EXECUTIVE SUMMARY

Down But Not Out: The Future of the Financial Services Industry

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We thank Lawrence Franko for his dedicated involvement in this project. He has been instrumental in the preparation of this report from its very nascent stages right up through its maturity. We have benefited from many discussions on the topic with him. He has provided numerous leads to articles and data sources that we have used in the report. His thoughts, observations, and insights have been paramount. We are grateful to Ed D’Alelio for his comments, discussion, encouragement, and direction. Robert Reitano, Mike Goodman, and Bill Koehler provided detailed comments on earlier drafts. Mike Goodman also supplied much of the data used in the report. Philip Quaglieri and John Cicarrelli extended generous financial support. Lisa Cantagallo provided invaluable research assistance. We also thank the many industry experts who were interviewed in the process of preparing this report. Errors and omissions are all ours.
Down But Not Out: The Future of the Financial Services Industry

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This report presents some recent trends and developments in the financial services industry in the United States and Massachusetts, and provides scenarios for the future evolution of the industry. Our analysis indicates that:

1. The industry is an important contributor to overall economic activity and employment in the United States and Massachusetts.

2. With the recent economic downturn and declining stock market values, the industry has been hit particularly hard. Assets under management, dollar figures on which much of the industry’s compensation is based, has declined. Many asset managers have not been consistently able to outperform market indexes, raising questions about their role in the future.

3. The industry has undergone rapid consolidation although the pace has recently declined. The industry will continue to consolidate in the future, with eventually only very large firms with scale economies surviving. Smaller, new firms with focused market strategies and innovative products will enter the market to cater especially to high-net-worth investors whose needs have been underserved.

4. The role of asset managers will change. They will no longer only pick and manage portfolios but will also act as consultants to an increasingly aging population that will have to live off and manage their own retirement nest eggs.

5. There will be further increases in the already growing number of hedge funds. Massachusetts lags behind and will continue to lag in hedge fund management. Mutual funds will face tough competition from hedge funds as investors increasingly begin to consider hedge funds as part of their portfolios. If indeed hedge fund management remains weak in Massachusetts, this could have significant economic consequences.

6. Asset management companies have invested large amounts in investment technology. Core technology that is central to the operation of especially technology-intensive financial products will be owned and managed by these companies. However, technology related to back office operations will be outsourced to partners, most likely ones located overseas, leading to job losses in Massachusetts.

7. Overall, the future of the industry is bullish. Markets will recover, and investor confidence will be restored. There will be a move back from cash and money market instruments into equity-related assets, management of which is the strength of Boston- and Massachusetts-based asset management companies. Demand for asset management will remain strong as the population becomes older and lives longer and as more individuals rely on defined contribution plans and individual retirement accounts. With social security systems under strain in the United States and many other countries, there may be international opportunities for asset management companies.
The financial services industry is a key sector of the U.S. economy. It is a noteworthy contributor to the overall gross domestic product and is an important component of the gross state product for many states. With the downturn in the economy at the beginning of this decade and the accompanying declines in stock market values, the industry has been hit hard. Asset management firms have experienced sharp decreases in their assets under management; banks and insurance companies have had to refocus their operations and have become increasingly vulnerable to acquisition. As evidence grows stronger that it is unlikely that fund managers will outperform market indexes consistently, many have started questioning the value of active asset management, thus jeopardizing the role of many players in the industry.

This report provides a look at the financial services industry, including recent developments and future trends. The primary focus is on the “asset management” sector; the banking and insurance sectors will be discussed only with respect to their involvement in asset management. We chose to concentrate on the asset management sector because between 1998 and 2001 this segment of the industry increased in significance most rapidly, especially in Massachusetts. For example, employment in asset management grew by 25.1 percent, whereas banking and insurance experienced declines of 3.5 percent and 14.4 percent, respectively.

Our analysis of the data, the existing literature, and interviews with leading practitioners in the field shows that the industry has indeed suffered in the recent past and that some structural changes are inevitable. The industry will continue to consolidate and downsize, and new players will emerge to meet changing demands. In the medium to long term, the future of the industry seems secure, given the demographics and the need for a larger proportion of the population to live off investment income.

