THE INVESTMENT ASSOCIATION

2025 VISION

Delivering for customers and the economy in a rapidly changing world

June 2019

ABOUT THE IA

The Investment Association is the trade body that represents UK investment managers, whose 250 members collectively manage over £7.7 trillion on behalf of clients.

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 & shares ISAs. The UK is the second largest investment management centre in the world and manages 37% of European assets.

Investment Association (IA) members hold in aggregate, one third of the value of UK publicly listed companies. We use this collective voice to influence company behaviour and hold businesses to account. More information can be viewed on our website.

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FOREWORD

THERE HAS NEVER BEEN A GREATER FOCUS ON HOW WELL INVESTMENT MANAGEMENT FIRMS DELIVER FOR THEIR CUSTOMERS AND THE WIDER ECONOMY. THAT FOCUS, WHICH REFLECTS SIGNIFICANT EXPECTATIONS OF INVESTMENT MANAGERS, WILL ONLY INTENSIFY IN THE COMING YEARS AS THEIR ROLE INCREASES. ALL OF THIS IS TAKING PLACE IN THE CONTEXT OF A MAJOR CHANGE AHEAD IN THE UK'S OWN POSITION IN THE REGIONAL AND GLOBAL ECONOMIC AND POLITICAL ORDER.

This paper presents an overview of the key elements driving the evolution of our industry and, most importantly, key actions that we identify as necessary to ensure good outcomes for our customers. It is not an exhaustive list, but it is a demanding one, and sets out how we can work better with regulators and policymakers domestically and in the context of an ever more competitive international environment.

While technological change is almost certainly going to be revolutionary in many respects, many of the actions outlined in this paper are more evolutionary. They build on significant policy and regulatory measures, as well as industry initiatives already starting to take place, and aim to adapt to accelerating changes in customer demand and the markets in which we invest. They also recognise the central importance of our stewardship role in the economy and of getting our culture right. We must make diversity and inclusion a defining feature of our firms, not an optional extra.

The prize is an ever more efficient, value-focused industry, aligned with the needs of its customers and society more broadly as we face multiple collective challenges, particularly ensuring sustainable investment and achieving good retirement outcomes for a population that is living longer but often finding it difficult to save enough.

Over the coming months, we will be publishing more detail around some of our proposals, particularly the Long Term Asset Fund, designed to offer a new way to gain sustainable returns from investments in areas such as private companies and infrastructure. Recent events have highlighted the importance of getting this right, widening the range of options available to savers and investors. The industry has been working on a new framework for some time, in collaboration with customer groups and other key stakeholders.

This report raises critical issues about the future of the industry and we are focused on addressing these with our members, regulators, governments and wider stakeholders in the UK and beyond.

Chris Cummings

Chief Executive Officer
The Investment Association

EXECUTIVE SUMMARY

Long-term investment is the life blood of the economy, providing companies and projects with the funding they need, while generating returns for savers, and for institutions such as pension schemes acting on their behalf. At the heart of this process is the investment management industry, serving millions of customers in the UK and around the world.

We are entering a period which presents the industry with significant challenges, but also opportunities. These challenges and opportunities are driven by profound changes in customer needs; much stronger societal expectations; an evolution in the markets in which firms invest; and accelerating technological advances. In the UK, all of this is overlaid by the need to prepare for a post-Brexit world.

This paper sets out how the investment management industry can deliver competitively and innovatively for its customers in the UK and internationally. Based on an analysis of key trends, we set out a series of actions for industry, regulators and government that will help to chart a path to success. These build on a number of initiatives already under way and look ahead to what is still needed.

PART ONE: CENTRAL DRIVERS OF CHANGE

In Part One, we explore a range of inter-connected changes in the domestic and international operating environment that will contribute to a significant evolution in industry delivery over the next decade:

