

The Edinburgh Reforms

RESPONSE TO THE TREASURY COMMITTEE FROM THE INVESTMENT ASSOCIATION

1. About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our members manage £10 trillion for savers, and institutions such as pension schemes and insurance companies.

2. Regulation to support growth: the Smarter Regulatory Framework

An effective regulatory system is vital to a thriving investment management sector, and we are pleased to see this set out by the **Smarter Regulatory Framework**.

High regulatory standards are a cornerstone of the UK's success. We power the economy directly through channelling capital *from* individual investors who are looking to secure their financial futures (most often through their pensions) *to* the businesses and infrastructure projects which are looking for finance. Through this, investment managers invest £1.6trn directly into the UK economy.

The UK investment management industry is highly international: overseas investors choose the UK as the base to manage over £4.6trn, making us by far the most successful international investment management venue. This benefits the UK directly – it is the cornerstone of the 122,000 jobs that this industry provides. But perhaps most consequentially, it also means that UK investors have easy access to the world's best products and expertise. And UK businesses and infrastructure projects benefit from having global investors, with their capital and expertise, on their doorstep.

The UK's international success is founded on high standards of regulation. Appropriate regulation is crucial to encouraging people from around the world to trust us with their money, and regulation which recognises the role and international nature of investment management lets the industry thrive.

Regulation and regulatory approaches must focus on securing these outcomes, rather than looking simply at process. We see high quality regulation as founded on three principles:

- **Founded on customers' needs.** This is the principle of good regulation: ensuring that our customers get the services they expect and keeping bad actors out of the market. Preventing bad behaviour is central to this, but should go further, with regulations and a regulatory approach which **fosters the innovation** which will keep products and services worldclass into the future. Regulation should also encourage **inclusion**: ensuring that as many people as possible can access the products which are appropriate for them, as well as simply protecting those who already use them.

The Investment Association

Camomile Court, 23 Camomile Street, London, EC3A 7LL
www.theia.org

politics@theia.org

- **Responsive and effective.** Regulatory approaches need to be cost effective and predictable if they are to translate paper policies into good outcomes. Our regulators need to be appropriately staffed and resourced to enable the deep expertise this requires. This also requires a culture which is open and focused on overall outcomes. Regulation needs to take into account the whole of the regulatory environment and not focus on narrow silos. This will be particularly important as the new secondary regulatory objective for Competitiveness and Growth is brought in: we hope to be working with regulators to make a significant change in approach and culture to facilitate this.
- **Internationally aware.** Regulation and regulators need to be aware of the international dimension of their work. This has two aspects. First, as a global industry the UK's success in investment management is not inevitable. If regulators add complexity and cost with little benefit or move away from alignment with partners (most importantly the EU) there will be increasing moves to locate business elsewhere. Second, many businesses operate across borders. Awareness of where rules are internationally aligned (or if not, the impact of this) minimises the cost and complexity of doing business in the UK, which in turn makes us more competitive.

We support the approach taken by the Smarter Regulatory Framework to achieve this regulatory environment, although we are keen to see action on the cultural as well as institutional changes which will allow this. As control over UK regulation is brought back to this country there is a pressing need to ensure that regulation and regulators are appropriately scrutinised. We see two pitfalls if this does not occur:

- **Disconnect between regulatory policy in this sector and wider public policy objectives.** Policy success can depend on the detail of regulation developed. Without adequate oversight it is possible for regulation to become detached from its original aims and the social and economic environment in which it operates.
- Lack of accountability on **how regulators are run**: whether they have the expertise and resource to operate successfully, whether they are cost effective, and whether their culture is aligned to their objectives.

We see three potential ways of achieving this:

1. Parliamentary scrutiny to align regulatory activity with wider policy objectives.

Parliamentary scrutiny should be the cornerstone of oversight, considering regulators' day-to-day-activities and perhaps most importantly the extent to which their activity and strategy aligns with wider policy.

This alignment is crucial given the role that financial services play in the wider economy and society. It is a growth powerhouse, but also vital in achieving wider social and economic objectives from spreading that growth across the country to supporting the development of technologies which will be core to fighting climate change.

We therefore firmly support the creation of the House of Commons Treasury Sub-Committee on Financial Services Regulation, and we have been glad to see its initial scrutiny activity. For this to be as effective as possible, we recommend that this evolves in the following ways.

