abrdn plc – Supplementary written evidence (SCG0068)

The following evidence is supplementary to abrdn's written evidence of 1 November 2024 and oral evidence of Sir Douglas Flint, Chairman of abrdn, on 6 November 2024.

1. **In his opening statement, Sir Douglas noted four areas that could drive growth in UK asset management and the wider economy: the amount of money saved, how it is being saved or invested, where those investments are allocated, and whether the asset management industry is investing sufficiently in its own capabilities (p. 2). In response to the Chair's request, Sir Douglas undertook to expand on how these issues could be addressed in writing. In response to this, please answer the following:**

a. **According to the OECD, in 2022 UK households saved 2% of their disposable income, compared to 5.8% in Canada and 11.1% in Germany. What actions can the regulators take to make saving and investing easier or otherwise improve the savings landscape in the UK?**

Low levels of long-term savings and investment by UK households has long been recognised as a both a social and economic problem and a cause for concern for regulators and policymakers alike. As highlighted in our recently published research paper ***'Tell Sid and tell him again,'*** UK adults hold the smallest percentage of their wealth in investments of any G7 country (8%). The vast majority of UK adults hold their wealth in perceived "lower risk" assets such as property (50%) and cash or cash-type products (15%). The UK has the third highest proportion of wealth held in property and the third highest proportion in cash compared to the rest of the G7.

Addressing this imbalance will require a multitude of carefully considered and inter-linked policy interventions so long-term saving and investing are more deeply embedded in financial behaviours, ideally becoming the norm rather than the exception. We recognise that some of these interventions are outside of the remit of regulators. For example:

Stamp duty – as outlined in our *Tell Sid* research paper, stamp duty on UK share trades represents a significant cost barrier and a disincentive to investment. It is inconsistent with practice in many other jurisdictions where no such tax is applied and direct retail investment in capital markets is far more prevalent.

Research conducted for abrdn by Opinium research[1] found that over two fifths of the UK public would be more inclined to invest in UK shares if they did not have to pay stamp duty rates.

ISA simplification - Individual Savings Accounts (ISAs) have been a great success but what started as a simple idea has grown progressively more complicated through too much choice. We have previously recommended consolidating the existing adult ISA range into a single ISA which gives access to all of the underlying investment choices. A single adult ISA account for both cash and stocks/shares would simplify the decision-making process for customers and lead to a more diversified asset mix being held within the same wrapper. Junior ISA and Lifetime ISA would continue to remain separate to avoid complexity. We also recommend a review of ISA limits which have not increased since 2017.

While taking action on stamp duty and ISA market simplification would help create an environment more conducive to retail investors, we believe it is equally important – perhaps more so - to address regulatory barriers to investment and we would highlight two points in our initial written submission to the committee:

Risk and reward - There needs to be a cultural shift in attitudes to risk. As we (and others) have noted, since the Global Financial Crisis of 2008 the regulatory pendulum has swung too far towards elimination of all risk. Working towards a more optimal balance between consumer protection and appropriate risk exposure would potentially deliver higher rates of return for investors on their DC funds and other long-term assets. We see encouraging signs this mindset is beginning to take hold but there is still a long way to go before policymakers, regulators and other stakeholders accept that a higher degree of managed risk is essential for economic growth, vibrant capital markets and the financial security and well-being of UK households. The FCA are looking at the need to simplify and rebalance disclosure but could go further and faster.

Cost versus value

Alongside an acceptance that risk is essential for delivering better long-term investment returns, there needs to be a much greater focus on value over cost. Indeed, placing an excessive focus on constantly driving down the cost of products and services to a minimum may be detrimental to the interests of consumers in the long run if it cuts off opportunities

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[1] Research conducted for abrdn by Opinium research in Q3 2024 amongst 2,000 UK adults weighted to be nationally representative

which have higher charges, but have the potential to deliver far better outcomes.

In addition, we believe regulators can help to create a better investment environment in the following ways:

Closing the advice gap

Creating a stronger culture of saving and investing in the UK cannot be achieved without addressing the 'advice gap' which leaves far too many people without access to the help they need to take important financial decisions. We very much hope the FCA's ongoing Advice Guidance Boundary Review (AGBR) – of which abrdn is very supportive - will directly address this problem.

We have engaged with HMT and the FCA throughout the AGBR process to date and we will continue to do so as we believe it is vital to have the right framework in place to support advisers and savers in making key financial decisions. We therefore welcome the FCA's recent update (15th November) setting out next steps and the intention to focus on Targeted Support (TS) for pensions with further consultation and engagement on widening TS to other investments and draft rules which will apply across consumer investment and pensions.