- **Transformation of the long-term savings and pensions landscape**, driven by greater longevity and moves towards a landscape in which individual responsibility and choice lie at the heart of the policy framework. This will result in millions more customers for investment management firms, both directly and indirectly, and already means greater visibility for the industry.
- **Shifts in customer demand**, reflected in a much greater focus on value and outcome across all customer segments. This is having a range of consequences for indexing products, where demand is increasing, and for active strategies, where an evolution is likely to continue towards products tailored to specific customer needs. A key feature of this evolution is greater asset class diversification, with accelerating growth in investment outside public markets, in turn reflecting wider trends in the economy.
- **A wider societal expectation** for investment managers – and financial services – to be more clearly aligned with their customers and the economy. This is driven by a range of overlapping factors, including the aftermath of the Global Financial Crisis of 2008, a growing sustainable and responsible investment agenda and a wider focus on culture and diversity. The sustainable and responsible investment agenda also reflects an increasing emphasis on how investee companies themselves behave and contribute to the economy and wider society.
- **Acceleration in the pace of technological change** that will eventually transform significant elements of the delivery chain, from back office through to distribution, and is already dramatically changing the way in which firms interact with the capital markets. This technological shift will have far-reaching impacts for customers, driving operational efficiency and reducing cost while also opening the door for features such as mass customisation that will allow the industry to respond much more effectively to the diverse needs of customers.
- **Growing internationalisation** of the UK industry. Over the past decade, overseas customer assets have increased as has the proportion of assets managed in the UK by non-UK companies. The depth and breadth of investment management expertise in the UK is almost without equal internationally. At the same time, continued success depends upon a range of factors, including open, inter-connected capital markets which may be subject to increasing pressure.

PART TWO: PREPARING FOR A DIFFERENT WORLD

There is not yet a defining new paradigm, but clear indicators are emerging of the changes ahead both in what the industry delivers – the nature of investment products and services – and how it does so. Ensuring the appropriate focus on the 'what' as well as the 'how' will ensure that the industry remains relevant and aligned to the needs and changing expectations of its customers and wider society.

The toolkit we set out **focuses on how to provide sustainable long-term returns in the most professional and cost efficient manner**. We identify three important areas which build on action already taken in recent years:

- **An investment process where sustainability and stewardship themes move to the fore, particularly in the context of climate change.**
- **A dynamic, responsive UK investment fund regime, helping domestic and international customers meet specific investment needs in the context of changing markets.**
- **Adoption of technology to drive innovation, improve operational efficiency, lower costs to customers and protect against increasingly complex and borderless cyber threats.**

Success in these areas depends in turn upon three critical elements:

- **A healthy firm culture encompassing greater diversity and inclusion alongside increased transparency and strong governance.**
- **Better communication and education that finds new ways to engage and support customers in the long-term savings and pensions markets.**
- **A policy and regulatory environment that supports innovation and international competitiveness.**

We see an intrinsic connection between domestic delivery and international competitiveness. Successfully delivering for UK savers and investors will drive skill sets that can be exported – with the right policy and regulatory framework. Equally, the right domestic environment will encourage international firms to build new bases here or expand existing capacity.

Brexit adds a further critical dimension here as policymakers, regulators and industry work to adapt successfully in the context of potential threats and the opportunities to reposition. In this new world, the reference points for industry, government and regulators should be simultaneously domestic and international. This paper proposes an institutional framework to ensure that this can be achieved.

PART ONE: CENTRAL DRIVERS OF CHANGE

LOOKING ACROSS THE DOMESTIC AND GLOBAL OPERATING CONTEXT, FIVE KEY THEMES ARE AFFECTING THE INDUSTRY'S ROLE IN SERVING ITS CUSTOMERS AND DELIVERING FOR THE BROADER ECONOMY. THEY ARE WIDE-RANGING AND, TOGETHER, MARK A NEW PHASE IN THE INDUSTRY'S DEVELOPMENT. EVEN WITHOUT CONSIDERING THE POTENTIAL IMPACT OF BREXIT, THIS IS A PERIOD OF UNPRECEDENTED CHANGE, DRIVEN BY POLICY, REGULATION, TECHNOLOGY AND THE INDUSTRY'S OWN INNOVATION AS IT ADAPTS TO NEW CHALLENGES AND OPPORTUNITIES. THE INTERNATIONAL REACH OF THE UK INVESTMENT MANAGEMENT INDUSTRY MEANS THAT THESE OPPORTUNITIES ARE HIGHLY SIGNIFICANT.

TRANSFORMATION OF THE LONG-TERM SAVINGS AND PENSIONS LANDSCAPE

Five years ago, in a seminal speech for the Bank of England, Andrew Haldane highlighted a view that globally, an 'Age of Asset Management' was becoming evident.[1] A combination of demographic shifts, and changes in income and wealth globally suggest a prolonged period of growth for the investment management industry. Global assets under management increased from $27.3trn in 2002 to $79.2trn by the end of 2017. For UK-managed assets, growth was also strong during these years, from $3.5trn to $9.8trn.[2]