The Financial Services Industry: Some Recent Developments

Significance of the Industry in the United States and Massachusetts

The financial services sector has evolved into a complex mix of banks, real estate companies, insurance companies, and asset management firms. The total gross domestic product (GDP) of the industry, including real estate, in 2001 was $2,076.9 billion out of a total U.S. GDP of $10,082.2 billion, representing nearly 21 percent of the 2001 GDP. With real estate excluded, the remaining financial services industries contributed 9 percent to the GDP in 2001. Depository institutions accounted for about 3.6 percent of the total GDP, while securities and commodity brokers and insurance carriers each accounted for about 1.7 percent. The “finance, insurance, real estate, and rental and leasing” sector employs about 6.9 percent of the national labor force. Over the three years from 2000 to 2002, employment in the financial services industry averaged 5.2 percent of total U.S. employment.

Massachusetts has played an important role in the financial history of the United States. In 1909, Massachusetts was the first state to pass the credit union law. The first mutual funds were established in the state in 1924 and the first money market mutual funds were introduced in 1972. Currently, in Massachusetts the financial services sector plays an even more dominant

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role than in the national economy. It contributes 11.2 percent to the total gross state product (GSP). It accounts for 8.2 percent of the state’s employment; the banking and financial services sectors combined employed over 100,000 workers in 2003, and had about $30 billion in total revenues (Boston Globe Archives). Employment in asset management has increased in the 1998–2001 period while the banking and the insurance sectors have experienced a decline (see Figure 1). Twenty-six of the top 300 firms in asset management, ranked by assets under management (AUM) in 2002, are headquartered in Massachusetts; Fidelity and State Street rank first and second respectively, and ten of the top 50 firms are located in the state (Institutional Investor, 2003). This is especially significant in light of the fact that the asset management industry is highly concentrated. For example, for the top 300 money management firms, the top 100 represent 90 percent of the total, and the top 200 represent 97 percent of the total. In fact, the 26 firms in Massachusetts in the top 300 account for about 17 percent of total AUM (see Figure 2 for a state-by-state breakdown of AUM and Figure 3 for a list of Massachusetts firms in the top 300). Massachusetts- and Boston-based firms have a relatively large proportion of their total portfolios in equities, particularly in equity mutual funds. For example, in 2002 Fidelity Investments had $406,037 million in domestic equities versus $121,782 million in domestic fixed income assets. Similarly, in that year State Street Global Advisors had $278,025 million in domestic equities versus $42,986 million in domestic fixed-income assets (Institutional Investor, 2003).

The financial services industry has increased in prominence in the last decade as a larger proportion of the U.S. population has invested in financial instruments. Net investment in U.S. equity funds alone between 1995 and 2000 was $1.2 trillion (Investment Company Institute, 2003). Populations in the developed countries are becoming older and living longer. In many countries, including the United States, the social security system is under considerable strain. There has been a gradual shift from defined benefit plans to defined contribution
The financial services industry has increased in prominence in the last decade as a larger proportion of the U.S. population has invested in financial instruments.

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<table>
<thead>
<tr>
<th>Rank</th>
<th>Firm</th>
<th>2002 AUM*</th>
<th>2001 AUM*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Fidelity</td>
<td>794,095</td>
<td>882,999</td>
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<tr>
<td>2</td>
<td>State Street</td>
<td>762,947</td>
<td>781,706</td>
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<td>20</td>
<td>Wellington Management Co.</td>
<td>302,863</td>
<td>311,372</td>
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<tr>
<td>24</td>
<td>Putnam Investments</td>
<td>250,882</td>
<td>314,566</td>
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<tr>
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<td>Evergreen Investments</td>
<td>230,673</td>
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<td>MassMutual Financial Group</td>
<td>198,857</td>
<td>201,163</td>
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<td>40</td>
<td>Sun Life Financial</td>
<td>137,391</td>
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<td>41</td>
<td>John Hancock Financial Services</td>
<td>127,412</td>
<td>124,079</td>
</tr>
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<td>42</td>
<td>Old Mutual Asset Management</td>
<td>127,335</td>
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<td>CDC IXIS Asset Management</td>
<td>123,249</td>
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<td>Affiliated Managers Group</td>
<td>59,522</td>
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<td>Eaton Vance Corp.</td>
<td>57,079</td>
<td>58,498</td>
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<tr>
<td>100</td>
<td>Grantham Mayo, Van Otterloo &amp; Co.</td>
<td>27,444</td>
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<tr>
<td>101</td>
<td>Robeco USA</td>
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<td>118</td>
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<td>140</td>
<td>F &amp; C Management</td>
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<td>156</td>
<td>Oechsie International Advisors</td>
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<td>Harbor Capital Management</td>
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<td>223</td>
<td>Boston Private Financial Holdings</td>
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<td>262</td>
<td>Rhumbline Advisors</td>
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<td>267</td>
<td>Numeric Investors</td>
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<td>271</td>
<td>Merganser Capital Management</td>
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<td>289</td>
<td>Fiduciary Trust Co.</td>
<td>3,876</td>
<td>4,548</td>
</tr>
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<td>291</td>
<td>Income Research and Management</td>
<td>3,847</td>
<td>3,705</td>
</tr>
<tr>
<td>295</td>
<td>Baupost Group</td>
<td>3,730</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Source: Institutional Investor, July 2003  * AUM numbers are represented in millions.

