## 2023 Allfunds Data Analytics (ADA) & Mediolanum Research Paper:

## Bringing boutique talent closer to investors through delegated fund management

*Source: All Sub-advisory data is sourced from ADA; Fund-in-Funds data is sourced from ADA and Morningstar*

### Introduction

Investors in mutual funds can gain access to a broad range of asset management talent from distribution platforms and their advisers by investing in a fund:

1. Managed by these asset managers directly. This requires the investor's own fund research or utilising fund selection capabilities of their distributors and advisers. **ADA provides real-time transactional data on more than €1.3 trillion administered by Allfunds**, the leading fund distribution platform in Europe.

2. Initiated and run by a distributor or adviser who in turn invests in one or several funds managed by third party managers. This model is best known as a Fund-in-Funds (FiF) or Fund-of-Funds (FoF). In its fully transparent Fund-in-Funds insights data tool, **ADA records €812 billion of assets in mutual funds delegated to third-party fund houses inside FiFs** at the end of Q2 2023.

3. For whose management the distributor / adviser is responsible and which bears that distributor's / adviser's name, but for which that distributor decides to formally delegate a portion or all of the investment management to a third-party manager. This model is known as a Sub-advised Fund (SaF). In the industry's most comprehensive, fully transparent Sub-advised Fund insights data tool, **ADA records €1.38 trillion in SaF assets delegated to third party managers** at the end of Q2 2023.

**This paper explores the second and third models** in terms of their attractiveness and Mediolanum's positioning relative to European distributors that have adopted these models.

### Delegated mutual funds update

By the end of Q2 2023, ADA recorded over €2.19 trillion in assets delegated to third-party managers across EMEA sub-advised funds and fund-in-funds. Adjusted for comparability, ADA estimates that these delegated third-party assets represent about 19% of the addressable UCITS market[1].

Delegated fund assets grew by 2.1% in the year to Q2 2023, in line with the moderate growth recorded by EFAMA for the European fund industry.

Activity in the delegated funds market remained positive over the last twelve months despite this being a period of significant market volatility and macroeconomic uncertainty:

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[1]Comparison based on EFAMA data on fund assets. For better comparability, Money Market fund assets have been removed from EFAMA's figures (insignificant in sub-advisory) and South-African domiciled funds have also been removed for ADA data (not captured by EFAMA)

- The number of mandates within sub-advised funds grew by 65 (+2%).
- The number of third-party funds within fund-in-funds was also up by 53 (+1%).

In the 12 months to June 2023, the Pension channel grew by 6% reducing the asset gap with the top three channels. The Wealth Manager channel enjoyed a 2% increase in assets, taking the second place from the Bank Distributor channel which saw assets drop by 1%.

**Delegated funds AuM ranked by distribution channel (H1 2023)**

| Channel | Unaffiliated Fund in Fund Assets (€ bn) | Sub-advised Assets (€ bn) | Total Assets (€ bn) |
|---|---|---|---|
| Asset Manager | 323 | 204 | 526 |
| Wealth Manager | 123 | 304 | 426 |
| Bank Distributor | 205 | 186 | 391 |
| Pension | 6 | 319 | 325 |
| Insurance (Unit-Linked) | 45 | 89 | 133 |
| Investment Consultant | 8 | 122 | 130 |
| Private Bank | 51 | 62 | 113 |
| Personal Pension | 11 | 60 | 71 |
| Other | 42 | 32 | 73 |
| Total | 812 | 1,377 | 2,189 |

St. James's Place, the UK's Local Government Pension Scheme and Mercer continue to be the largest sponsors for delegated funds – all three with assets under management in excess of €100 billon. BlackRock and True Potential Investor have joined the top ten while Mediolanum remains in eighth place but has narrowed the gap with Generali.

**Top 10 Sponsors of Delegated Funds ranked by AUM (H1 2023)**

| Asset Manager | Total Assets (€ bn) | Distribution Channel |
|---|---|---|
| St. James's Place | 164 | Wealth Manager |
| Local Government Pension Scheme | 118 | Pension |
| Mercer Global Investments | 102 | Investment Consultant |
| AP7 | 78 | Pension |
| Aviva Group | 73 | Insurance |
| Lloyds Banking Group | 69 | Wealth Manager / Bank Distributor |
| Generali | 48 | Insurance |
| Mediolanum | 46 | Bank Distributor |
| BlackRock | 38 | Asset Manager |
| True Potential Investor | 37 | Distribution Platform |

If we only focus on retail and wholesale sponsors (i.e. excluding institutional channels such as pension fund assets), St. James's Place is the only player with assets above the €100bn mark, followed by Aviva and Lloyds in the top three. Mediolanum remains fifth, being the largest pure play bank-affiliated sponsor.

