The Investment Association – Supplementary written evidence (SCG0058)

1. **In response to Lord Hill's question regarding the steps the regulators and government should take to improve the consumer saving and investing landscape in the UK, Mr Cummings suggested the following three points: government should work to improve financial literacy, the regulators should act to ensure consumers can access appropriate financial advice, and the ISA regime should be simplified (p. 5). The Committee would be grateful if you could expand on these points, answering the following:**

    a. **What specific policies should government take forward to improve financial literacy and public understanding of investing?**

Improved financial literacy is a crucial component of creating an inclusive investment environment which enables the broadest range of people possible to confidently invest to grow their long-term financial security. Too many people don't have sufficient rainy-day savings. But many people do. Over 15 million adults in the UK have investable assets of over £10,000, but more than half of these people have at least three-quarters of these assets in cash.[1] This means that they are missing out on the potential investment growth while being exposed to the detrimental impact of inflation. If these consumers had put £10,000 in a cash ISA a decade ago, it would be worth less than £8,500 today due to inflation. If they had invested that same £10,000, for instance in a Global Equity Fund, they would have over £18,000.

We must end the sense that investing is 'not for people like me', which often entrenches existing economic inequality. For instance, September 2024 research by the IA shows that only 14% of women hold a stocks and shares ISA, compared to 26% of men. Research by Boring Money[2] found that the gender investment gap in the UK stands at £567 billion as of January 2024. To support the financial wellbeing of the entire population this needs to change.

[1] FCA Financial Lives Survey (2020).

[2] FT Article: Women's lack of confidence widens gender investment gap, study finds, March 7, 2024

The fact that it can be simpler and feel less daunting to take out debt (such as overdrafts or credit cards) than to start investing can lead to perverse outcomes, both for consumers and for the wider economy.

Policymakers in the UK must shift the perception of investment from being challenging to one that is actively encouraged. In our response to the Financial Services Competitiveness and Growth Strategy, we have proposed several solutions.

- **Financial Resilience Score:** Consideration of the potential for a 'financial resilience score', in addition to the existing credit score. This would map people's overall financial health, rather than simply their record of repaying debt, acting as a nudge towards positive financial behaviour.
- **Financial Education:** More effective financial education throughout life so that core concepts (including the power of compound growth, inflation risk, and the very fact that ordinary people can participate in capital markets) are understood. This should start at school and continue at appropriate points throughout life. Although support around the point of retirement is helpful, this will be less effective (and perhaps even less likely to be sought out) by people who do not already have a basic level of understanding and confidence with money. The Just Finance Foundation, chaired by Chris Cummings, has developed helpful resources outlining when to introduce financial concepts to children. Their staged approach includes:
  - **Early Childhood (Ages 4–7):** Introduce basic financial concepts through playful, hands-on activities. For instance, parents can use storybooks to teach the value of saving and decision-making.
  - **Middle Childhood (Ages 8–12):** Build on earlier lessons by involving children in real- life budgeting and financial decision-making.
  - **Adolescence and Beyond:** Expand understanding to include more complex topics such as investing, risk management, and long-term financial planning, focusing on independent application and deeper financial literacy.
  - **Continuing Education into Adulthood:** While

financial support at key milestones like retirement is valuable, its impact will be greater if individuals have already developed foundational knowledge and confidence. Lifelong learning opportunities—such as community workshops or online resources—can further reinforce and expand financial literacy.

This staged, activity-based approach ensures financial education grows with the individual, fostering practical skills and deeper understanding.

- **Risk Disclosure:** Regulatory decisions should consider the differing financial literacy levels and existing attitudes towards participating in investing which different groups of consumers have. A live issue today is that of disclosures. Risk disclosures should be reformed to inform and empower consumers, rather than simply warn them. This aligns with presenting both the risks and potential rewards, fostering a deeper understanding of the investment landscape. This approach encourages more confident and engaged investors who are better equipped to make informed decisions. Research by the University of Nottingham[3] shows that traditional risk warnings ('Capital at Risk') often discourage women more than men. However, when risk warnings are framed differently (such as stating, "Investing can over the long term outperform cash. However, investments can go up and down and you may lose money as well") customers, especially women, felt more engaged. The proposed Consumer Composite Investment regime should help distributors add contextual information to help explain risk and reward differently depending on the customers' needs.