Source: Department of Labor, Bureau of Labor Statistics
Consolidation in the Industry

Consolidation has played an important role in the industry, leading to an increase in the size of the primary players in most segments. In all sectors except securities, the top 10 firms have increased their share of assets since 1995 while the number of participants has declined. The number of commercial banks in 2001 was 8,096, as compared to over 25,000 before World War I. The number of securities brokers and dealers in 2001 was 7,029, down from 9,515 in 1987. The number of life insurance underwriters fell from about 2,200 in 1985 to 1,549 in 2000. The number of property and casualty insurers, now 3,215, is expected to fall by 30 percent over the next decade. Consolidation is occurring both within sectors and across sectors, but at a slower pace than in the late 1990s. The number and value of deals have declined in the securities and bank sectors from 2001 to 2002. Specialty finance deals were up slightly in number, but their value did not increase.

The data indicate that net new cash flows from investors were the most important contribution to increases in AUM, especially in years when stock market returns were low. The data indicate that net new cash flows from investors were the most important contribution to increases in AUM, especially in years when stock market returns were low.

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pattern is similar to the overall industry; increases in AUM by mutual funds leveled off in 1999, and AUM actually decreased in 2002. Figures 9–12 show more details regarding the mutual funds industry. Figure 9 shows the number of mutual funds, Figure 10 the number of mutual fund shareholder accounts, Figure 11 the average assets per mutual fund over time, and Figure 12 the average assets per shareholder account. The industry showed significant increases over time; the 1999 average assets per fund were more than double that in 1990, but decreases have set in since 2000. As of mid-2002, the number of mutual funds in the United States was 8,212, down by 141 (or less than 2 percent) from the all-time high of 8,353 in March 2002 (Financial Times, 2003).
Figure 13 shows net new cash flows into mutual funds along with the GDP growth rate. In periods of robust economic growth, more net new cash flows move into equity funds; in low-growth periods larger net new cash flows move into money market and bond funds. Figure 14 correlates net new cash flows into mutual funds with financial market returns. Net new cash flows into equity funds were positive and enjoyed a general upward trend until 2000. In fact, 2002 was the first year to see a negative cash flow into equity funds in the past 10 years. Cash flows into bond funds were low in the past decade until 2001. With negative cash flows into equity funds in 2002, a reallocation to bond funds occurred. Investment in money market accounts increased in 1998 and surged in 2001. During the 1991–92 economic slowdown, a reallocation to bond funds occurred almost immediately. After 1995, stock market downturns seemed to first boost inflows to money markets.

Declines in AUM and net flows into mutual funds have not been the only worrisome factors for the industry. From 1989 to 1999, index funds returned an annual average of 14.7 percent to their investors, and the S&P 500 grew annually at 12.4 percent, whereas actively managed funds returned 10.9 percent (Morningstar, 2003). Between 1984 and 2002, passive investors received about 13 percent a year, compared with 2.7 percent for those who put their money with active fund managers (DALBAR, 2003). This has raised the question of whether key people add value to companies and investors and whether investors see added value from active fund management.10
The decline in AUM and the relatively low performance of active management have several implications. Asset managers are paid a fee on AUM, and with its decline observers are pointing toward a change in the AUM business model. Some suggest a “revolutionary” change from a product focus to a “process” focus in the financial services industry (Walker, 2001). The AUM business is expected to shift to a fee-oriented consulting model. Assuming that long-term demand for financial services exists and that pension funds and the retirement market become a major priority, asset managers will play more of a “coach/consultant” role rather than the traditional roles of order taker, problem identifier, and problem solver. Coach/consultant roles are expected to further increase in importance with globalization and the emergence of alternate investment products such as hedge funds (Rutter, 2001). Recruitment and retention of highly skilled workers who can manage assets, employees, customers, and suppliers will become critical for success in this industry.
If the role of the asset manager does become more consultative, then this could have a significant impact on the industry as a whole and in Massachusetts. A large proportion of back office, account management, and customer service jobs would be at risk of elimination. Moreover, investors shying away from active management may also have a profound impact on asset management firms in Massachusetts. The strength of Massachusetts firms lies in active management; very few of them are engaged in creating index funds.