**Top 10 Retail & Wholesale Sponsors of Delegated Funds ranked by AUM (H1 2023)**

| Asset Manager | Total Assets (€ bn) | Distribution Channel |
|---|---|---|
| St. James's Place | 164 | Wealth Manager |
| Aviva Group | 73 | Insurance |
| Lloyds Banking Group | 69 | Wealth Manager / Bank Distributor |
| Generali | 48 | Insurance |
| Mediolanum | 46 | Bank Distributor |
| BlackRock | 38 | Asset Manager |
| True Potential Investor | 37 | Distribution Platform |
| CaixaBank | 36 | Bank Distributor |
| Quilter | 34 | Wealth Manager |
| UBS | 33 | Bank Distributor |

## Scale and scalability

### Active vs Passive

Passively managed fund components are a cost-effective, easily tradable vehicle to give exposure to market performance (beta) of the specific index which they are replicating, or a derivative thereof, often used for asset allocation bets. In theory, they are almost infinitely scalable, especially those that replicate an index synthetically, i.e. without holding the actual securities contained in the index.

By definition, after cost, passive funds are not designed in and by themselves to achieve market outperformance (alpha). This is what actively managed investment strategies are designed to do, which deviate from their underlying index or benchmark.

Amongst delegated mutual funds, sub-advised funds are typically preferred over fund-in-funds for accessing active managers. This is mostly because of the lower regulatory restrictions and higher commercial leverage that the sub-advised fund model can offer (the average mandate size is €351m while the average fund-in-fund allocation to third-party funds is €79m).

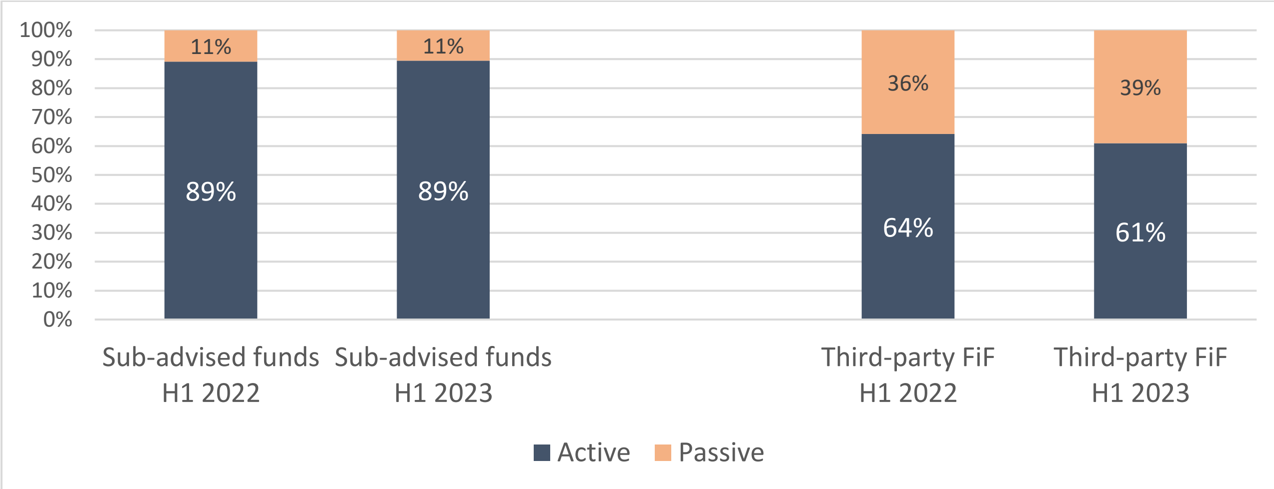
In contrast, the proportion of passively managed third-party fund assets inside fund-in-funds continued to increase in the year to Q2 2023, remaining significantly above the passive exposure of sub-advised funds[2].

In this context, Mediolanum has more exposure to sub-advised funds (71% of its delegated fund assets) than to fund-of-funds (29%). This reflects Mediolanum's ambition to deliver market outperformance for investors by appointing best-in-class active managers, including boutique[3] managers as explained later on in this paper.