- **Bringing in expertise from across Parliament.** Members of the Treasury Select Committee have demonstrated that their insight, expertise and strong links to the wider public are crucial in providing scrutiny. However, this is also found in the House of Lords, with Peers often bringing a particular perspective founded in outside work on consumer rights, business, or financial services. We suggest bringing this into the Sub-Committee's work by forming a joint committee.
- **Appropriate resources.** The scale of financial services regulation is phenomenal, and the time and expertise to appropriately scrutinise this all is outside the Sub-Committee's current capacity. We suggest additional resources should be made available to ensure committee members are backed up by the research and insight that is needed for thorough scrutiny of all appropriate regulatory action; that a triage system is developed to allow the most important regulatory actions to be

considered (which should include input from those most impacted by regulation); and there are appropriate mechanisms for the Committee to make concrete recommendations leading to further action where needed.

- **Insight from all involved.** Financial services and its interactions with the wider economy is complex and fast moving. The current system of inviting evidence to inform the Committee’s work is vital, but may not always be sufficient especially when resources are stretched. We therefore recommend that the Committee is supported by a panel of experts who have experience in financial services and consumer advocacy. Such a panel could apply for appointment by the government for a period of time, indicating subject-matter expertise to provide support to Parliamentarians on technical aspects.

2. National Audit Office (NAO) oversight to consider overall effectiveness

Parliamentary scrutiny should be supplemented by scrutiny taking a long-term view of the regulators’ effectiveness. One option would be that this could be within the remit of the NAO. The NAO should be tasked with conducting regular, thorough and public assessments of the regulators’ operational effectiveness, and the wider economic value they create.

The NAO’s existing wide remit gives them the scale and expertise to carry out this task, especially when considering how the industry facilitates wider economic growth. They are also well placed to comment on regulators’ operational efficiencies. Most importantly, their existing structures and expertise means that they are likely to be able to operate effectively and with minimal set up costs.

This approach has proven effective before (the NAO’s 2007 review of the then FSA), which proved a helpful mechanism for understanding the regulators’ effectiveness, their wider role in creating growth, and strategies to enhancing this.

Instigating such a review on a regular basis (perhaps every two to three years) would provide continuity, allow assessments of any changes which have been recommended, and track progress over time.

This may involve regular international benchmarking exercise, perhaps modelled on the World Bank’s ‘Ease of Doing Business’ ratings to ensure that the UK is not dropping behind on crucial measures including whether more people are investing appropriately, and whether listings are being attracted to the UK.

3. Regulatory Cost-Benefit Analysis (CBA)

CBA is a fundamental part of any regulatory policy making process, checking that underlying policy intention and the implementation is effective and proportionate. Without it there are limited mechanisms for ensuring that the benefits of regulation are achieved in a way which does not drive unnecessary costs or complexity. The Statutory CBA Panels to be established by the Financial Services and Markets Bill are therefore welcome. As the process is developed, attention should be paid to:

- The panels’ membership including how members are selected and what expertise they bring.
- The panels’ authority to oversee the FCA’s approach and how it is performing its duties in preparing a cost benefit analysis.
- The process and criteria for assessing circumstances in which the panel will not be required.
- Mechanisms by which plans found to have a negative cost-benefit impact are required to be scrapped or reconsidered.

3. Regulation tailored to the UK: Retained EU Legislation

The opportunity to reshape retained EU law is a particularly important one for investment management given our global role. Not only does this bring about the economic benefits described above, it gives the UK expertise and authority to shape global regulation in a way which underlines the UK's leadership, particularly in the areas that will be vital to our future prosperity, for instance fintech and green finance.

Our domestic work is also vital. At least three quarters of UK households use the services of an investment manager, and the depth of this impact on families' finances means that it is particularly important to consider British customers' particular needs.

The potential for this is great. For instance, the Edinburgh Reforms highlight the replacement of the European Long-Term Investment Fund (ELTIF) with the new **Long-Term Asset Fund (LTAF)**, which provides a better fund structure for the UK market.