Special Role of Institutional Investors

While the industry in general has experienced a decline in AUM, assets of corporate and public pension funds in the United States have been hit particularly hard with falling stock market returns; assets fell in value by just over $1 trillion between 2000 and 2002 (Greenwich Associates, 2003). Trustees and companies must decide whether to stick to their high allocations to equities or rethink their investment strategies (for example, utilizing more fixed-income investments), in which case fund managers must rethink their product mixes. Ultimately, growth prospects for the asset management business will depend on stable rates of client retention and investors generally adhering to the long-term asset strategies (Wall Street Journal, 2002).

Given their huge investments, institutional clients can be a force for change in the financial services industry.

With the disappointment in the stock markets continuing, trustees of pension funds must educate themselves and become more aware of the different options available for investment. Fund managers, on the other hand, must take note of clients’ (trustees’) needs. For both parties, there is a big push to make individuals responsible for pension savings and investments. Industry regulators are going to be more watchful of the actions of asset managers and of the kinds of products asset managers market and sell to potential investors. Legislation has been introduced in June of this year by Richard Baker, chairman of a congressional committee on capital markets, insurance, and government-sponsored enterprises, that will give investors more information about mutual fund fees and other aspects of the business such as operating expenses, portfolio transaction costs, and fund managers’ pay. Greater disclosure of information on costs can be expected.

The decline in asset values has pressured asset managers to seek markets overseas. There may be opportunities for asset management companies to sell abroad, and in fact large companies are using mergers and acquisitions (M&A) strategies to enter key global markets. One of the emerging trends in this industry is the globalization of providers with the ability to provide greater depth and breadth of services (Rutter, 2002).
Emerging and Possible Trends for the Industry

Will Consolidation Continue?

Although consolidation has been on the decline, the questions as to whether the rate of consolidation will increase in the future and what form it will take still remain hotly debated issues. Consolidation is taking place because of the increasing need for technology investment, excess capacity, the high cost of distribution and customer service, and changes in regulation. Companies have attempted to improve efficiency and market reach through consolidation. For example, consolidation can give access to cost-saving technologies or create opportunities for economies of scale. Also, through consolidation, managerial efficiencies can result, and companies can enhance their opportunities for cross-selling packages of services under the same name, thus enjoying economies of scope. However, it is interesting to note that a review of the last 20 years of M&A deals in the financial services industry in the developed world concluded that firms derive no gains in economies of scope or managerial efficiency and only modest gains in economies of scale up to a relatively small size (Amel et al., 2002).

Until the mid-90s a large proportion (by some estimates 80 percent) of asset managers in the United States were independent of banks and insurance companies. Then, many authors (Streeter, 1999) predicted that large banks and insurance companies would take over a bigger share of the asset management business. The interest in asset management business was expected because of the need for scale economies, demographic changes favoring the retirement market, large numbers of small- and medium-sized firms, and relatively strong buyers. Yet another article highlights the notion of cross-selling between asset management firms and banks (Rieker, 2002). Banks, Rieker says, will play the role of consolidators, offering advice to their clients on a host of issues including where and when to invest. As these studies suggested, throughout the 1990s, many investment banks and insurance companies paid high prices to buy large global asset management operations. Recently, with the softening of the economy, stock markets have taken a hit and revenues from asset management have fallen. Moreover, the relatively high prices paid for these businesses made it more difficult to achieve profitability. As a result, the acquiring companies are now reevaluating their acquisition decisions. Some of them are even considering divestment of their asset management businesses. Consolidation may be put on hold in today’s environment because a lot of sellers (especially large banks) are finding it difficult to obtain the “right” price for their asset management businesses. One industry expert predicts the reemergence of private equity firms as potential buyers of asset managers (Rutter, 2002). All this has raised questions about the long-term financial viability of the acquisition strategy of banks and insurance companies; how big a role banks and insurance companies will play in the asset management industry is also in doubt.