- **Gaps in financial literacy** should be considered when regulating all financial products, including cash products and cryptocurrencies, which should be subject to the same requirements to fully inform consumers in a balanced, useful way as investment wrappers, accounts, and other products. Currently, many consumers are unaware of the risks associated with holding cash long-term, particularly

[3] How Do Risk Warnings Impact Investment Choice? (https://www.tisa.uk.com/wp-content/uploads/2024/03/Risk- Warnings-Summary-Report.pdf)

the erosion of value due to inflation. Just as with other investments, consumers should be informed that while cash may seem safe, it carries its own set of risks over time.

b. **The FCA intends to consult on new rules for financial advice following Advice Guidance Boundary Review in H1 2025. What specific changes would materially improve access to financial advice, and how best might the regulator safeguard against conflicts of interest?**

Too few people have the professional support they need to invest productively and secure their financial futures. Just 12% of people currently receive help from a financial adviser, and this service is often limited to those who already have the most secure finances. The UK is a global outlier in this – we have about half the number of financial advisers per capita than comparable countries, including the US and Australia.

The FCA and HM Treasury are currently taking steps to reform the advice/guidance boundary, which the IA is supportive of. The FCA's proposals on Targeted Support will help consumers on their investment journey and enable providers to for example, better intervene if they see a customer at risk of a scam or inform a customer of the dangers of inflation.

The IA also supports the development of a simplified advice proposition. To offer a simplified service, firms need to either ringfence the input/process or the outcome. When developing the regimes we have urged the FCA to consider the principles of Abridged Advice, which allows a streamlined process where advisers perform a limited fact-find to address specific issues without full-cost advice. Clients should be able to seek advice on specific investment decisions or retirement products without requiring holistic advice.

It is, however, important that these new regimes are carefully monitored and open to constant evolution over the next decade to ensure that the reforms work and appropriate advice and guidance remain easy to access. In particular, it is imperative that the advances in AI, which might revolutionise the cost and availability of financial advice and guidance, are carefully and appropriately nurtured.

c. **Mr Cummings suggested streamlining ISA offerings to an investment and cash ISA (p. 5), what else could be done to help increase ISA uptake, specifically the uptake of investment or stocks and shares ISAs?**

Research from IA member abrdn shows that three-quarters (74%) of British adults are savers outside of their pension, but for most this simply means keeping their money in cash. For those investing in listed company shares (19%), four people in 10 do not use an ISA tax wrapper. This highlights the need to increase ISA uptake to improve the financial resilience of UK savers.

One simple yet significant suggestion the IA has called for in the past, is to change the name of the Stocks and Shares to 'Investment ISA'. While some firms may already brand their Stocks and Shares ISAs as an 'Investment ISA', having a rebrand come from the Government will send a strong signal to consumers that the ISA is a means to invest for the long-term, not just in shares, but also in other assets and in different collective vehicles such as investment funds and investment trusts.

We strongly feel that any ISA reform should be done holistically and prioritise simplicity to avoid confusing consumers with new complex rules. Reform should build on the success of the ISA brand, safeguarding its strengths, while ensuring it remains commercially viable.

The Swedish Investeringssparkonto (ISK) offers an excellent international comparison when exploring ways to boost the ISA and retail investment landscape in the UK. In 2012, the Swedish Government introduced the Investeringssparkonto (ISK), a move that significantly boosted household investments, contributing to both individual financial well-being and the growth of Sweden's capital markets. Modelled after the ISA, the ISK offers nearly tax-free benefits, with a minimal tax rate currently set at 0.375%.

The success of the ISK can be attributed largely to structural reforms and user-centric policies, rather than traditional marketing efforts. By simplifying the tax system, replacing capital gains tax with a standardised annual tax, and allowing investments across a broad range of financial instruments, the ISK became attractive to both novice and

seasoned investors. Financial institutions quickly adopted ISK accounts, offering easy online access and promoting financial education. This pragmatic, policy-driven approach led to rapid adoption, with 3.8 million Swedes (out of a population of approximately 10 million) holding ISK accounts by 2023. These accounts collectively contained investments totalling 1.6 trillion SEK, or approximately £124.88 billion GBP (roughly 25% of the country's GDP).

d. **What other recommendations could the regulators take forward to improve the provision and uptake of investment services in the UK?**

Whilst this question specifically asks for recommendations regulators could take forward, we have also included recommendations central government could take forward in case it is helpful to the committee.

