets directly rather than via a fund structure – on a so-called segregated account basis. (Segregated account clients will usually be institutional investors who contract directly with an investment manager, who will invest directly on their behalf, rather than buying units in a collective investment scheme.)

[13] In July 2016, ESMA advised the Commission that the third country AIFMD passport should be available for Jersey and Guernsey (but not the Isle of Man).

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Third country equivalence

21. Third country equivalence regimes exist for third country alternative investment fund managers under the AIFMD. However, no such third country regime exists under the UCITS Directive, and the Commission has yet to make a decision to initiate the AIFMD "third country passport" based on ESMA's third country equivalence assessments.

Existing frameworks for how trade is facilitated between countries in this sector

22. The arrangements described in this section are examples of existing arrangements between countries. They should not be taken to represent the options being considered by the Government for the future economic relationship between the UK and the EU. The Government has been clear that it is seeking pragmatic and innovative solutions to issues related to the future deep and special partnership that we want with the EU.

23. With respect to international standards, the International Organization of Securities Commissions (IOSCO) sets out core principles for good securities regulation and general best practice. IOSCO's standards are not legally binding, but they can influence the legislative process. For example, recommendations by IOSCO and the Financial Stability Board (FSB) informed the EU's Regulation on Money Market Funds.

24. With respect to international trade, World Trade Organisation General Agreement on Trade in Services (WTO-GATS) establishes a baseline for trade in services including in relation to all financial services, including asset management.

25. More broadly, portfolio management delegation is considered an international norm, supporting a global business model that allows fund management companies to procure expertise that they would otherwise lack in-house, also capitalising on economies of scale to reduce costs and increase net returns.

26. More widely, in line with other financial services sectors, there are well-developed principles for asset management at the international level which seek to support cross-border activity and avoid duplicative regulation and fragmentation.

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Sector views

[This information was provided by the Government to the Committee, but the Committee has decided not to publish this section]