Given the current co-existence of large and small firms, what can we expect to happen in the future? Asset management requires the entrepreneurial culture that can be fostered in small firms. Indeed, the industry’s history and the success of hedge funds strongly suggest that fund management can be effectively done by small groups of entrepreneurial people with reasonable sums.
of AUM. Countering this is the industry’s need to consolidate and weld together lumps of assets for a global market. Several large U.S. companies have already organized their operations into retail, institutional, and global private divisions. However, in 2001 quite a few industry experts predicted the demise of multi-engine asset management models, stating that it is very difficult for parent companies to extract the scale or scope benefits associated with many different individual firms under the same corporate umbrella (Darragh & Wurster, 2003). The general opinion is that asset management is a skilled balancing act and that the future challenge will be to combine the economies of scale with the entrepreneurial flair that produces good investment returns. One CEO predicts that in the near future large global competitors will dominate the industry, accompanied by a handful of “boutiques” with strong strategic direction that specialize in one or two products (Feinberg, 2001). The global companies will offer a variety of products and services but in a manner that promotes entrepreneurial actions, perhaps through loosely connected, decentralized business units. The boutiques will be niche players that will operate through exclusive focus and branding, and will do particularly well when large firms with high costs are hurting in a poor economy. In fact, specialists who were interviewed for this report generally felt that the challenge for all players will be to try to find the right brand, since branding is going to become more important. Asset allocation has become more conservative over time, with a move into money market and bond funds, and a more conservative investment climate helps name-brand companies. High-net-worth investors have been underserved; thus, new companies can benefit from the right package of services and products directed at this client base.

Another aspect to consolidation that has not been widely discussed is that innovation will bring new firms into the business — firms will emerge to take advantage of new laws and regulations. For example, many experts feel that firms will take advantage of the Bush tax cut, which eliminated taxes on dividends, by focusing on dividend-paying companies. Furthermore, given the current economic conditions, downsizing is likely to continue in the industry. Typically, over half of a fund management firm’s cost base consists of salaries. More cuts will probably be made unless the economy shows signs of a quick recovery. Asset management firms will have to compete with the continued strength in real estate and a revival of the venture capital industry.
Securities firms in the United States spent $27.9 billion on information technology (IT) (Celent Communications, 2003). Back office brokerage operations have benefited most from IT spending ($8.3 billion). Using advanced information technology, financial institutions have transformed some of their core services. For example, consumers can now conduct many banking activities over the telephone and online as well as in traditional branch offices. The use of personal computers to conduct personal finances has increased as consumers have become more comfortable with making routine purchases online. By 2005, about one-third of households are expected to use online banking services.

The increase in the attractiveness of hedge funds may have important ramifications for Boston-based companies primarily known for their expertise in stocks and bonds. It is estimated that Massachusetts firms manage approximately 7 percent of total hedge funds (see Figure 15). Clearly, Massachusetts and Boston are thus currently not the focal point for hedge funds. Specialists interviewed generally felt that Boston and the local area may continue to lag behind other states in hedge fund management, particularly because high-net-worth investors apparently have a preference for businesses with prior links to Wall Street, which may explain the high concentration of hedge fund management in New York and Connecticut. Also, many interviews indicated that even if hedge fund activity does accelerate regionally, it might not necessarily positively impact Boston and vicinity to a large extent. Since location is not crucial to hedge fund operations in today’s high-tech environment, many new hedge funds will choose to locate in lower-cost places, ignoring Boston and vicinity. That Massachusetts continues to lag behind in hedge fund management and hedge funds are prospering at the expense of mutual funds poses a significant threat to the regional asset management sector.

<table>
<thead>
<tr>
<th>STATE</th>
<th>FUND CAPITAL (in $millions)</th>
<th>PERCENT OF WHOLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>146,824</td>
<td>43.02</td>
</tr>
<tr>
<td>Connecticut</td>
<td>53,712</td>
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</tr>
<tr>
<td>Out of U.S.</td>
<td>52,678</td>
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</tr>
<tr>
<td>California</td>
<td>24,653</td>
<td>7.22</td>
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<td>Massachusetts</td>
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<td>Texas</td>
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<td>Illinois</td>
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<tr>
<td>Maryland</td>
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<td>New Jersey</td>
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</tr>
<tr>
<td>Total</td>
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</table>

Source: Institutional Investor, 2003
The financial services industry has experienced considerable changes in the recent past and will experience changes in the future. Although its fortunes may be temporarily down, its future is bullish. Declines in AUM will soon be replaced by increases, because of recoveries both in equity values and new cash flows. Consolidation will continue; eventually large asset management firms and banks and insurance companies with scale economies will survive. New players will enter the arena, especially small firms that will service high-net-worth investors with exclusive branding. Investment in IT will continue, and many back office operations will be outsourced, especially to locations overseas. The Boston area and Massachusetts will continue to benefit from the strength of the industry. Growth in the mutual fund management sector will compensate for job losses from consolidation and outsourcing, as demand will remain strong in this area because of the growing population engaging in mutual fund investment.