Pension Adequacy

We see demographic change as one of the most important trends that needs addressing in any future financial services strategy. Pension provision is still inadequate to meet the needs of people living longer and increasingly requiring care, with 12.5million working-age people still undersaving for retirement[4]. We therefore have three recommendations to ensure that pensions saving and retirement incomes are adequate:

- Bringing the self-employed into the Automatic Enrolment system
- Increasing contribution rates from the current 8%, when appropriate; and
- Fostering the creation of new decumulation and in-retirement financial products.

Technology

We are on the cusp of a revolution in how technology can help more consumers to access investment, and in ways which better suit them. Domestically, this can be the key to greater retail participation in capital markets and therefore greater funding potential for the UK economy. It would also have a highly complementary international competitiveness element.

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[4] DWP Analysis of Future Pension Incomes, March 2023 (https://www.gov.uk/government/statistics/analysis-of- future-pension-incomes/analysis-of-future-pension- incomes#:~:text=Just%20over%20half%20of%20the,88%25%2C%2030.4%20million)

While the UK has the beginnings of such an ecosystem, much more needs to be done to coordinate it effectively. Whether on digital wallet usage, digital ID, digital securities and investment funds, or digital pounds, the groundwork is emerging for us to capitalise upon. Although no jurisdiction internationally has achieved what we would see as critical mass, other countries are starting to pull ahead in the energy and practical enabling of this new world. The UK can still catch up and emerge as a global leader, and we believe the two recommendations below will help achieve that.

- The re-establishment of the Asset Management Taskforce with a new mandate of establishing the UK as the leading global centre for digital asset management. The taskforce previously brought together industry, regulators and government to facilitate significant progress in the integration of emerging technology within the investment management industry for consumer benefit, with knock on positive impacts for other sectors.

- Progress towards tokenisation should be supercharged by putting in place a senior strategic oversight group to define what a fully digital UK retail investment eco-system will look like in practice. This should set out a vision of the future retail experience from individual investors with digital wallets to the underlying investment delivery architecture. Building on extensive existing reforms to modernise communication (CCI regime), investor support (Advice Guidance Boundary Review) and consumer protection regulation (Consumer Duty), this project will provide the technological momentum to make the UK one of the most forward-looking jurisdictions in the world.

Capital Market Reforms

The UK's vibrant and dynamic capital markets remain some of the strongest and deepest globally and we welcome the Government's commitment to build upon this strong foundation. We believe the following recommendations would help further improve the provision of investment services in the UK.

- Continue to champion "Modernising Capital Markets" including ongoing work such as the reform of the UK listing rules, the

development of a UK consolidated tape for all asset classes, the transition to T+1, the review of the UK research market, the development of PISCES and creating optionality for payments for investment research.

- Support the buy-side community's work towards the automation of IPOs, making the UK listing process more efficient.
- Support the wider digitisation of the market, including policy and regulatory work on tokenisation.
- Consider the abolition or phased reduction of stamp taxes on shares of UK-listed equities, which is an international outlier, to re-invigorate interest in UK markets.
- Encourage changes to the policies governing corporate defined benefit (DB) pensions schemes to push further capital market growth. These include new guidance for trustees, an increase in protection offered by the Pension Protection Fund (PPF), and mechanisms to support surplus sharing.
- Commission a study on the role of AIM, echoing recent work on junior markets across Europe, to ensure that it continues to be attractive in light of changes (particularly IHT) which may have has a negative impact on perceptions of it.
- Commission a study on the potential for regional municipal bonds, which could help to power the UK's regions, and the infrastructure needed within them.

Regulatory Disclosure

Finally, and further to our answer on how to improve the public's understand of investing. We recommend the government and regulators ensure that regulation considers positive outcomes, in addition to harm prevention. By way of example, this should include reforming regulatory disclosures by:

- Reforming the disclosures on investment products so they inform not just warn consumers; and providing consistent risk information across all financial products, including cash products.
- Ensure regulation takes into account the difference between wholesale and retail financial services and does not apply unnecessary burdens on wholesale services which are designed to address specific retail circumstances.

