

Written evidence submitted by the Investment Association

About the Investment Association

The IA champions UK investment management, supporting British savers, investors and businesses. Our 250 members manage £8.5 trillion of assets under management (AUM) and the investment management industry supports 113,000 jobs across the UK.

Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital.

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs.

A Global Industry

The UK is the second largest investment management centre in the world and the most international global hub for the industry. At the end of 2019 assets managed in the UK on behalf of overseas clients increased by £550 billion to £3.6 trillion AUM, the equivalent to 43% of total UK-managed assets.

How the industry works internationally

The UK asset management industry provides services to the international market in three different ways:

- Provision of investment management services direct to institutional investors on a segregated mandate basis.
- Provision of investment management services to funds established in non-UK markets across the globe,
- Distribution of cross-border funds from the UK.

Within international markets existing and potential clients of the UK asset management industry's services are:

- Institutional investors (such as pension funds or sovereign wealth funds) that may use any one of, or a combination of, the above services.
- Retail investors who will use either cross border funds or funds established in local markets.
- Wealth management clients who may use any one of, or a combination of, the above services.

The opportunities ahead

Ensuring investor access to UK expertise and products is a core mission for the UK's economic diplomacy. This is important because we are now in what is being called "[the age of asset management](#)" as the services provided by the industry are in greater demand

than ever before. [Global AUM doubled between 2008 and 2019](#). Emerging markets are seeing the steepest rises and also the exhibiting the greatest potential for further increases. This is all part of new world – affected by Covid-19 - with a changing and growing pattern of personal pension provision, a rising middle class, greater interest in sustainable investment, evolving requirements of the retiring “baby boomer” generation, and the issue of inter-generational wealth transfer. All of which require the services of the investment industry and all of which can be done from the UK. It is our ambition that the UK continues to be seen as the natural home for global asset management, bringing with it jobs, skills, and tax take.

This submission contains responses to questions, links to the briefs, documents, and surveys that the Committee will find helpful in its inquiry. The IA is ready to provide further information and to expand on any issues that the Committee wishes to examine in greater detail.

Executive summary

The UK is a globally leading portfolio management hub. Whilst there is a clear opportunity and priority in policy terms to extend and enhance this position, it is equally important that this is not done in a way that affects the UK’s ability to be the recipient of delegated portfolio management mandates from countries around the world.

The IA envisages the UK enabling an agile regulatory environment where rules are more capable of adaption, fit to new developments in the market both at home and abroad. The new model requires adequate resources, joint-working, clear definitions and boundaries, as well as appropriate and transparent feedback mechanisms. This will ensure that the regulatory outcomes meet the objectives and principles laid out by the government and overseen by Parliament.

The IA has provided considerable material to this Committee, HM Government, the regulators, and other parliamentary committees on the future of the UK’s investment management industry and the opportunities provided by the new trading relationship it will have with the rest of the world. However, there are two recommendations that should be drawn to the immediate attention of the Committee Members:

- There is mutual benefit to UK investors and the asset management industry of the UK continuing to be renowned for offering an open, robust, client-centric regulatory regime. A suitably empowered parliamentary financial services committee, for example, would provide an opportunity to review how the FCA’s remit relates to wider political and societal expectations on a continuous basis and ensure the FCA adhere to the activity-based principles.
- The IA recommends HM Treasury’s Asset Management Taskforce should be made permanent to provide a provide a useful advisory group for government, regulators and industry to exchange views on both domestic delivery and international competitiveness.

In amending the regulatory architecture, government and Parliament should aim for a healthy financial services system, with three key priorities:

- improve consumer engagement in long-term savings and investment;
- foster innovation to create a vibrant and diverse market; and

- ensure that firm failures do not lead to unwelcome costs of doing business in the UK but are addressed more effectively through robust authorisation and better supervisory processes with a reduction in the rising cost of regulation.

Answers to Questions

1. How can the UK financial services sector take advantage of the UK's new trading environment with the rest of the world?