However, the process for repealing and reforming EU law must be carried out carefully. We propose two criteria to assess this:

- **Is the consideration of EU-derived legislation appropriately paced, taking into account capacity constraints within regulators and the industry?** A sudden requirement for large scale change could undermine the intentions of the process if changes are not appropriately considered, or time given for their implementation.
- **Are changes proposed appropriately co-ordinated and prioritised?** Financial services regulation is interdependent, and there will need to be detailed consideration of changes' wide and sometimes unintended effects. This will require sufficient time and detail for industry and other stakeholders to comment on proposed plans.

4. The Edinburgh Reforms: individual measures

The principles of world class regulation which supports the wider UK should be carried through the wider changes set out in the Edinburgh Reforms. The areas highlighted below are those of particular importance to the investment management industry. This response is necessarily brief, and therefore the IA would be extremely happy to submit further information to the Committee on individual measures.

A. A world leader in sustainable finance

The UK has the chance to become a world leader in green finance, a double opportunity to both attract economic activity here and to play an ever more important role in mitigating and adapting to climate change. With a 62% increase in responsible investment funds under management last year, now is the right time to take the next steps.

We were therefore pleased to see the Edinburgh Reforms highlight the **Green Finance Strategy**. There has been concern among investors about the potential for a shortfall between the UK's legally-binding net zero target and the policy measures in place to achieve an orderly transition in the assets in which they invest.

The new Green Finance Strategy provides welcome clarity and consistency by building on the previous strategy and the Greening Finance roadmap. We welcome the commitment the Government has made to international consistency and developing aligned approaches with other major economies and the Government's recognition of its role to shift and scale up the availability of finance for the transition to net zero by de-risking green investments, broadening pools of capital, and lowering the cost of capital.

While the strategy's intention to "better track private investment into the net zero economy and [build] towards a fuller way of tracking green investment flows in the UK" is positive, we would have liked to have seen more detail on how this is to be done. The IA has previously called for a 'UK Net Zero Investment Plan' to kick-start the private finance needed to deliver green growth in the UK economy. This must involve dialogue between private finance and all departments to ensure investment supports orderly transition and sustains economic growth.

We also support plans to **bring ESG rating providers within the regulatory perimeter**. Data provided in this way is heavily relied on, but is not currently subject to the consistent scrutiny that this change would bring.

B. A competitive marketplace promoting effective use of capital

Thriving capital markets are the bedrock of the UK economy, underpinning our success in financial services and more importantly acting as the conduit of capital between investors seeking to securing their financial futures and businesses seeking finance to grow. We therefore strongly support the Edinburgh Reforms' ambition to boost the UK's attractive and internationally respected ecosystem for financial services regulation. Specifically:

- The **Accelerated Settlement Taskforce** is an important step. It's right that speedier settlements should be explored given moves by other jurisdictions in this direction. However, this should be approached with care given the potential impacts on wider markets, including fund operations lifecycle (typically T+3) mismatch; securities lending considerations; FX funding and liquidity issues; product specific issues around ETFs; and compression of operating hours to match a trade and settle a trade.
- We welcome proposals for a **review of investment research**. Research is key in investment decisions, but certain regulations have raised costs and limited access to this. The review should explore the impact of previous rule changes and identify reforms aimed at improving the investment environment for investment managers and their clients.
- The Call for Evidence on the **Short Selling Regulation Review** is important, as short selling plays an important and beneficial role in the orderly and effective functioning of financial markets, including (amongst other things) aiding liquidity, price discovery and risk management. However, there are areas of the regime which would benefit from reform most notably the public disclosure requirements and the position reports submitted to the FCA.
- We welcome the **wholesale review of the Prospectus requirements**, in particular the focus on improving the efficiency of the capital raising process for both issuers and investors; the FCA's new responsibilities to embed the practical elements of the prospectus regime into its rulebook; and the differentiated approach for primary and further issuances as a way of meeting investors informational needs. But we believe this should go further by:
 - *Protecting pre-emption rights*, to shield minority shareholders from the dilutive effects of large non-pre-emptive capital raises. A weakening of these rights could effect the ability to attract the capital of both domestic and overseas investors into the UK's equity markets.
 - *Encouraging greater forward-looking disclosure*, helping investors to assess a company's future strategy and ability to generate long-term sustainable returns.
- The **Secondary Capital Raising Review** will be important in allowing UK-listed companies to have access to a secondary capital raising structure allowing them to raise capital quickly and efficiently. Rights issues as a mechanism to do this came under pressure during the pandemic, when many businesses needed additional capital quickly. This experience demonstrated that there was a need

for a system of capital raising that provides issuers with the speed offered by undocumented deal structures, with pre-emption rights at the heart of this.