In view of its mass market potential, we support the FCA's decision to focus on TS for pensions. We would also like to see other forms of consumer investment included in scope as soon as possible. TS has the potential to help both advised and non-advised customers, and we believe we can help to make TS a success through our adviser platform and our D2C investment platform, interactive investor.

Points on which we would like further clarity:

• A clearly defined boundary between TS and regulated holistic advice so firms have confidence the FOS will not apply its own interpretation when dealing with any complaints, thereby leaving firms liable for any shortcomings on what they regarded as TS but is subsequently deemed to be holistic advice and therefore judged by that standard. (We know from our conversations with the FCA they understand the importance of having a clear boundary and a consistent approach between intention of rules and FOS decision-making.)

• Whether a firm providing TS (under the new regime under consultation) will have an ongoing obligation to track the outcome where it provides a targeted support "nudge" and to continuously re-assess if further nudges

are required. In this context a “nudge” under TS could involve a more personalised communication suggesting a client take action to improve their outcome. The greater personalisation should increase the likelihood of the client taking action, while not becoming full holistic advice. An example of this would be sending communications to clients in retirement who appear to be taking large withdrawals from a pension to highlight they risk running out of money with a generic suggestion that most people would benefit from taking a specific lower percentage.

While the focus is now on progressing and implementing TS, we note the FCA’s intention to consult with smaller firms on Simplified Advice in 2025. We will continue working with our trade bodies on how Simplified Advice could work alongside holistic advice as we continue to believe it could provide an additional layer of support.

We believe that the introduction of Simplified Advice is essential as Targeted Support by itself will not meet all of a consumer’s needs. We know through our adviser platform that larger advice firms do have an interest in delivering more simplified cost-effective advice models to different customer segments. We will continue working with our trade bodies on how Simplified Advice could operate alongside both holistic advice and Targeted Support.

Financial literacy

The absence of a well-coordinated national financial education framework is a clear barrier to investing and saving in the UK. Research we conducted with permission from the Global Financial Literacy Excellence Centre found that a fifth of UK adults (20%) were unable to correctly answer any of the “Big 3” financial literacy questions asked of them. A quarter (24%) only answered one question correctly. This means that 44% of our respondents – equating to 23.3 million UK adults – would be classified as having poor financial literacy. That means two fifths of the UK population lack the essential skills needed to manage their money effectively. Meanwhile, those with the lowest financial literacy levels (scoring ‘very poor’) were around twice as likely to have a low risk tolerance for investing than those with the highest (scoring ‘very good’) – 62% vs 34%.

On 2 September 2024, abrdn, MyBnk and the Just Finance Foundation issued a joint letter to Bridget Phillipson MP, the Secretary of State for Education and Minister for Women and Equalities, calling for the following urgent steps to be taken:

- Undertake a formal review of the mathematics curriculum to expand the provision and relevance of financial education (as the Education Committee recommended).
- Extend mandatory financial education to primary schools and Sixth Forms in England to ensure fewer young people miss out.
- Embed financial education more deeply into the curriculum in England and integrate it into relatable subjects, from maths, economics, citizenship and food tech. This would ensure greater consistency, with Scotland already integrating maths into relatable subjects, and this consistency across the home nations is something Government should focus on.
- Consider how financial education can be extended to academies, private schools and faith schools – which do not currently have to follow the national curriculum.
- Introduce a new GCSE and/or sixth form qualification that focuses on financial skills – reflecting the Government's commitment to a skills revolution.
- Begin measuring adult financial literacy in the UK – bringing us in line with 39 other countries.

We believe the FCA and Bank of England have a vital role to play in the implementation of these measures, through close collaboration with the Department of Education and curriculum developers to ensure that mathematics, economics and the broader curriculum reflect the realities of managing money, understanding debt, saving for retirement, and investing, for example. They could also collaborate with financial institutions to produce educational resources or participate in pilot programs. Additionally, the FCA has a long track record of in-depth consumer research and in our view this should be extended to nationwide measurement of financial literacy levels.

b. A recent analysis conducted by Barclays estimated that UK adults held £430bn 'possible investments' in cash. What role do regulation, product offerings, and consumer culture each play in the disincentivising the investment of these cash holdings? What regulatory action could be taken to increase access to appropriate investment vehicles for non-high net worth individuals?

Please see previous answer.

c. In the week following Sir Douglas' appearance the FT reported that Minister for Pensions, Emma Reynolds MP, did not rule out mandating pension funds allocate a proportion of their holdings to UK assets. What is your response to this? What should the government do to drive the investment of UK funds into UK assets?