The IA endorses the government's view that that UK's approach to the future of financial services should be based on three pillars: innovation, resilience, and openness. Each is a critical and mutually reinforcing foundation for the competitiveness agenda. For example, in the area of technology:

- Innovation will help to better serve customers domestically and internationally, increase resilience and reduce barriers to openness.
- A resilient and stable business environment, facilitated by appropriate regulation, will incentivise inward investment in the UK, and thereby further stimulate advances in technology.
- A set of policies that encourage open trade and access to talent are a further critical support for innovation.

A similar logic applies to specific areas such as the international competitiveness of the UK fund regime. Innovation helps to foster world-leading products and services; a resilient regulatory and fiscal regime provides a highly supportive environment, while the ability to export globally, delegate portfolio management and attract world-class personnel is essential for the industry's wider success. Underpinned by a long-term promotional strategy, this provides the key pre-conditions for world class customer delivery and a strong contribution to the UK economy.

The key opportunity is for the UK to grow its current £1.7 trillion international business outside the EU. Since total assets under management globally amount to £63 trillion, out of which there is £27 trillion in the five markets identified by HM Government as part of the Global Financial Partnerships (Hong Kong, Japan, Switzerland, Singapore, and the USA) the opportunities for growth are theoretically many multiples of the current size of the UK's international asset management industry.

The pace of change and requirement for further innovation has intensified and the IA identifies three principal subject areas of greatest relevance that retain one aspect in common: a continuing focus on client needs and expectations. They are:

- Maintain the leading edge on fintech
- Become the global centre of excellence for sustainable and responsible investment
- Create a globally attractive UK funds range

The ability to provide the services is predicated on different aspects of regulatory openness:

- As a general proposition, in most international markets there are few, if any, barriers to providing asset management services on a segregated mandate basis to institutional clients.

- In contrast, significant obstacles to cross-border fund distribution exist globally, despite success for UCITS, which remains the only established global fund brand. One key aspect of future UK competitiveness is the extent to which some of this momentum can be leveraged for UK funds (HM Treasury is currently [reviewing the UK's future funds regime](#)).

The jewel in the UK's crown is its role as a globally leading portfolio management hub. Whilst there is a clear opportunity and priority in policy terms to extend and enhance this position, it is equally important that this is not done in a way that affects the UK's ability to be the recipient of delegated portfolio management mandates. The IA explicitly rejects moves towards regulatory arbitrage in this or any other respect as it would damage the long-term interests of our clients and consequently our industry.

2. What changes should be made to the UK's financial services regulations and regulatory framework once the UK is independent of the European Union?

The Committee will find the IA's response to HM Treasury's *Financial Services Future Regulatory Framework Review Phase II Consultation* provides an extended review of the regulatory landscape and offers recommendations. A copy of this is included for information. Overall, The IA envisages the UK enabling an agile regulatory environment, where rules are more capable of adaption as necessary to new developments in the market. However, what will be key to the success of the model is that there are adequate resources as well as appropriate and transparent feedback mechanisms to ensure that the regulatory outcomes meet the objectives and principles laid out by government and Parliament.

As set out in the IA's [Vision 2025 report](#), it is recommended that the UK regulators should have a remit which recognises the importance of global innovation and competitiveness, similar to the objectives that other regulators have in internationally active financial centres. To that end the IA welcomed the current Financial Services Bill that states, "the FCA must consider the United Kingdom's standing in relation to other countries and territories..."

3. What should the Government's financial services priorities be when it negotiates trade agreements with third countries?

Most free trade agreements create a 'foot in the door', where initial commitments are typically low. There should be provisions for ongoing negotiations to increase market access and reduce 'beyond the border' regulatory barriers. These are best achieved as part of a regulatory dialogue either committed to in a Financial Services annex of the FTA or as a stand-alone bilateral commitment.

The aim of regulatory cooperation is to ensure that where divergences exist, they only do so for valid reasons and that decisions are taken with an understanding of their consequences in the business world. Cross border firms come across conflicting regulatory demands – for example, the transatlantic clash over research payments, or where different timescales are required by regulators, or face differences over investor classifications – and minimising them provides savers and investors with greater value for money without compromising the regulators' objectives.

