The Investment Association – Written evidence (SCG0009)

1. Introduction

The IA welcomes the opportunity to provide input into this well-timed inquiry into the FCA and PRA's Secondary Objective for competitiveness and growth. Our work is largely within the remit of the FCA and our answers therefore focus here.

We are particularly grateful for the committee turning to this topic so early in its establishment. The new regulatory architecture brought forwards by the Financial Services and Markets Act needs new and expert scrutiny at a strategic as well as operational level.

We welcome the FCA's firm and public commitments to the importance of their new competitiveness and growth objectives, most recently as the highlight of their 10th anniversary communication. But this is only valuable if it is followed by action throughout the organisation, with a reflexive focus on competitiveness and growth in all action.

We are not here yet. Research from New Financial into market outcomes in the UK since the creation of the FCA across nearly 60 metrics of financial services activity shows a fall in just over half of the metrics in real terms and in two thirds of them relative to GDP. In 80% of the metrics, growth in activity has been lower than in the US.[1]

This is not solely due to the regulatory framework, nor would we expect this to be turned around in the short time since the secondary objectives have come into force. But it does illustrate the scale of the shift needed to allow financial services to play their fullest potential in powering growth across the country. We have therefore answered the committee's questions by considering the importance of the secondary objective and its impact so far, with reference to characteristics of regulatory activity which promote growth and competitiveness.

2. The importance of the secondary objective

A competitive financial services sector supports powers the wider economy. Today, our members own a third of the FTSE and invest in many thousands of unlisted and high growth companies, infrastructure

[1] A FOCUS ON MARKET OUTCOMES: EVALUATING THE UK REGULATORY FRAMEWORK, October 2024

projects, and of course buy UK government debt. In total, we channel £1.4trn into the British economy. In addition, we provide over 126,000 jobs and are responsible for 5.5% of the UK's total exports in services.

Even more fundamentally, having a world leading investment management sector right here in the UK makes it easier for British savers to access the very best products and expertise which helps them to become more financially resilient. A regulatory focus on growth, including ensuring that people have access to the products and services which will help them to save for their financial futures, is key to boosting this.

This global success story is dependent on the right regulatory framework, but in recent years, regulators have not always paid sufficient regard to economic growth and international competitiveness. This has limited UK consumers' access to the products which might suit them best, stymied investment managers' work to finance growing businesses, and led to a loss of jobs and tax paid as a result of diminished attractiveness. This manifests itself in a range of ways, most notably greater complexity and cost of doing business.

In part, this is due to an approach rooted in **'safetyism',** which is hampering our collective risk appetite. Safetyism is the over focus on eliminating risk without considering the wider unintended consequences. Agreeing what is appropriate risk is a challenge that we need to face head on if we are to maximise investment managers' ability to drive financial returns and efficiently allocate capital.

We have not got the balance right in recent years. Research, again from New Financial, tells us that the proportion of household financial assets in the UK sitting in cash (earning a negative real return) has increased from less than a quarter in 2014 to nearly a third today. The proportion of UK pension assets invested in fixed income has tripled to 47% over the past 25 years.[2]

It is right that the FCA's primary objectives to protect consumers and the integrity of the market remains their central focus. However fully implemented, the new secondary objective for competitiveness and growth supports the UK's world leading financial services industry to power the wider economy.

This should not be in conflict with the primary objectives. No financial services centre will thrive if it has a reputation for low standards, and

[2] The future of smaller company capital markets in the UK, October 2024

low standards do not create growth. Growing the UK investor base is good for competitiveness and growth, and this can only happen if public is reassured by high standards. This too feeds into perceptions of the FCA around the world, giving the UK a particularly loud voice when regulation is discussed at an international level.

International competitiveness is often as much about **perception** as concrete facts. Jurisdictions seen to be competitive are an easier choice for international businesses. Conversely, a narrative suggesting that a regulatory system might be uncompetitive can feed into a wider wariness to do business. It is therefore vital that all changes, whether or not they are thought to have a significant impact in and of themselves, are considered through a prism of how they might be seen to impact competitiveness.

3. Impact of the secondary objective

Investment managers' focus is largely on the work of the FCA, and here we are grateful for the effort that has been made to support implementation of the secondary objective.

There are positive examples of how FCA work has supported competitiveness and growth in the last year. In some work, notably the Listings Review, a focus on growth runs throughout the programme. However we are yet to feel a change in the way that the FCA works to the extent that is necessary to impact on the financial service sector's ability to support the UK's competitiveness and growth.

Looking across recent regulatory activity it is clear that the following characteristics promote regulation that supports competitiveness and growth:

3A: Working closely with industry and other stakeholders

The best regulation is made when those who will be most impacted by it – industry, consumers and other stakeholders – are involved in its creation. This does not mean that industry and regulators will always agree, but we must work constructively to make sure that regulation can be implemented effectively and achieve its objectives. This input often means that regulations' practical impact mirrors its intention, and that it can be implemented in the most effective way.