[2] We may be underestimating the proportion of passive components inside sub-advised funds. While ADA can reliably identify passive components in the form of mutual funds held by fund-in-funds, this is not possible in the case of sub-advised funds that compose multiple mandates for each fund, the mandate structure not allowing the reliable determination of whether it is actively or passively managed

[3] Allfunds Data Analytics defines investment managers with <= $20 billion AUM globally as boutiques.

**Active vs passive asset split of sub-advised funds and third-party fund-in-funds**

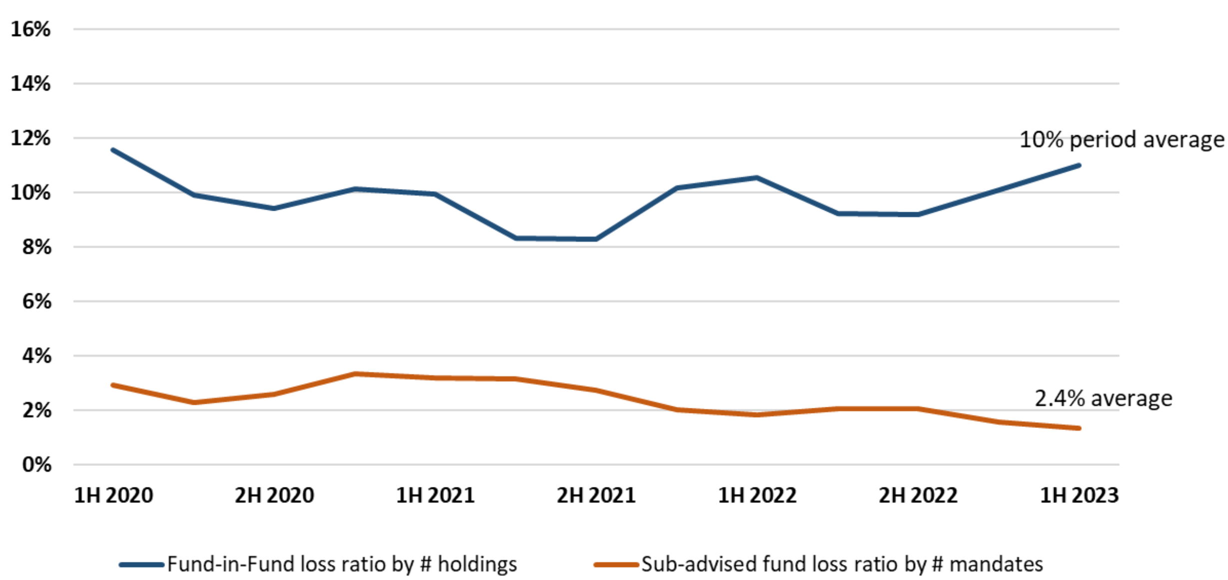



## Turnover

The turnover ratio for sub-advisory is steadily going down and sits at around 2.4% when considering the last three years. This is far lower than for fund-in-funds at around 10% and trending up due to recent market volatility. This notable difference – by a factor of 4 to 5 – is a clear indication of longer holding periods for sub-advised assets as the below chart illustrates.

Analysis of Mediolanum's turnover ratios shows a lower turnover than the market average across both sub-advised funds (half the market average) and fund-in-funds over the three year period in scope. This reflects Mediolanum's ability to build strong relationships with external managers having been a sponsor of delegated funds for many years now.

**Annualised turnover ratio for actively managed funds: sub-advised mandates vs fund-in-fund holdings**



## Delivering differentiation through sub-advised funds

### Providing investors with access to boutique solutions

To differentiate its investment solution, a fund-in-funds provider can vary the allocation to specific fund components. However, by themselves, these components are the same for each of the funds' investors, except for share class specific pricing differences and currency hedges.

Therefore, due to their large assets and associated buying power, sub-advised fund providers are able to differentiate their propositions in two ways:

1. First, they can work with their appointed delegates to customise investment mandates away from the third party's mutual funds to obtain a truly bespoke solution.
2. Second, they can introduce their clients to talented investors and investment strategies, traditionally only available to institutions, as 'boutique' offerings.