Ideally, FTAs should include measures to pursue regulatory dialogues through a dedicated financial services committee, one that ensures regular reporting, concentrates on implementation, and whose members have the commitment to anticipate and tackle issues likely to cause future divergences.

The UK-Japan Comprehensive Economic Partnership Agreement, for example, contains the commitment to an annual dialogue between HM Treasury, UK financial regulators, and the Japanese FSA that will explore ways to further reduce regulatory friction.

The UK-Swiss financial regulatory dialogue takes place outside of a free trade agreement but is the most advanced of the UK's negotiations. The plans now are to move forward with negotiations on delivering a comprehensive mutual recognition agreement that would reduce costs and barriers for UK firms accessing the Swiss market, and vice versa.

4. Should the UK open its financial services markets to external competition from countries outside of Europe, or should the UK maintain the current regulatory barriers that apply to third countries?

Savers and investors in the UK and elsewhere benefit from global supply chains, allowing them to access specialists in different sectors and disciplines no matter where they are based. Investment firms also benefit by being able to locate their operations in international centres of excellence, enabling them to access the best talent and support services – and to generate the best returns for investors. This is made possible by an open, rules-based international trading system that the Department for International Trade's (DIT) White Paper Preparing for our future UK trade policy endorsed.

5. What skills and immigration policy will the UK financial services sector need once the UK has left the European Union?

The IA's [Investment Management Survey 2019-20](#) includes the observation that, "as long as Brexit does not impact the UK's ability to attract global talent, the continued success of the UK as an investment management centre is assured." The breadth and depth of the talent pool in the UK is a key feature of UK investment management that is often underestimated. Many globally headquartered firms have indicated that the talent pool is a key driver in setting up regional offices in the UK versus other jurisdictions.

The IA's surveys show that about a fifth of the industry's workforce is from overseas, with about a fifty-fifty split between EU Member States and the rest of the world. IA member firms have identified city clusters and access to talent as key features for the UK to maintain its global competitive advantage over the long-term.

Technological advancements have led to a significant skills gap across the industry that needs to be filled by local as well as international talent. This is why the UK must have joined-up policies which grow and attract talent from both domestic and international sources, for instance from the university sector and from overseas. The IA's [Talent Strategy for the Investment Management Industry](#) sets out the industry's priorities and the Investment20/20 talent programme gives young people from a wide range of backgrounds a first foot on the ladder of a career in investment management.

Improved diversity and inclusion (D&I) are high priority themes for the industry. In addition to the operational benefits that D&I brings to company performance, it is increasingly important that the industry better reflects its customers and wider society.

6. How can Government policy and the UK regulators facilitate the emergence of FinTech and new competition; develop new areas of growth for the financial services sector; and promote the UK as the best place to incubate new financial technologies and firms?

The UK should continue to build upon the FCA's position as the leading global regulatory body for fostering innovation and capitalising on technological developments by extending this culture to allow greater innovation within existing firms as it does for fintechs. Examples of this could include the scaling-up Project Innovate to strengthen support for domestic and foreign fintech's operating within the asset management and related buy-side sectors. The IA also recommends continuing to include fintech as part of the UK's economic diplomacy (and the openness agenda), specifically by creating and fostering buy-side specific fintech relationships.

In addition to a stimulating regulatory environment, a critical success factor for the future competitiveness of UK's investment management industry is its own ability to adopt technology across the entire value chain. The chain starts with the client interaction and experience, moves through the investment process and then to the middle and back offices responsible for administration and operations. There are opportunities to reduce costs and improve client outcomes throughout with fintech.

The IA is playing its part through the accelerator [Engine](#) and the related [Global Partner Programme](#). The programme provides information and connections for fintechs that are interested in exploring opportunities to expand to new markets, and also for UK Asset Managers that want a more global view of the fintech scene.

7. Through what legislative mechanism should new financial regulations be made?
8. What role does Parliament have to play in influencing new financial services regulations?

The IA broadly supports the division of responsibilities, with government setting the regulatory framework and parameters through legislation, and the regulators being responsible for creating the rules that apply to firms, with Parliament scrutinising both the regulators and government to ensure democratic legitimacy and effectiveness.