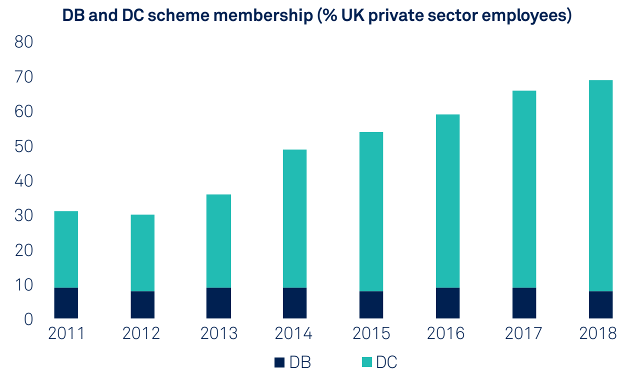
The implications of this growth are particularly significant given the changing nature of the relationship between savers and capital markets:

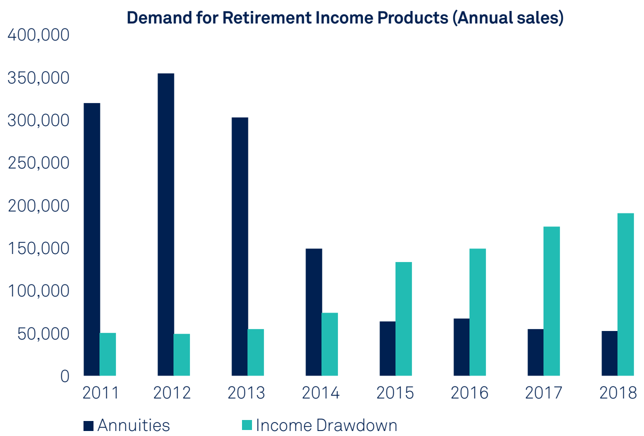
- Globally, there is an accelerating shift away from defined benefit (DB) pension provision towards defined contribution (DC). This has turned the spotlight on the increasing responsibility – and expectations – of the investment industry that sits at the heart of the pension system. With investment risk transferring to individual savers, returns are likely to be ever more closely scrutinised, alongside the providers of those returns.
- DC pension savers generally do not make active choices. Default arrangements drive behaviour at every level: automatic enrolment, pre-determined contribution levels and adoption of investment strategies provided by schemes. That creates a connection and expectations challenge for the investment industry, as well as an education and support issue for retirement income decisions that are not as easily addressed by defaults.
- In the UK, the 'Freedom and Choice' reforms announced in 2014 created a radically different environment. While the first few years of the freedoms have seen a strong demand for cash, driven by the specific circumstances of current cohorts of retirees,[3] there are some clear trends emerging. As Exhibit 1 shows, there has been a significant decline in the purchase of annuities and more customers choosing to maintain control over their capital by using an income drawdown product.

[1] "The age of asset management?" Speech at the London Business School, London, 4 April 2014.
[2] Source: Boston Consulting Group and IA data (IA members).
[3] Namely recourse to DB pensions and other assets. See the FCA's 2017 Retirement Outcomes Review: Interim Report for a detailed discussion of this point.

Taken together, these shifts represent a fundamental change in the landscape compared to the late 1980s and 1990s when DB pension schemes, annuities and with-profits policies were still prevalent in the private savings market. Pension scheme members and a large part of the retail market were already dependent upon investment outcomes, but the level of connection between underlying market returns and outcome was far less direct. The shift in underlying risk creates very different dynamics, also reflected in regulation and policy as we discuss below. As the balance between DC and DB assets shifts further, and the retirement income market matures, these dynamics will be even more pronounced.

EXHIBIT 1: THE TRANSFORMATION OF THE UK PENSIONS AND RETIREMENT INCOME LANDSCAPE (2011-2018)





Source: ONS, Annual Survey of Hours and Earnings; FCA Product Sales Data – Retail Investments Aggregated Statistics: 2005-2018 H1

SHIFTS IN CUSTOMER DEMAND

The shifts taking place in the long-term savings and pensions market are resulting in significant demand-side changes for investment managers.

At one end of the spectrum, cost-focused delivery is driving the accelerating use of indexing approaches, both in the UK and internationally. Some of this is due to competition and customer preference. Policy is also shaping the process: for example, the charge cap for UK DC default arrangements has had an impact on investment behaviour. The increased availability of indexing products is also fuelling competition for the supply of asset allocation services along the value chain.