In line with the prevailing view of our industry, we consider the Government should not mandate or direct capital to achieve improved domestic investment. This could lead to conflicts with fiduciary duty, introduce greater volatility (UK equities can be riskier than diversified global portfolios), create asset bubbles and undermine flexibility and autonomy.

While we are not supportive of mandated investment, there are various other policy interventions that would lead to increased domestic investment. This is an issue which was analysed in considerable depth in a 2023 report by New Financial which was sponsored by abrdn and Citi.

The core recommendation of the report – which we fully endorse – is the urgent need to divert DC capital from 'safe' assets (i.e. low risk/low return) into those with higher risk/higher return potential. If done correctly we believe this could increase capital flows into UK public and private equities (both large and small cap), infrastructure and other private assets, as well unlocking capital for high growth companies/sectors and addressing societal priorities (e.g. new social and economic infrastructure, re-development and the transition to a low carbon/Net Zero economy). Specific recommendations from the report include:

- **Consolidation**: Accelerate consolidation of the DC and DB pensions market (there has already been movement in this direction, e.g., pooling among local government pension schemes.)
- **Participation and contribution**: Increase pensions participation (e.g., introduce auto enrolment for the self-employed, which we believe IPSE* would be supportive of subject to ability to opt out as for employed) and progressively increase contribution rates from 8% to 15% or above through phased increases. (*Association of Independent Professionals and the Self-Employed).
- **Pensions asset allocation**: Empower and incentivise trustees to diversify DC asset allocation into more equities and alternative assets without risk of being in breach of fiduciary duty by balancing

risk management with better returns (and the concept of "value foregone") within an appropriate framework.

- **Cost to value**: Shift regulatory focus from cost to value. Increase awareness that low charges do not necessarily benefit savers in the longer run if they mean less access to higher returning investments. Regulators and regulatory policy need to be aligned to this.
- **New vehicles**: Encourage the investment management industry to design/test/provision products and vehicles which provide access to private markets (e.g., Long Term Assets Fund) alongside other long-term investment options such as Investment Trusts.
- **Societal priorities**: Deploy capital more effectively in growth areas with alignment to societal priorities i.e., transition to Net Zero.
- **Resolving the cost disclosure issues in the UK investment trust sector***:* Efforts to encourage UK funds to invest in UK assets would also be greatly assisted by resolving the ongoing confusion over cost disclosure in the UK investment trust sector, an issue which was arguably made more complex by the forbearance measures announced by the FCA in September 2024. As investments trusts are often major investors in a wide range of UK assets, including illiquid assets such as infrastructure, we look forward to the Government providing much needed clarity for investors through the introduction of new legislation and regulations on cost disclosure later in the year.

  Moving away from the previous EU-designed PRIIPs regime will help to restore the sector's domestic and international competitiveness and raise billions of pounds of new capital for long term investment. However, this will only be achieved by allowing investment trusts to compete with other investment options on a level playing field. For this reason we would advocate against investment trusts being included in the proposed Consumer Composite Investments regime. In our view investors should be able to rely on high-quality governance provided by investment trust boards, transparent operating expense disclosure and market-driven share price discipline, as was the case for more than 100 years in the UK prior to the introduction of the PRIPPs regime and would restore a level playing with our international competitors.

d. Sir Douglas queried whether UK asset managers were sufficiently investing in the technologies and resources

needed to remain competitive (p. 2). Can you provide any data, or signpost any existing data, that might help the Committee better understand this issue? What else can the regulators do to help improve this situation? Connected to this, the day prior to Sir Douglas' appearance, the FCA published a Consultation Paper stating its intention to allow the bundling of research and trade execution, what is your reaction to this?

In our view large UK asset management companies are investing significantly in the adoption of new technologies while smaller companies tend to lag behind due to resource constraints, which reduces adoption and research capacities. Additionally, many UK asset management companies face problems in integration of new data platforms or AI models due to their ongoing dependence on legacy systems.

Overall, to remain globally competitive the UK's asset management industry will need to prioritise investment in technologies that will be revolutionary to asset trading and management. Forward thinking companies will see developments like AI and tokenisation as strategic opportunities to improve portfolio management and allocation and deliver better customer outcomes, whilst improving ESG integration, delivering robust cybersecurity, and streamlining compliance with regulatory change.

As regards the recently announced consultation on investment research payment optionality (CP24/21), we are supportive in principle of the proposed reforms and while we currently have no plans to change our current approach in the short term, we are closely following market developments.