Even where 'boutique' offerings are available in fund format, the fund may not be accessible to fund-in-fund providers because of investment limits, especially in the case of small boutique funds that lack the distribution resources to gather assets.

Sub-advised fund providers will be a natural fit for such boutiques as key distributors in attaining market entry and proliferation among private investors.

The below table highlights the number of mandates awarded to boutique asset managers.

**Sub-advised fund mandates by sub-adviser type as at H1 2023 and year-on-year change**

| Sub-adviser type | Number of mandates | Net change in number of mandates (last 12 months) |
|---|---|---|
| Boutique | 1,144 | +27 |
| Small | 686 | (18) |
| Mid | 1,097 | +20 |
| Large | 371 | +15 |
| Mega | 628 | +21 |
| Total | 3,926 | +65 |

Boutiques are increasingly attracting attention from sub-advised fund sponsors. It is remarkable that during the year to June 2023, boutique managers were the main contributors (27 out of 65) to the net increase in number of mandates in EMEA.

Mediolanum has an impressive track record of partnering with boutique managers:

- Mediolanum is currently working with 47 boutique managers while sub-adviser sponsors work with an average of 3 boutiques.
- In addition, boutique managers are responsible for 41% of the total number of mandates within Mediolanum's sub-advisory programme – this is significantly higher than the 29% seen across the market (1,144 out of 3,926 in the above table).

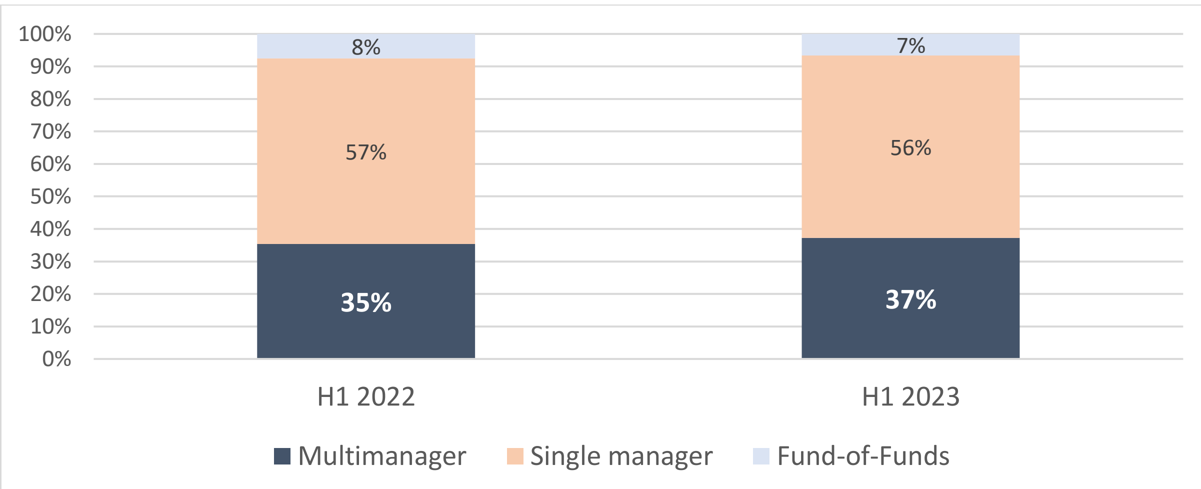
## The rise of the multimanager approach

The use of boutique managers by sub-advised fund sponsors is often associated with the adoption of a multimanager structure for running mandates.

These multimanager mandates are becoming increasingly popular amongst sponsors looking to reduce concentration risk within their sub-advisory programmes. The growth of sub-advised fund assets over the last 12 months was driven almost entirely by multimanager mandates, with these assets now accounting for 37% of the EMEA sub-advisory market.

In line with its ambition to access the best boutique managers, Mediolanum is well ahead of the market in the use of multimanager mandates with 68% of its sub-advised assets managed under this approach.

**EMEA sub-advised funds AuM breakdown by mandate structure**




## Finding the best managers to deliver ESG strategies

ESG is fundamentally re-shaping many aspects of fund distribution in Europe: asset manager due diligence, fund selection, product development or client reporting to name a few. The rising importance of ESG is also evident in the sub-advised fund market.

In the last twelve months, mandates relating to funds within ESG sectors accounted for 45% of the net increase in mandates (29 out of 65). The notable weight of ESG-related mandates is being driven by a combination of new fund launches as well as existing/new mandates being put out to tender following changes in the funds' investment approach.