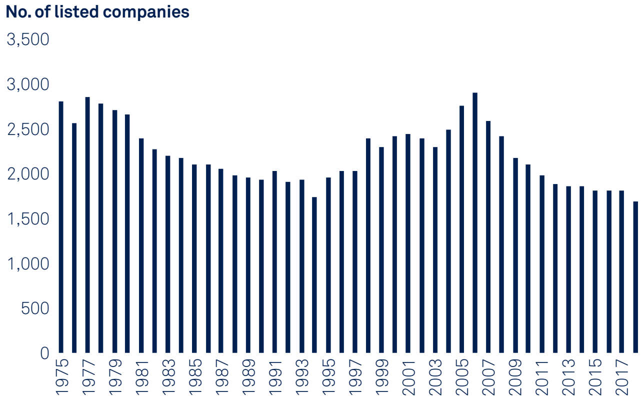
At the other end, both retail and institutional customers are looking to the industry to provide a different set of products and services:

- **Wider asset class exposure**. Pension schemes, and other institutional customers, are looking for more diversified sources of return and income, reflected in greater interest in alternative strategies and asset classes, including private markets. Some of this is cyclical, particularly in the context of low interest rates post-2008 and has coincided with greater activity from corporates finding public markets less attractive. This phenomenon is most evident in the US, but can also be seen in the UK (see Exhibit 2). Constraints on banks' ability to lend and governments' ability to borrow has also seen a growing role for market-based finance in many areas of economic and social infrastructure, such as housing (see Exhibit 3).

- **Greater focus on outcomes**. Many DB pension schemes are seeking ever more sophisticated approaches to liability management, partly driven by accounting and regulatory requirements. The low yield environment, coupled with market dislocation (both in the dot com crash of 2000-01 and 2008-09 financial crisis), have pushed the UK retail market more towards outcome-oriented funds. IA survey research also suggests that this may signal a more permanent shift in demand, reflecting a more mature funds market.

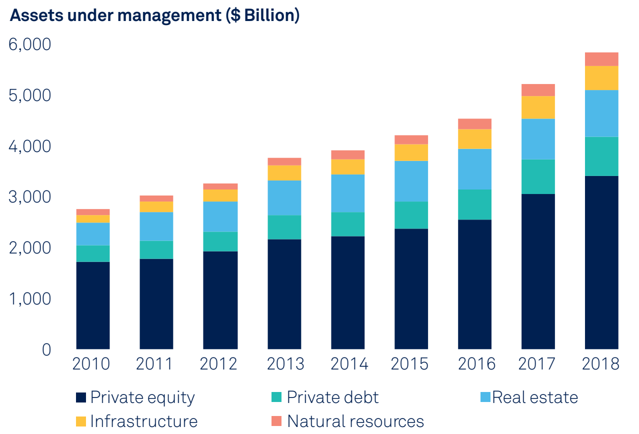
- **Increasing importance of sustainable investment**. There is growing customer emphasis on the material impact of sustainability issues on financial returns, notably among institutional clients, as well as a more prominent focus on setting non-financial objectives (for example, to invest in companies and projects that have specific social or environmental benefit).

EXHIBIT 2: NUMBER OF UK LISTED COMPANIES OVER FOUR DECADES



Source: World Bank / IA estimates

EXHIBIT 3: ACCELERATING GROWTH IN PRIVATE MARKETS (2010-2018)



Source: Preqin

All of this is contributing to a range of choice in investment management products and services that is probably unprecedented in the history of the industry, with innovation in the underlying building blocks of investment strategies (particularly indexing products) and in customer-focused strategies:

- The introduction of Exchange Traded Funds (ETFs) has added an important new access point for those wishing to track an index, and ETFs are available for some actively managed strategies.

- There is now wider access to certain asset classes (e.g. commodities) and sub classes (e.g. direct lending to business), both in single asset class and multi-asset funds.

- To enable customers better manage risk, new types of funds have emerged that are much more specifically targeted at outcomes, such as control of volatility. In the current context of the low yield environment and 2014 Freedom and Choice reforms, there is also wider availability of funds with income objectives, notably multi-asset income.

- Liability Driven Investment (LDI) strategies are increasingly used to help DB pension schemes better match liabilities that stretch over decades and are subject to major uncertainty in areas such as inflation risk. This, in turn, is seeing rising usage of fiduciary management, challenging the traditional separation of investment consulting and implementation.

- Sometimes used alongside LDI, Cashflow Driven Investing (CDI) strategies are emerging to meet the demands of mature DB pension funds that are becoming cashflow negative and seeking income streams to meet their pension obligations.

- Overlaying the changing product set is an intensifying industry focus on how to deliver sustainable investment. This is explored in more detail in the next section on changing wider expectations.