2. **In response to Lord Vaux's question regarding the cost of regulatory compliance in the UK compared to other jurisdictions, (p. 7) Mr Cummings noted that UK firms are impacted by both direct costs of complying with the FCA rulebook, and indirect costs, such as contributions to the FSCS and FOS (p. 9). Lord Vaux subsequently requested that specific data, if available, be shared with the Committee (p. 10). In response to this, please answer the following:**

    a. **Are you able to provide or otherwise signpost data that would help the Committee better understand the monetary cost of compliance to asset managers in the UK?**

Our industry data highlights that the industry headcount for Compliance, Legal and Audit has almost tripled from 2009. One IA member reported that 8% of their total headcount is dedicated to compliance with rules that did not exist 8 years ago. This is only part of the impact as there are other activities within the business which are required for regulatory compliance purposes such as senior leadership time and product design. This additional headcount required to manage compliance with regulation has a large monetary cost on UK asset managers.

Although specific industry wide data is not currently available, there are a number of indicators which give a sense of the level of impact. One IA member reports that the UK part of their business is about a third of total assets under management and revenue of the global business, but their regulatory bill is around four times the rest of the organisation, making their UK business far less profitable than their APAC or North American businesses. This is in large part due to the cost of regulation.

Regardless of size, business model or ownership type, there is a widespread view that costs have increased to a point where the UK is becoming a much more difficult place to do business as a fund management and or investment management business. Firms often point out that there are other jurisdictions, including the US, which provide high consumer protection regulation and a lower regulatory compliance burden that could see the UK's global competitiveness reduced.

This can be illustrated by looking at specific regulatory issues. As part of his verbal evidence, Chris Cumming provided statistics on the significant resources required for Consumer Duty. We have also previously conducted research within our membership around the impact of specific measures such as Assessment of Value. All interviewees agreed that the FCA's Cost Benefits Analysis had materially underestimated the resource required at both board and analytical level. One interviewee cited 6 additional Board level meetings a year being required just to deal with the regulation. This is a key example of compliance costs that were not properly factored into the regulators Cost Benefit Analysis when considering the overall cost of regulation.

The monetary cost of compliance is not just an issue for asset managers. The Annual Compliance Health Check Report from SteelEye[5], which measures the trends shaping the compliance industry across financial services, highlights that 2-in-5 firms view keeping up with ever-changing regulations as main driver of costs. Out of the firms that have seen compliance expenditure increase, 37% attribute keeping up with everchanging regulations as the main driving factor. This marks an increase from 32% in 2023, signalling a growing concern among compliance professionals regarding the complexity and volume of regulations.

Furthermore, when analysing the different factors driving up compliance costs across regions, firms based in the UK scored 'keeping up with ever-changing regulations/more regulation to comply with' as the largest factor driving up compliance costs. Whereas firms based in the US and Europe attributed technology as the primary driver behind compliance costs. The report also considers the factors across business types, which highlights that compliance costs go beyond the cost of compliance officers, and that for asset managers in particular the cost of compliance is often felt most in providing the technology to support the process of complying with new regulations.

[5] The State of Financial Services Compliance: Annual Compliance Health Check Report 2024, Steeleye.

b. Are you aware of any indicators that might usefully be used to measure the cost of compliance to asset managers across jurisdictions?

Meaningful comparison across jurisdictions is an important tool in understanding the competitiveness of the UK internationally. However, it is often hard to compare competing jurisdictions as few publish quantitative metrics equivalent to those of the UK regulators. For many firms it is often the "on the ground" relationship and engagement with regulators across jurisdictions which matter most when taking decisions on where to base their businesses or make investments. Making better use of qualitative metrics as part of a wider framework would greatly help when comparing the UK's international competitiveness.

The regulator's cost benefit analysis panels could potentially play and important role in monitoring compliance costs – particularly in respect to new regulations but ideally looking at existing regulations as well. As set out in the example above on AoV, our industry experience has been that regulator's analysis of costs have not adequately reflected the true cost of the regulation. The IA has also previously argued that the new panels should consider the cumulative cost of regulation, not just the cost of a specific change in isolation. Furthermore, the Panel could play a role in spearheading research or surveys of firms to assess the true cost of regulation.