Over the same period, Mediolanum enjoyed impressive asset growth in ESG sector funds (+94%) compared with the wider sub-advisory market (+12%) despite having a line-up of sub-advised funds less weighted to ESG sector funds – 4% of assets relate to ESG sectors compared with 11% overall.

**Sub-advised fund mandates by ESG focus as at H1 2023 and year-on-year change**

| Sub-advised fund sector | Number of mandates | Net change in number of mandates (last 12 months) |
|---|---|---|
| ESG | 420 | +29 |
| Non-ESG | 3,506 | +36 |
| Total | 3,926 | +65 |

The above analysis focuses on ESG nature of the sub-advised funds. However, many sponsors also include ESG criteria in their overall manager screening process across asset classes, so we are certainly underestimating the importance of ESG in the sub-advised fund market.

## Commercial and Control factors drive adoption of sub-advisory

### Commercials

Investors in mutual funds, including Fund-in-Funds, have little bargaining power on the investment fees they pay. By comparison, because of the large assets and mandate sizes that they control, sub-advised fund providers are formidable price makers, leaving third party managers choosing to work with sub-advised fund buyers as price takers. That is the trade-off for nine times larger average assets with 70% greater longevity of earnings to delegates, compared with fund-in-funds.

The beneficiaries of lower negotiated investment fees are the sub-advised funds which providers may choose to pass on to underlying investors, in the form of lower ongoing fees – either whole or in part.

Compared with a fund-in-fund offering, operating a sub-advised fund platform is complex and costly, with large set-up costs and ongoing operational, administrative, reporting and regulatory overheads.

ADA's research leads to the conclusion that, from a purely economic perspective, at least €1 billion in assets are needed for such a platform to achieve the economies of scale that justify the operation of a sub-advised fund platform, in favour of a fund-in-fund structure.

### Control

Fund-in-fund as well as sub-advised fund providers have regulatory obligations to fulfil. In the case of fund-in-funds, these revolve chiefly around the adherence to investment restrictions imposed by UCITS and specific investment objectives, while the responsibility for the management of each of the underlying fund investments rests with the respective fund manager. While this makes the fund-in-fund model easier to operate, it also exposes the provider to changes in the underlying funds such as investment objectives or style, their managers and closures or dealing restrictions. The providers can, but doesn't always have the option to, sell one fund and invest in an alternative. However, a suitable alternative that is large enough to absorb the available investment is not always available, or a switch could lead to a taxable event for the underlying investor.

A sub-advised fund provider can avoid these challenges because, by formal agreement, it has control over such events except in the case of a fund manager departure. On the flipside, the sub-advised fund provider also has regulatory and fiduciary responsibility toward its underlying clients for what is happening inside each mandate. This makes its operation more complex and costly, an aspect for which smaller distributors are not equipped.

Within a sub-advised fund, there is complexity involved in changing the underlying asset manager, including the transfer of large assets, which leads to sub-advised fund providers and their delegates forming deep and long-lasting partnerships to overcome these challenges as efficiently as possible.

According to ADA's data, the average sub-advisory mandate age is 6.4 years, versus 1.9 years average holding period of funds invested in by fund-in-fund providers.

## Conclusions

Delegated fund assets have reached significant scale with over €2.19 trillion, making up for about 19% of the UCITS market.

The fund-in-fund model is typically used by smaller scale providers of solutions that incorporate third party asset managers' expertise, while sub-advised funds are more likely to be operated by large scale providers with the same goal: offering third party investment talent to investors.

Ongoing distribution opportunities are available in both sub-advisory and fund-in-funds:

- Rise of multimanager mandate structures, typically designed to reduce manager concentration risk and with the potential to offer more boutique managers to private investors.
- Demand from new sponsors wanting to develop vertical integration into asset management.
- Demand from pension funds converting managed accounts into funds.
- Supply push of sub-advised funds (demand for sub-advisers) from outsourced selectors / CIO service providers.
- Key sponsor countries for sub-advisory: UK, Ireland, Switzerland and France.
- Actual transacted investment fees in Europe are declining towards US levels, but longevity of assets and mandate sizes justify engagement.
- Trend towards sub-advised funds being used inside sponsors' fund-in-funds is increasing. Asset managers need to be open to partnerships to not lose fund assets from fund-in-fund programmes.

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