The IA also suggests making the HMT Asset Management Taskforce permanent, to provide a high-level forum for government, regulators and industry to exchange views on both domestic delivery and international competitiveness. It would enable continuous dialogue between policymakers, regulators, and industry, in a way that is complementary to and not an alternative to the formal policy making apparatus. The benefit of these dialogues is proven, and lead to operationally more effective legislation whilst leaving policy initiation and direction firmly under the control of the regulators.

Further details are available from the IA's response to HM Treasury's *Financial Services Future Regulatory Framework (FRF) Review*.

9. How should new UK financial regulations be scrutinised?

Policy priorities need to be clearly articulated so that the regulators can be measured against delivery. This could include:

- a mechanism for HMT to report to Parliament on its conclusions whether the relevant policy outcomes have been met;
- proactive scrutiny by the Treasury Select Committee and/or a Joint Committee from the Houses of Commons and Lords with a clear mandate to hold the regulators to account;
- an agile regulatory environment, where rules are more capable of adaption as necessary to new developments in the market; and
- adequate resources as well as appropriate and transparent feedback mechanisms to ensure that the regulatory outcomes meet the objectives and principles laid out by government and Parliament.

There will need to be a robust audit trail for how regulatory policy has been created with due consideration for the FSMA principles, the statutory objectives and the proposed activity-specific principles. Regulators also need to be held accountable if any of these aspects are deemed not to have appropriately shaped the regulations they introduce.

The IA recommends that a parliamentary group, such as a Joint Committee of the House of Commons and House of Lords, should be tasked to consider policy formulation, which could provide a more effective link between the sector and Parliament; helping create better financial services policy at inception and help foster a long-term savings culture. However it is set up, there is a need for an effective, informed and appropriately resourced body to scrutinise the activity of the FCA and hold it to account in the new regulatory environment. This would do two things: to contribute to “policy formulation” (i.e. ex ante) and to look at the “real world effects” (i.e. the ex post assessment of whether or not the regulators actually delivered on the mandate they were given).

10. What progress has the Government and regulators made in facilitating key financial services equivalence agreements with third countries; and would an alternative mechanism serve the interests of the UK market better?

The IA welcomed the government’s and regulators’ work to put the EU’s financial services regulations into UK law, establish the necessary network of MoUs, and put in place continuity trade agreements.

Global regulatory coherence and consistent implementation of global standards in a way that fosters cross-border activity, encourages fair and open competition. This kind of competition benefits customers, firms, and their regulators alike. It is also good for economic growth and financial stability.

The IA, working with its members and through the International Regulatory Strategy Group (IRSG), supports the search for frameworks for mutual recognition, equivalence or deference arrangements that could deliver significant benefits for investors. The UK is using the opportunity now to move from the inherited EU/CJEU model and definition of equivalence - where industry faced 30-day notice periods, political application, and being subject to cross-retaliation in wider trade disputes - to one that reflects international best practice and its own Common Law business environment. One step was industry proposing an outcomes-based approach for the UK-EU relationship and another was using the concept of deference that was identified by the G20 Leaders as a tool that authorities

may use to help make reforms across jurisdictions interact better and facilitate the meeting of the objectives of the reforms.

This new approach is reflected in the UK-Swiss agreement to negotiate an ambitious, outcomes-based mutual recognition agreement between the UK and Switzerland. Here, as the [Chancellor said](#), “it is possible to achieve genuinely fluid cross-border trade in financial services, while recognising and respecting that different jurisdictions can achieve the same outcomes in different ways”.

The IA recommends using the “full international toolbox” for mutually beneficial cooperation and mutual access arrangements. This includes:

- Working with the industry to use the full range of policy routes to advance cooperation, including FTAs, mutual recognition options (funds, firms, and people), regulatory dialogues, MoUs, tax treaties and data agreements.
- Strengthening the UK’s voice in global rule-making bodies while developing strong bilateral partnerships with the major markets, their regulators and governments as part of the UK’s economic diplomacy. Make the representation of the UK’s interests on international bodies such as IOSCO a metric for the FCA, PRA and other regulatory bodies.