Even without a holistic study to identify cross industry metrics, there are numerous examples where the UK has imposed compliance costs of firms which do not exist elsewhere.

One example is the ease of making changes to authorised investment funds. The UK is currently at a competitive disadvantage when it comes to the FCA's regulatory regime for authorised fund managers. In order to make a fundamental change to an authorised fund, the Authorised Fund Manager (AFM) must seek approval from both the FCA and fund unitholders. In Luxembourg, only the regulator's approval is required for a number of types of change deemed fundamental in the UK. The additional step in the UK process adds to the AFM's compliance burden. To gain unitholder approval an EGM must be convened and a vote taken to approve the changes. These meetings are costly, time-consuming and often poorly attended. The FCA could bring the UK regime into line with international competitors such as Luxembourg by replacing the

requirement for unitholder approval of certain types of change with an obligation on AFMs to demonstrate how the proposed change would be in the interests of unitholders and give unitholders reasonable notice of proposed changes.

There are several other compliance costs for firms which do not exist in other jurisdictions. The Assessment of Value example given in answer to Q2a is another prime example of regulation adding to the compliance burden of firms in the UK, putting them at a competitive disadvantage. As stated above the Cost Benefit Analysis of this regulation also underestimated the impact it would have on firms.

We would also point to the difference in capital requirement internationally, we go into further detail on this point in answer to Question 2c. The capital requirements currently imposed on firms in the UK, should not be imposed on non-market intermediaries like asset managers which would bring the UK into line with the US where there are no capital requirements for SEC-registered investment advisers.

Finally, the FCA's recent Sustainability Disclosure Requirements and investment labels regime highlights the cost of compliance on UK firms and the risk of regulatory divergence on the UK's international competitiveness. While it is too early to quantify the upfront direct implementation cost caused by SDR given firms are still in the process of implementing the regime, the impact has been significant and has required resource from all parts of the business, from product development, marketing, legal, compliance, fund management. In many instances, hiring outside legal teams to help with the FCA authorisation process as well as consultants. Furthermore, for smaller firms with less resource, procuring services of outside firms to comply with independent assessment reviews. For all firms under the regime, there is also the increased cost of sourcing the data needed to support mandated disclosure requirements (including for KPIs and metrics). Lastly, regulatory divergence will damage a competitive and dynamic product market to the disadvantage of customers and as a hinderance to sustainable and inclusive growth so any future expansion of SDR to overseas funds being marketed into the UK needs to take this in to account.

c. **What other factors contribute to the indirect costs of compliance for UK based asset managers? Are these factors common across jurisdictions, or are they unique to the UK?**

Where regulation has moved ahead of international norms there is an indirect cost in regulation for the industry that is not faced by other competing jurisdictions. We have listed a few examples below.

FSCS Levy

An example that should be considered when discussing the cost of compliance is that of the FSCS levy. We support the need for consumer protection and a robust compensation scheme of last resort that provides retail consumers with a necessary safety net. However, it is a significant cost of business that does not exist to the same extend in other jurisdictions. Section 213(5) of FSMA states that the regulators must take account of the desirability of ensuring that the amount of levies imposed on a particular class of authorised person reflects the amount of claims made, or likely to be in made in respect of that class of person.

While other jurisdictions have investor compensation schemes, the FSCS levy is far more comprehensive. The FCA DP21/5 lists other international investor compensation schemes for comparison. The FCA argue that in the UK a wider scope is required due to the prevalence of smaller intermediaries.

However, the implementation of the "look through" methodology for calculating the levy, introduced in 2018, has resulted in investment managers disproportionately bearing a significant portion of the costs. Investment managers accounted for around 20% of the total FSCS levy in 2022/23, despite the sector never having been the cause of a claim. This not only contravenes section 213(5) of FSMA, it also generates a clear competitive drag on the sector and must be reconsidered urgently.

Comparisons with the US

The culture of safetyism in regulation, which Chris referred to in his oral evidence, has also had a negative impact. The IA attended a senior roundtable hosted by a senior UK government representative in New York; the number one barrier raised by the executives was the difficulty in setting up bank accounts. Access to banking facilities was also raised

as an issue by a prominent Australian pension fund setting up in the UK, and again at a recent roundtable with the British Embassy in Washington D.C. The risk-averse approach applied to both individuals and corporate entities with both finding it difficult to open accounts.