A further evolution lies ahead as the industry's traditional role in helping people in the savings phase of their lives extends further to supporting retirement income, possibly with more specific goals relating to medical and long-term care needs. This links to a wider point relevant across the savings lifecycle: while retail customers recognise the low returns offered by traditional bank savings accounts, the risks inherent in the capital markets can still act as a deterrent to many. This explains the appetite for products that can mitigate factors such as the volatility of returns – it is a trend that may grow as responsibility further transfers to individual savers.

WIDER SOCIETAL EXPECTATIONS OF INVESTMENT MANAGERS

Expectations and scrutiny of the investment management industry have both increased dramatically over the past decade:

- The aftermath of the 2008 Global Financial Crisis has seen a focus on behaviour and culture that has extended through the financial system, starting initially with the banking system and gradually extending to other parts of financial services. In a number of jurisdictions, including the UK, there have been interventions relating to the way firms operate and are accountable to customers, whether through mechanisms such as increased transparency or broader aspects of oversight and alignment.

- This reform process has coincided with, and been given further impetus by, the much more visible role of the investment management industry in delivering for customers (e.g. broadening Defined Contribution pension participation) and in the wider economy through greater use of market-based finance. The latter has partly been a consequence of the financial crisis, amid constraints on bank lending and government finances.

- The shift to DC is taking place at a time of rising inter-generational wealth divisions and challenges for many individuals and households in saving more generally. Notably, UK savings rates remain low in historic and internationally comparative terms. This also heightens the focus on the value provided by investment managers alongside other parts of the financial services industry, including pension providers, distributors and advisers. It also raises broader questions for industry, regulators and policymakers about how to address different savings needs across generations.

Growing importance of sustainability and stewardship

The policy emphasis on sustainable and responsible investment is building on environmental and social themes as well as on more traditional stewardship activities such as corporate governance oversight and engagement. Four factors are now deepening the debate and can be expected to do so further:

- The scale of concern about environmental change and its implications, probably the most potent theme at international level.

- A growing expectation that private finance should support projects aiming at positive social impact.

- Stronger expectations of what the investment management industry can achieve in key areas of corporate oversight and holding companies to account. These include executive pay, improving board and company diversity, audit quality and long-term investment, as well as broader behaviours that may negatively impact corporate and wider economic sustainability. Recent corporate governance scandals in the UK have turned the spotlight on the responsibilities exercised by, or on behalf of, institutional investors.

- The question of corporate oversight in turn raises questions about 'stakeholder voice' and the extent to which mechanisms are developed to ensure that corporate decision-making is not just focussed on shareholder value but more representative of the wider society, including employees, suppliers and customers. In the UK this theme has featured in policy discussion on both the right and left of the political spectrum.

These strands are often brought together under the label of Environment, Social and Governance (ESG) issues. Multiple initiatives at national, regional and global level are exploring new frameworks for monitoring and development. These involve government, regulators, industry and wider stakeholders, and are increasingly affecting both customer behaviour and industry delivery.

In the UK, the government set up an independent Advisory Group chaired by Elizabeth Corley, which published a report in 2017 on "Growing a Culture of Social Impact Investing in the UK". In 2018, the Prime Minister commissioned an industry taskforce to progress the recommendations of this report.[4] The IA has also established a policy group dedicated to sustainability and responsible investment, and has been engaging in extensive consultation on industry-agreed definitions and potential product labelling options.

All of this work is taking place against a fast-moving backdrop, building on existing initiatives such as the UN Principles for Responsible Investment (UNPRI). Recent developments include:

- The European Commission's Sustainable Finance Package, including EU Taxonomy and Ecolabel, building on the final report of the High-Level Expert Group on Sustainable Finance.[5]
- A global focus on the private sector's role in the delivery of the UN Sustainable Development Goals.
- British Standards Institute (BSI) work on Sustainable Finance.
- The FCA Discussion Paper on Climate Change and Green Finance.[6]
- A growing debate on the role and responsibilities of UK pension schemes. Following Law Commission reports of 2014 and 2017, the DWP subsequently introduced regulations clarifying and strengthening trustee investment duties in this area.[7] The FCA is currently consulting on similar requirements for Independent Governance Committees (IGCs) in respect of the insurance-based pension schemes they scrutinise.[8]

On the UK stewardship side, there is policy and regulatory activity at multiple levels:

- The government has set out its expectations of companies and institutional investors in its Corporate Governance Reform package.
- The FRC has been consulting on a new Stewardship Code to encourage active stewardship by investment managers and asset owners.
- The FCA has led a discussion on what effective stewardship looks like, the minimum expectations of firms that invest for clients, the standards which the UK should aspire to and the role of the regulator.