This has a clear impact on a programme's impact on competitiveness and growth, as well as its effectiveness. Regulation which achieves its intentions bolsters the UK's reputation as a world- leading hub for safe, secure and high-standard financial services. Regulation which can be implemented effectively helps individual firms, and the wider sector, to thrive.

An example of where this proved essential was the **development of the Sustainability Disclosure Requirements (SDR)**, which aims to improve trust and transparency to the market for sustainable investment products. Although not yet fully implemented, much of the work to develop the new regime happened in late 2023.

This work was notable for the degree of industry involvement, with an official industry advisory group supporting the FCA (the Disclosures & Labels Advisory Group), a further industry-led working group for financial advisers, and additional, informal co-working, including regular deep- dive sessions with the IA on specific aspects of the SDR implementation. To date, this process has involved major changes to initial plans, both at a strategic and technical level.

Whilst it is a notable example of industry-inclusive FCA work, the **implementation of SDR** clearly illustrates the complexity and scale of work that still needs to be done to call this novel regime a success. As of November 2024, just a handful of funds have received a label, despite us being just a month away of the original deadline at the end of this year. Delays have been caused both by very slow working processes, and by interpretation of the rules which remain complex and may not have factored in the potential impact on UK competitiveness.

Illustrating this too, the FCA's proposals on **publicising enforcement investigations** was published with little or no advanced consultation with the industry. This has led to deep concern about the proposals' impact. The FCA has subsequently been clear that they believe that these proposals will be used sparingly and therefore will have minimal impact. But this debate, coming late in the process and very publicly, will do little to dispel a sense that this policy was designed with little thought to its effect on competitiveness. Damage may well have been done to the UK's standing by the process, as much as the policy itself.

3B: Swift working

Regulatory issues often require swift attention, either to allow industry to take advantage of current opportunities or to ensure that there is no lag in consumers being supported and protected.

While a lengthy process can sometimes be appropriate in the most complex areas, speed where possible keeps the UK at the forefront of global change, enhancing our competitive position. It also allows any developing gaps to be plugged before serious issues arise.

One area at the very front of tech change where this has been seen recently is in the use of **tokenisation** in investment management: the process of converting real-world assets into digital 'tokens' that can be bought, sold or traded on exchanges. This can be done with private assets, including assets such as infrastructure, with the result of opening these markets to a broader set of investors by reducing the minimum levels of investment.

The FCA responded immediately when this was flagged as a developing area, quickly identifying how tokenisation could be used within the current Handbook, and areas where change is needed. Close work between the FCA and practitioners resulted in it taking just two weeks to identify how tokenisation could be done within the existing handbook, and identify the steps needed for its full potential to be realised.

Many investment managers are now poised to take the first steps in using tokenisation, keeping the UK at the very forefront of this developing technology and opening up new ways to channel capital into the projects which underpin growth.

Conversely, implementing the **Consumer Duty** has been more difficult due to the ambiguity of the rules and its application to our sector. Obtaining a clearer understanding of FCA expectations has been challenging. Although firms are now in the process of fully embedding the requirements and making improvements, the process of implementing the policy may have damaged the UK's reputation for competitiveness by creating deep uncertainty about how it would work, and whether it would be possible to implement by the deadlines set given the delays to providing important information.

3C: Supporting positive change

Industry is often best placed to see the future of our work, be it new products because they are close to consumer demands, or new technology as they understand the current gaps and future possibilities. Good regulation supports this, enabling and supporting progress while making sure that consumers and markets are protected in new areas.

Doing this well supports the UK's competitiveness by keeping us at the forefront of global financial services, cementing our place as the location the world looks to when seeking the most advanced, highest quality financial services. UK businesses consumers benefit too from having these high standards on their doorstep, boosting growth.

The UK's competitiveness and growth received a major boost thanks to the FCA's support for and detailed work on the **Long Term Asset Fund** (LTAF), a new fund structure, unique to the UK, allowing wider access to assets such as infrastructure and private companies which are not regularly traded.

Initially proposed by the Investment Association, the FCA took up the challenge of making the LTAF into a reality, working collaboratively with industry to meet our shared objective of a fund facilitating investment into the UK economy.

However the LTAF also illustrates the need for positive words from the top of the FCA to lead to action throughout the organisation. The LTAF is still not playing its fullest possible part in supporting UK growth. Amongst several issues, the FCA are proving far slower at authorising applications from host AFMs than in-house AFMs. This is limiting the number of LTAFs coming into existence, as for many managers, using a host AFM would be the preferred way forwards.

Opportunities to proactively support competitiveness and growth are too often missed. One example of this is last year's discussion paper on **updating and improving the UK regime for asset management**. This major review of the regulatory regime for our industry suggested the possibility of a top to bottom review, looking at how competitive we are internationally, and how our services support UK growth. The resulting work was solid and helpful at the margins. But a more confident and comprehensive review could have created a positive tipping point.

We look forward to working with the committee to put in place the step change needed.

22 November 2024