Prudential regulation also is more challenging than other jurisdictions, and a new balance of risk needs to be found. As part of the IA's annual Investment Firm Prudential Regime survey, more than half of international firms surveyed indicated that the UK prudential regime was more onerous than other jurisdictions in areas including capital, liquidity requirements, and regulatory reporting.

For example, capital requirements are imposed today on all firms with a convoluted, complex formula but should be imposed only on market intermediaries and with a simple formula based upon net capital for brokers and non-banks, and solvency capital for banks. Non-market intermediaries, such as investment managers, should not have capital requirements. As an example, we cite a complete lack of capital requirements for SEC-registered investment advisers. Further detail on this issue can be found in our response to the Government's recent Financial Services Competitiveness and Growth Strategy, specifically in answer to question 5.12.

VAT zero rating on UK domiciled funds

Another key factor is the UK's complex tax systems for investment funds which is difficult to navigate compared to other fund centres. The UK has not been able to utilise its success as a fund management location to become a centre for fund domicile due to our internationally uncompetitive VAT treatment. The UK has for decades, originally as part of the EU, adopted the VAT exemption for fund management activities. The purpose of the exemption was to ensure that retail savers and investors did not incur VAT simply for choosing to invest via a fund instead of making direct investments, thereby promoting access to UK-regulated investment services, top-tier governance, and portfolio risk diversification. However, The UK VAT regime has since not kept pace with how investment management and financial services are delivered to end customers and is increasingly being applied in its narrowest sense by tax authorities. This results in a perverse outcome that makes it more expensive to manage a UK fund than a non-UK fund which are both available to UK investors. This outcome is sub-optimal for investors who would get a worse return for investing in a UK fund than in a fund

with an identical strategy located outside the UK due to the additional cost.

The introduction of VAT zero-rating for UK management of funds could help address the above issues by levelling the inconsistent VAT treatment of management of UK and non-UK funds. Research commissioned by the IA in 2023 on the likely benefits of a more competitive UK funds regime, including VAT zero rating, highlighted the potential positive impact to the UK economy through increased activity, growth, and jobs in the form of:

- increase total tax revenue by up to £693 million after five years of change in the regime due to the economic activity it would generate across the UK.
- increased UK funds under management by up to £683 billion after five years of change in the regime arising primarily from new funds providing investors access to a wide range of investment opportunities in the private markets

Further information on the UK internationally uncompetitive VAT treatment can be found on pages 16-18 of our response the Government's recent Financial Services Competitiveness and Growth Strategy.

Consumer duty

A longstanding concern held by industry relates to the cost and complexity created by the layering of new regulation onto similar existing requirements. Over the past decade, the UK has seen an unprecedented level of significant new regulation affecting the asset management industry. Examples include rules derived from the remedies set out in the Asset Management Market Study (AMMS); implementation of MiFID II; Senior Managers & Certification Regime (SM&CR); LIBOR Transition; Consumer Duty; Taskforce on Climate-related Financial Disclosures (TCFD) and Sustainable Disclosure Regulations (SDR).

The industry has embraced and adapted to these changes with a focus on driving efficiency, raising standards of governance and oversight and thereby improving the outcomes for our customers across the market. However, the layering of requirements is having an adverse impact on the investment management industry, creating a compliance burden that suppresses innovation and prevents UK-based firms from

reinvesting in their businesses, making the UK a less attractive place to conduct business and ultimately stifling growth. The removal of unnecessary compliance costs is an important step toward reducing the overall cost of doing business.

With respect to the introduction of Consumer Duty, the compliance costs, direct or indirect, were vastly underestimated in the FCA's original cost benefit analysis. This highlights how the consequences of layering regulation can go unassessed to the detriment of the competitiveness of the asset management industry. While it is very difficult to give an industry wide cost, the work undertaken by the IA demonstrates how complex and costly Consumer Duty was for firms to understand and implement. As highlighted in Chris' remarks to Lord Hill's question (Q203) on regulation, the IA invested approximately 8,000-10,000 working hours since July 2022, which is equivalent to three full time employees, plus legal counsel to help members implement Consumer Duty. The IA held over 60 formal meetings with roughly 100 members per meeting to discuss implementation issues and challenges.

23 January 2025