Underpinning all this work is a fundamental question as to the role of regulation of stewardship, which has also been a longstanding debate at EU level, with the Shareholder Rights Directive II being implemented through 2019. Internationally, stewardship codes are now in place in dozens of countries, reflecting the growing importance of this area of investment management activity. As we discuss in Part Two, the review of the UK Stewardship Code is an opportunity to re-position the UK as a global leader in this area.

[4] https://www.gov.uk/government/publications/growing-a-culture-of-social-impact-investing-in-the-uk
[5] https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en
[6] https://www.fca.org.uk/publications/discussion-papers/dp18-8-climate-change-and-green-finance
[7] In 2014, the Law Commission issued a report, Fiduciary Responsibilities of Investment Intermediaries, which clarifies expectations that pension trustees should take into account the financially material aspects of sustainability, and also set out circumstances in which non-financial factors could be relevant. It was followed by a Law Commission report of 2017, which clarified how far pension funds may or should consider issues of social impact when making investment decisions.
[8] CP19/15 Independent Governance Committees: extension of remit

ACCELERATION IN THE PACE OF TECHNOLOGICAL CHANGE

Technological innovation will transform every aspect of the industry, from investment decisions to client experience. It is already evident in a number of areas, facilitating new products such as ETFs, cost effective ways of reaching customers (e.g. robo-advice) and dramatic changes in the speed and process of trading in capital markets. The consensus is that transformational change lies ahead as the industry undergoes a revolution in technology, which will affect front, middle and back offices, as well as the advice and distribution landscape.

Looking to the longer term, the full impact of this is difficult to predict beyond the scale of change. Over the short to medium term, key areas to watch will include:

- **Increased internalisation** as more firms internalise resources and decrease offshore headcount to retain IP and support cross-functional initiatives.

- **Role redeployment** through a shift of resources to value-add functions and oversight activities, meaning automation – and potential outsourcing – of commoditised activities.

- **Evolving skillset** with investment managers increasing tech talent to take advantage of Artificial Intelligence (AI) data analytics and Robotic and Automation technologies with the potential to transform business operations (discussed in more detail below).

Change throughout the value chain

These trends are being driven by the increasing adoption and implementation of new technologies throughout the value chain expressed as:

- Acceleration of operational modernisation and robotic process automation (RPA), ensuring substantial efficiency gains within and between different functions of the middle and back office.

- Increasing use of AI and data analytics in fund marketing and distribution to portfolio decision-making and risk analysis.

- The further emergence of AI assisting key decision processes, including asset allocation, security selection, portfolio construction and trading. From a technology perspective, trading is already a major focus for firms to ensure the most efficient trade execution in a fast-evolving environment.

- Changing patterns of distribution, which may see a further blurring between the role of investment manager and advisor/distributor.

- Increasing cloud migration with growing prevalence of third party applications as firms re-optimise internal architectures for cloud readiness and evaluation of vendor security maturity.

- A shift to digital platforms leveraging distributed ledger technologies and broad Application Programme Interface (API) architecture, both internally and with external clients along with integration of third party platforms to provide best of breed client experiences.

Wider technology questions for the industry

The ways in which investment management firms respond will vary, both between and within different categories of managers. Key questions will include:

- The balance between outsourcing vs internal system development.
- The balance between manufacturing and distribution in the long-term savings and pensions markets, likely leading in turn to a greater role for robo-advice.
- AI ethics and accountability and its impact on resource reallocation.
- The shape of the client acquisition and retention experience.

Clearly, the extent of this digital transformation will require the implementation of new governance oversight control processes and compliance frameworks, as well as enhanced operational and cyber resilience in the context of a rapidly evolving and borderless threat environment. Ultimately, management buy-in and firms' appetite for moving from legacy applications to the scaling-up of data driven AI and RPA solutions will determine the pace of digital adoption and transformation.

GROWING INTERNATIONALISATION

The relevance of the shifts outlined above is heightened by the fact that the UK investment management industry is one of the most international in the world and is therefore in a position to respond to delivery challenges and opportunities both domestically and across the globe:

- **Customer base.** About 40% of assets are managed on behalf of overseas customers, based in Europe and across the globe (from around 35% ten years ago). A significant part of the European customer base accesses UK expertise through overseas-domiciled investment funds, particularly those located in Ireland and Luxembourg.
- **Investment process**. Increasingly, the UK industry is investing globally from the UK for customers, amid further reductions in the historic 'home bias' seen both among UK customers and in other markets. Of £3trn in shares managed from the UK, around 70% are invested in overseas markets (from 54% ten years ago).
- **Corporate identity**. Investment management firms locate capacity in the UK from around the world. Measured as a proportion of total assets managed here, overseas-headquartered firms account for 57% (from 41% ten years ago).
- **Operational range**. Equally, a number of UK-headquartered firms also operate internationally, with offices in financial services hubs around the world, for the purposes of portfolio management as well as commercial promotion.