2. **In response to Lord Vaux's question regarding the cost of regulatory compliance in the UK compared to other jurisdictions, (p. 7) Sir Douglas noted that international comparisons, particularly with the US, are challenging (p. 7) and that regulatory cost was often driven by lower-level compliance teams in the regulators and firms pushing to formalise compliance processes (p. 8). 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?

Three lines of defence

Most modern financial services firms operate a 'three lines of defence' model for risk management, i.e. (1) the business (first line) makes business decisions and manages the risks related to them, (2) the risk and compliance function(s) set the compliance standards and risk framework for the first line and (3) the audit function (third) reviews the first and second lines approach to compliance and control. Consequently any assessment of compliance cost should be holistic, i.e. spanning all three lines of defence.

Second line of defence

Assessments of the cost of compliance for asset management often tend to focus on the second line of defence and fail to account for the costs incurred by the first and the third lines.

The size of the second line of defence (i.e. risk and compliance) depends on the size and complexity of a firm as well as the level of risk & compliance maturity in the first line of defence. From experience, a good rule of thumb is that second line functions account for 2.5%-4.5% of a firm's headcount and pay bill. Within this, compliance would account for roughly 55%-65% of second line resource costing.

Cost of Anti Financial Crime Compliance Costs

Furthermore, the cost of financial crime compliance – where the governing laws do not sit within regulation specific to financial services (rather, they apply to all industries) – is likely to represent a significant proportion of total compliance cost, when compared with cost of compliance with bespoke financial services rules. There is more available data on financial crime compliance, where a 2024 study from Lexis Nexis (available here) states that UK financial institutions spent £38.3 billion on financial crime compliance in 2023, up 12% on the previous year and up 32% since 2021. This can be viewed as a proportion of revenue as follows:

Company AUM	2023	2022	2021
<£49m AUM	2.3%	2.0%	1.8%
>£49m AUM	0.43%	0.37%	0.33%

b. Are you aware of any indicators that might usefully be used to measure the cost of compliance to asset managers across jurisdictions? In your view, how useful are such comparisons?

Pertinent metrics in this context are second line headcount/total headcount or second line compensation/total compensation (see answer to question 2a). However, it is important to note certain caveats when interpreting statistics across jurisdictions.

To start with, we would distinguish between different jurisdictions on the basis of how much investment management (manufacturing) takes place. For example, Ireland and Luxembourg tend to be 'governance heavy'/'manufacturing light' and therefore have larger second line teams. In contrast, asset managers in the US and UK have greater balance across their three lines of defence.

As cost metrics tend to consider second line costs versus total costs, the total cost (denominator) can vary across different types of asset management: public markets passive/index tracking vs public market active asset management vs private markets assets.

c. What policies and approaches should the regulators adopt to limit the increasing formalisation of compliance processes? What steps should regulators and firms take to embed a flexible, principles-based approach to financial regulation?

Firstly, the problem for global firms is regulatory fragmentation driven by (i) differing national political/legislative interests and (ii) national approaches to rule-writing, supervision and enforcement. One jurisdiction's pursuit of principles-based regulation can be helpful. But different approaches can add to the operational complexity for global firms and make cross-border fund management, distribution and marketing more challenging.

Rather than 'principles-based regulation,' we would advocate for a somewhat different term: 'outcomes-based regulation. This has the advantage that it tasks firms with getting the outcomes to customers right, gives firms a certain level of flexibility in their operating models and then tackles the firms when the outcomes are poor. All other forms of regulation, including to a lesser degree principles-based regulation, tend to overly interfere in the operating models of firms and hence add to costs across the first and second lines of their businesses.

We would also emphasise the crucial importance of clarity on how to operate across the spectrum of regulatory engagement which is

characterised by ever increasing forms of regulatory intervention. Too often, the policy impulse is to dive in and write rules and dictate to firms, rather than to gather evidence and establish how to design smart rules on the basis of informed analysis. Policy makers should start at the left of the spectrum (measurement) and only move rightwards (more intervention) when there are good grounds to do so. Furthermore, any decisions to intervene further should be preceded by a thorough consultation with industry stakeholders and experts at an early stage.

Finally, regulation is only as good as the capabilities that operate across the spectrum (of monitoring, analysis, policy, regulation, supervision, enforcement & resolution). Regulators need clear talent (and technology) strategies to operate their activities in the right way. This means recruiting and retaining staff who have the requisite experience and expertise in their subject matter area but also have the ability look at issues from a much wider perspective and are able to see 'the big picture.'

30 January 2025