BANK OF ENGLAND

News release

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The age of asset management? – speech by Andrew Haldane

In a speech at the London Business School's Asset Management Conference, Andrew Haldane discusses the risks posed by the asset management industry to financial stability, and the associated policy implications. In doing so, he also highlights the ways in which asset management – "a key bridge between end-savers and end-borrowers" – can strengthen both the financial system and the real economy.

Andrew begins by outlining some facts on the evolution of the size and composition of the industry. Its Assets Under Management are currently estimated at around $87 trillion globally. It has also grown fairly rapidly – in the UK, from under 50% to over 200% of GDP since 1980. Global trends in population, ageing, incomes and wealth mean it is set to get larger still, perhaps to $400 trillion by 2050. Meanwhile, recent trends have seen allocation into more illiquid assets and index-linked, passively managed, funds, and away from actively managed funds in large-cap equity and government fixed income markets. Liability contracts have also put more risk back onto investors which may increase their incentive to run. These trends potentially have implications for financial markets dynamics and systemic risk – for example, greater illiquidity risk, correlated price movements and susceptibility to runs.

Andrew first asks whether the size of the industry means it poses the same "too-big-to-fail" challenges as the banking industry. The risks are different to banking, he notes, because asset managers do not bear credit, market and liquidity risk on their portfolios. Yet their size means that distress at an asset manager could aggravate frictions in financial markets, for example through forced asset fire-sales: "even if the "fail" element of too-big-to-fail is a red-herring, the "big" is not."

The second risk he highlights is the potential for asset management "to amplify pro-cyclical swings in the financial system and wider economy. If so, it may contribute to the mispricing of risk with risk premia undergoing cycles of feast and famine." He describes the channels that could generate pro-cyclicality, such as performance benchmarking and accounting and regulatory rules, and presents evidence indicative of pro-cyclical swings in asset allocation and asset prices.

That behaviour has implications for what Andrew refers to as "patient capital": the industry's potential to provide long-term financing, in the form of equity and long-term debt, to the economy. He says that "a world without equity is likely to be one with poorer risk-sharing and weaker long-term investment." Yet there has been a steady erosion of the industry's direct holdings of UK equities, with asset managers de-risking as global equity prices fell sharply during the financial crisis – "precisely the circumstances in which pension funds, as long-term investors, could play a stabilising, counter-cyclical role." Such behaviour is "likely to worsen returns to investors" and "amplify cycles in the financial system and economy."

That, says Andrew, poses the question of what policy response might best deal with the risks and opportunities posed by asset management. He focuses on three areas. First, he notes that international work is underway to help identify whether asset managers are classified as globally systemic financial institutions.

Second, he argues that a natural first line of defence against pro-cyclical swings is macro-prudential policy. To date, macro-prudential tools have tended to focus on bank capital. Yet, argues Andrew, "if risk in the financial system, and activity in the wider economy, are shaped importantly by asset management

behaviour and associated pro-cyclical swings in risk premia…[then] macro-prudential action may be justified even when leverage is not present and when banks are not at the scene of the crime." This is, he says, "the next frontier for macro-prudential policy".

Third, he describes a number of initiatives underway to encourage the financing of long-term investment. Among these, he highlights work on securitisation, where, "slowly, the market is being rehabilitated and reconstructed in a different image, helped by public and private sector initiatives to improve transparency." The Bank intends to support actively international work to consider a "high-quality securitisation product" that "might comprise much simpler structuring of payoffs and high and transparent underwriting standards." If successful, he believes that "the prize for regulators and asset managers is a big one", as it would enable non-bank investors to do more of the heavy lifting when financing the wider economy.