This international success has been driven by inter-connected factors, primarily:

- **Existing strength of the UK industry**, with major centres in London and Edinburgh, and proximity to other elements of the broader City cluster, which gives UK financial services a wider competitive edge. Innovative product sets, such as LDI, can be exported globally, while innovation and expertise flows in from other parts of the world.

- **Attractiveness of the UK as a place to locate**, which remains high for a number of reasons. These include time zone, language, business environment, access to talent and regulatory approach, all of which contribute to a perception of openness that has been critical for success. Despite Brexit-related uncertainty, surveys continue to suggest that the UK has an enduring attraction with London vying with New York for top place in competitiveness rankings over the past decade.[9] Human Capital is a consistently important aspect here, with rankings particularly influenced by the supply chain of appropriate skills and labour market regulation.

- **Customer and regulatory acceptance of a global and regional supply chain**, which provides investment management firms with the ability to relocate or build capacity in the UK that can then service customer groups globally, using a portfolio management delegation model. In addition, the UK has strong capabilities in asset servicing and oversight.

In comparison to its leading position as an investment management centre, the UK ranks #5 in Europe as a fund domicile, reflecting a primarily domestic market with limited exports into other parts of Europe. In the current model, UK-headquartered and UK-based international entities benefit significantly from the momentum seen in Ireland and Luxembourg. This is likely to continue in a post-Brexit environment, with a renewed opportunity for the UK to develop its fund market infrastructure further, both for the domestic and international markets.

At an international level, a key risk is the fracture of open, interconnected capital markets if policymakers or regulatory authorities move to restrict capital flows or protect local markets. IOSCO has proved a successful guardian of international standards and cooperation which has led to the ongoing maturing of international capital markets. This has brought greater efficiency to the investment management industry and benefits customers across the world.

In Part Two of the Report, we consider how industry, government and regulators can create an environment in which the UK industry can flourish both domestically and internationally, both as an investment management centre and a fund innovation hub.

EXHIBIT 4: FOUR MEASURES OF A GLOBAL INDUSTRY

[9] See The Global Financial Centres Index (Z/YEN and China Development Institute) The latest report, published in March 2019, shows the ranking of London broadly unchanged year-on-year, although as we discuss in Part Two, the narrowing gap between New York, London and Asian centres is the striking trend since the Survey started in 2007.

PART TWO: PREPARING FOR A DIFFERENT WORLD

CLEAR ACTIONS FOR CHANGE CAN BE IDENTIFIED AS THE UK INVESTMENT MANAGEMENT INDUSTRY POSITIONS ITSELF FOR DELIVERY IN A VERY DIFFERENT DOMESTIC AND INTERNATIONAL ENVIRONMENT. INDUSTRY ITSELF WILL BE RESPONSIBLE FOR MANY ELEMENTS, BUT PUBLIC POLICY AND REGULATION WILL ALSO BE ESSENTIAL IN SHAPING THE FRAMEWORK FOR LONG TERM SUCCESS. WE FIRST SET OUT THE WAY FORWARD IN THREE CRITICAL AREAS FOR COMPETITIVE DELIVERY: SUSTAINABLE INVESTMENT; THE FUTURE UK FUND REGIME; AND TECHNOLOGICAL ADAPTATION. WE THEN EXPLORE THREE THEMES THAT ARE CENTRAL TO SUCCESS: CULTURE, COMMUNICATION AND A SUPPORTIVE POLICY AND REGULATORY ENVIRONMENT.