The reference to data agreements comes because financial services rely on data. A UK FTA should include data sharing arrangements to ensure that regulators receive appropriate data and be compatible with the freedom of data-movement and data-processing measures that modern international commerce requires. The UK Government should make sure that the Information Commissioner’s Office is included in regulatory discussions and have competitive and international outlook objectives included within its mandate. In 2020, the IA worked with authorities in both countries to encourage a UK-US regulatory dialogue to end a gridlock caused by a US interpretation of UK data protection law which was preventing UK-based investment managers from serving clients in the largest investment market in the world.

11. How should financial services regulators be funded?

Industry funding for its regulator is a well-established practice, as well as the concept that the “polluter pays”. It is important to ensure that firm failures do not lead to unwelcome cost of doing business in the UK but are addressed more effectively through robust authorisation and better supervisory processes and reduce the rising cost of regulation.

Having a robust compensation scheme of last resort provides retail customers with a welcome safety net, but the current scheme is no longer fulfilling its purpose. The FSCS recently announced a forecast compensation scheme levy of over a £1bn and by any measure this is disturbing. The current situation does nothing to increase consumer confidence. The scheme was initiated with the concept of ‘polluter pays’ but this has been eroded through cross subsidy among various industry sectors. The investment management industry, a largely wholesale sector, has not increased its risk profile over time but is funding the bill for the poor behaviours of other sectors, funding fully one-fifth of the levy (£200m). Increasingly it appears as if those well capitalised firms with the deepest pocket are expected to pay regardless of the risk they present and the low levels of failures in their industry sectors. It is now an opportune time to consider the root cause

of firm failure and the resulting call on the FSCS levy and how this can be mitigated, as well as a fairer funding model based on the “polluter pays” principle.

Ultimately, a high-cost regulatory regime acts as a powerful disincentive for firms to establish themselves or stay in the UK.

12. Should the mandate and statutory objectives of the financial services regulators change to include wider public policy issues?

Subject to ensuring the primacy of being able to deliver most effectively for long-term savers and investors, the IA suggests the proposed activity-specific principles in the HMT consultation on the Future Regulatory Framework could also support wider public policy ambitions. For example, the net zero goals, which would benefit from the regulators ensuring that financial policy facilitates these climate change considerations. This is currently being implemented by the PRA through its work in enhancing the resilience of the UK financial system by supporting an orderly market transition to a [low-carbon economy](#). Focus on delivering effectively for long-term savers and investors would create a set of high-level principles that will give regulators a clear strategic reference point with respect to the key roles of the investment management sector. Alongside careful calibration with the other elements of the regulatory framework, a balance would also need to be struck between stability and change, such that both the regulator and industry are not subject to rapidly evolving expectations. To achieve this, the IA recommends a clear mechanism for stakeholder input into the formulation of these principles through a regular and open consultative approach. This mechanism could also be charged with the scrutiny of regulatory initiatives, including cost benefit, adherence to mandate and policy objective, proportionality, which would be a means of providing an additional ‘check and balance’ to authorities and support Parliamentary oversight. The existing Asset Management Taskforce could then provide a useful advisory group to offer insights on their deployment to ensure the right outcomes. We further recommend that the process is regularly reviewed.

13. How important is the independence of regulators and how might this best be protected?

The independence of the regulators, like the independence of the UK’s judiciary, is a valuable asset to the UK. Business looks to the UK’s regulators to provide a competitive, predictable, and client-centric regime.

The connection between UK government policy, parliamentary oversight and regulators’ autonomy must be more deliberately and systematically structured at an early stage and be transparent.

Good regulation is coordinated, not just within each separate regulator but across the system as a whole and it should be the role of Parliament to intervene should there not be appropriate levels of coordination. A good regulator’s priorities are transparent and should consider the cumulative impact of changes being made, and their total costs.