- We are pleased to see a review of **Senior Managers and Certification Regime (SMCR)**. SMCR has been a helpful tool in assuring standards in industries such as investment management which rely on expertise and trust. However review is welcome to streamline the process, which currently involves requests for information which are duplicative or contradictory. This would also be an opportunity to provide clarity on SMCR's objectives (helping firms to provide the information which supports this) and greater transparency on regulators' responses to breaches.
- The IA has responded at length to the Treasury's consultation on the **VAT treatment of fund management**. The Treasury's proposals here are disappointing. They do not meet their stated aim (on which we strongly agree) of making the UK a home for fund domicile, that is, where investment funds are located from a legal, regulatory and tax perspective. Boosting the UK's place as a home for fund domicile has the potential to bring significant economic benefits, including increasing tax revenues and creating highly-skilled jobs across the UK, mainly outside London.

One of the reasons that the UK is currently losing out on fund domicile activity is our internationally anomalous VAT treatment, a topic which is not being addressed as part of the Edinburgh Reforms. Third party research commissioned by the IA suggests that removing such an anomaly has the potential to increase the UK's total annual tax revenue by up to £693 million after a five year period due to the additional economic activity it is projected to generate across the UK.

- The consultation on the **retail digital pound** offers an opportunity for innovation in the market for providing payment, savings and investment services. Investment managers in particular see potential for this in the wholesale retail arena, where it could provide a trusted bridge for investors and portfolio managers into digital markets and to tokenised securities. Allowing 24/7 settlement of tokenised assets in central bank money will be key here, allowing the widespread tokenisation of investible assets like bonds, stocks and other securities, as well in enabling tokenised funds. The infrastructure underpinning a digital pound will need to be incredibly resilient as it would be a segment of critical national infrastructure that will be an obvious target for malicious cyber actors, terrorists, and state adversaries.
- **Repealing PRIIPS** in favour of a method for sharing information on investments which is centred around customers' needs is a sensible step that we strongly support. This is an area which involves a great deal of cross-border work, and therefore one where international alignment is particularly important. The new regime should:
 - Preserve investor choice by ensuring the UK remains an open market for overseas funds.
 - Maintain a level playing field for UK funds, both domestically and internationally.
 - Ensure appropriate levels of investor protection for UK citizens where wider choice may not come with the safety nets provided by the ombudsman and the compensation scheme.
- We also strongly support the creation of a **Consolidated Tape**. An appropriately-constructed and fairly-licensed Consolidated Tape would ensure that both retail and institutional investors have a reliable and transparent view of prices and liquidity in UK markets. This would improve investors' ability to access whether they have achieved best execution and increase trust and investor confidence in UK capital markets. In turn enhanced transparency and investor confidence would help attract more domestic and international investment into UK markets which would deepen liquidity and strengthen international competitiveness.

C. Delivering for consumers and businesses

Over three quarters of UK households use the services of an investment manager, most often to help them to build their pensions savings. This role is vital: pensions auto-enrolment means that most Brits now have a role in providing for their own financial futures, and need appropriate support to make the most of this. At the same time, those in legacy Defined Benefit schemes deserve the best possible investment outcomes.

We are particularly pleased to see the Edinburgh Reforms focus on the need to review the boundary between **regulated financial advice and financial guidance**. Millions of UK citizens would benefit from greater access to the long-term returns that investing brings, helping them achieve lifetime goals while at the same time channelling their savings into the businesses and infrastructure programmes which support our economy. We are immensely pleased that both Treasury and our regulators are focused on this.

Today less than 10% of people receive regulated financial advice. When combined with the restricted support that financial services firms are currently allowed to provide, this results in the vast majority of the population being under served and missing out on opportunities to improve their personal finances. This should be fixed through allowing:

- **Simplified advice services for those with less complex needs**, while full financial advice remains the bedrock of long-term planning.
- **Wider financial guidance** to help those already within the investment system including enabling providers to send personalised communications to customers.

The first step towards this is the publication of a clear timetable for consultation on the necessary legislative changes. For its part, the investment management industry is committed to supporting a new regime that works to ensure good outcomes for customers, and achieves high levels of customer protection, within a broader framework that empowers appropriate decision-making.