We conclude with some questions for further reflection and analysis:

1. As consolidation continues in the industry, how will companies incorporate not only different products and services but also different people and management styles under one corporate name?

2. Are Boston-based firms going to be acquired by large out-of-state firms? Could this result in a loss of high-skill and high-paying jobs?

3. Do small firms have a future in the mass retail or institutional markets?

4. Can active managers survive the mounting evidence against their ability to consistently outperform the market?

5. Who will best help and how can they help the holders of defined contribution plans?
“Asset Management” is defined as “Securities, Commodity Contracts, and Other Financial Investments and Related Activities” and falls under code 523 of the North American Industrial Classification System.

All GDP and GSP (gross state product) data are obtained from U.S. Department of Commerce, Bureau of Economic Analysis, and employment statistics are obtained from U.S. Department of Labor, Bureau of Labor Statistics.

It accounts for 34.6 percent of total economic activity in Delaware, 20.1 percent in New York, 15.2 percent in Connecticut, and 15.3 percent in Rhode Island.

The difference in employment trends in the asset management sector versus the banking and insurance sectors can perhaps be explained by the differences in consolidation in these sectors.

Boston-based State Street Global Advisors and Fidelity Investments also rank in the top five domestic equity management and tax-exempt asset management firms. None of the top five fixed-income securities management firms is located in the Boston area.

According to the United Nations, global life expectancy is increasing, and the proportion of the population above 60 years of age is increasing.

See Figure 5 for number of establishments in banking, insurance, and asset management.

In 2002, the number of financial services deals fell to 774 from 858 in 2001. Deal value fell 59 percent from 2001 to 2002. In 2002, there was almost the same number of deals in the insurance sector — 286 versus 287 in 2001 — but deal value fell substantially, to $9.7 billion from $65.1 billion.

Data on consolidation are from SNL Financial LC.

Of course, whether active management, through stock selection or market timing, provides value is still inconclusive and is hotly debated.

The notion of cross-selling has become even more important after the passage of the Gramm-Leach-Bliley Act (GLB) into law on November 12, 1999. GLB expanded permissible activities for bank holding companies by creating a new type of financial services company, the financial holding company (FHC). Under the act, securities firms, banks, insurance companies, and other entities engaged in financial services may affiliate under an FHC umbrella and cross-sell an affiliate’s products within a regulatory system overseen by the Federal Reserve Board. More than 500 bank holding companies elected to become FHCs within the first 12 months this option was available.

This will be particularly true if market recovery is slow and the investment climate remains conservative.

It should be noted that hedge funds are limited to clients who have upwards of $1 million to invest, with many hedge funds requiring $10 million minimums.

As pointed out earlier in this report, the outsourcing of back office operations puts jobs in Massachusetts at risk, since a large proportion of employment in the industry is in those areas.

Notes

1 “Asset Management” is defined as “Securities, Commodity Contracts, and Other Financial Investments and Related Activities” and falls under code 523 of the North American Industrial Classification System.

2 All GDP and GSP (gross state product) data are obtained from U.S. Department of Commerce, Bureau of Economic Analysis, and employment statistics are obtained from U.S. Department of Labor, Bureau of Labor Statistics.

3 It accounts for 34.6 percent of total economic activity in Delaware, 20.1 percent in New York, 15.2 percent in Connecticut, and 15.3 percent in Rhode Island.

4 The difference in employment trends in the asset management sector versus the banking and insurance sectors can perhaps be explained by the differences in consolidation in these sectors.

5 Boston-based State Street Global Advisors and Fidelity Investments also rank in the top five domestic equity management and tax-exempt asset management firms. None of the top five fixed-income securities management firms is located in the Boston area.

6 According to the United Nations, global life expectancy is increasing, and the proportion of the population above 60 years of age is increasing.

7 See Figure 5 for number of establishments in banking, insurance, and asset management.

8 In 2002, the number of financial services deals fell to 774 from 858 in 2001. Deal value fell 59 percent from 2001 to 2002. In 2002, there was almost the same number of deals in the insurance sector — 286 versus 287 in 2001 — but deal value fell substantially, to $9.7 billion from $65.1 billion.

9 Data on consolidation are from SNL Financial LC.

10 Of course, whether active management, through stock selection or market timing, provides value is still inconclusive and is hotly debated.

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