There should be frequent and detailed open letters between government and the heads of each of the regulators, like the letters between the Chancellor of the Exchequer and the Governor of the Bank of England, setting out how their work has supported UK economic growth. This could be similar to the annual strategy and policy letters that other regulators

have from their sponsoring government department, such as those between the Department for Culture, Media and Sport and OFCOM.

The IA would welcome the National Audit Office periodically reviewing the regulators in a manner similar to its review that resulted in its report of March 2019, “Regulating to protect consumers in utilities, communications and financial services markets”. To further improve the transparency and accountability of the regulators, the IA would also urge the Office for Budget Responsibility to perform period reviews of the regulatory costs of operating in the UK. This should consider all regulatory costs, including the FSCS levy, which now costs the industry more than the FCA.

14. How can the balance between lighter touch regulation and prudential safeguards be best secured?

We do not consider that shifting the UK to be a lighter-touch regulatory regime will be in the long-term interests of either consumers or the industry. This is true both of prudential issues generally and also with regard to the core responsibility of the FCA for consumer protection. At the same time, it is vital in the future that there is a joined-up approach to policy development and regulatory delivery. The industry supports initiatives that push towards high levels of competition, customer alignment and transparency. There needs, however, to be more attention paid to sequencing, timing, messaging and, in all cases, the substance of what is being proposed. The challenges facing the well-intentioned PRIIP Key Information Document are partly a reflection of untested methodologies being endorsed by regulators both in the EU and UK, which extended elements of these to the pensions market as well. More should be done to ensure that regulatory change processes, particularly those that affect the retail ‘front line’, are subject to robust testing, impact assessment, and a clear view of how it will affect the attractiveness of the UK as a fund management hub.

More than ever, it will be essential for UK regulators to consider explicitly how they position relative to other jurisdictions, whether in terms of appropriateness, proportionality, or international equivalence. To achieve this, regulators require a clear mandate internationally. They should have an explicit mission (and reorient resources) to engage deeply in international forums and to advance the UK’s national interests. This mandate could be similar to the ‘Core Principles’ set out by the US Administration by Executive Order and implemented by the Departments and regulators.

15. How should consumer interests be taken into account when considering potential regulatory changes?

There is mutual benefit to UK savers, investors and the asset management industry of the UK continuing to be renowned for offering an open, robust, client-centric regulatory regime. As said before, we do not consider that shifting the UK to be a lighter-touch regulatory regime will be in the long-term interests of either consumer or the industry.

A suitably empowered parliamentary financial services committee, for example, would provide an opportunity to review how FCA’s remit relates to wider political and societal expectations on a continuous basis and ensure the FCA adhere to the activity-based principles.

The IA proposes the statutory objectives of the regulators are amended to reflect their changed status. The updates to FSMA in the Financial Services Bill, would look to achieve a better balance between the need for consumer protection and consumer engagement to support appropriate levels of risk-taking to deliver long term sustainable returns. These would also have due consideration for the UK's standing in relation to other countries, recognising the importance of global innovation and competitiveness.

The IA supports the existing general regulatory principles but would like to ensure the FCA have appropriate regard to these principles, the statutory objectives, and the activity specific principles. For example, the FCA's current operational objective to protect consumers has the potential to run counter to the general principle that consumers should take responsibility for their decisions, even though this issue is recognised in FSMA 1C(2)(d). Perhaps more importantly, this objective has no clear connection to the wider good of ensuring that individual savers are taking appropriate levels of risk in their savings and investment behaviour.

16. What are the strengths and weaknesses of the European Union model of scrutinising financial services legislation?

17. Should the UK seek to replicate the EU's model for drafting and scrutinising financial services regulation?

The EU model is based on the tripartite relationship between the European Council, the European Commission, and European Parliament. The passage of regulation through the EU structures was slow and set up to meet the needs of its unique "sui generis" constitutional arrangement. It was thorough, mostly transparent, and scrutinised by those with expertise.

The EU system provided politicians with a democratic mandate to be directly involved in discussing the major trade-offs between different policy objectives. This is important for the ultimate legitimacy of the measures introduced. The UK will need appropriate resources across Parliament, government, and regulators to provide the necessary levels of scrutiny and accountability relevant to the UK's constitution.

ENDS

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