The developments outlined in Part One are likely to have a transformative impact on the industry. Importantly, patterns of international and domestic demand – and hence industry success in meeting that demand – are likely to have strong parallels in the coming years:

- **The challenges faced by customers internationally are increasingly similar to those faced in the UK**. This is partly the result of demographic shifts and pension reforms that are pushing towards greater individual saving for later life. This will continue to create opportunities for investment managers, despite the high level of intermediation that characterises the industry in many jurisdictions.
- **Institutional customers are increasingly sophisticated and looking to fulfil specific investment needs** that will see a further evolution in the demand side. We are already seeing a growing focus on areas such as LDI and private markets that might have been considered more niche a decade ago.
- Despite quite different current approaches in the United States and Europe, **a critical driver of changing expectations regarding product development and wider economic oversight by investment managers is the theme of sustainability and responsible investment**. Climate change is a key driver, as there is a growing global awareness of the threat posed to the environment, but other aspects are also significant, specifically executive remuneration, diversity and wider aspects of the treatment of employees.
- From a customer delivery perspective, **the policy and regulatory environment is likely to retain a focus on three core themes: alignment, transparency and oversight**, which in turn link to questions of wider culture. Although expressed in very different ways, this is an increasing preoccupation for both national, regional and global regulators and an opportunity for the industry to build on the strengths of the agency model.

One key feature of the response to these changing demand patterns is already apparent in the UK and internationally: a blurring of the lines between different types of investment management style and product set (see Exhibit 5). For example:

- Active management is typically defined as stock and securities selection vs. an indexing alternative. This is too narrow and will expand in a world of more outcome-focused products and services as well as with the mainstreaming of the responsible investment agenda, including strategies that incorporate particular sustainability-related outcomes.
- At the other end of the spectrum, indexing itself is no longer characterised simply as a replication of the returns of an index. It can incorporate a wide range of factors or 'tilts' (e.g. using market capitalisation or volatility of shares to define the investment universe). Both active and indexing funds can provide the building blocks for different forms of actively-delivered investment objectives.

We expect the next stage of development will further blur those lines in two key interconnected areas: the role of sustainable investment strategies and related implications for stewardship activity, and the roles of alternative asset classes vs. mainstream (liquid, public markets).

EXHIBIT 5: BLURRING BOUNDARIES IN INVESTMENT MANAGEMENT

Current landscape	New world
Conventional v. ESG	Financially material ESG factors and wider sustainability indicators become more explicit part of the conventional investment process.
Mainstream v. Alternatives	Alternatives become clearer part of mainstream, including a fund architecture that accommodates illiquid as well as liquid investments.
Active v. Indexing	Asset allocation / solution-based products and smart beta redefine both active and indexing.
Retail v. Institutional	DC transition creates new kind of long-term investor, with similar needs to long-term institutional investors in terms of risk management and diversification. Accelerating intermediation by platforms creates wholesale quasi-institutional relationships in the traditional retail fund market. Standards in areas such as disclosure are also increasingly converging.

AN INVESTMENT PROCESS WHERE SUSTAINABILITY AND STEWARDSHIP MOVE TO THE FORE

UK investment managers already offer a wide range of responsible investment products. While responsible investment has existed in various forms for many years, over the last decade sustainability has gained increased focus both within the UK and around the world:

- Fund products may screen both positively (actively choosing certain investments) and negatively through excluding sectors such as tobacco or armaments on ESG criteria. A number of funds focusing specifically on social impact have also been established and this is likely to increase.

- A number of firms embed ESG considerations into their underlying investment processes across asset classes to deliver long-term value, such that their fund products and investment services are underpinned by these processes.

For customers and intermediaries, there needs to be far greater clarity and comparability over different responsible investment approaches available, as well as improved disclosure of how they relate to sustainability. Increasingly, investment managers are encouraged, and in some instances expected, to disclose the 'non-financial outcomes' or 'environmental and social impacts' of their investments. This expectation comes from the position that all investments will have some form of impact on society and environment – whether negative or positive, intentional or incidental and there is a growing number of international frameworks which are designed to help communicate these wider impacts to clients and other stakeholders.

Greater clarity will help customers navigate what can sometimes be a confusing landscape, whether it is diversity of the investment approach taken or diversity of language used to describe that approach. With a range of domestic and international stakeholders involved in the debate, there will be no single correct approach. Instead, the emphasis should be on facilitating informed investor choice through transparency of approach and outcomes and use of consistent language.

Stewardship activity

In the area of stewardship activity and governance oversight, many firms have diverse capabilities. While they tend to deploy them 'under the radar' to greatest effect, they understand the need to demonstrate outcomes, which at firm level takes place through public reporting.

For its part, the IA has engaged in a range of work, including: the Public Register on shareholder opposition;[10] member firms expectations on Board Diversity; better alignment of remuneration for executive directors; and the Productivity Action Plan, aimed at encouraging a different kind of long-term investment agenda.

For investment managers to be better long-term stewards and integrate material ESG factors into investment decisions, the industry needs better and more consistent reporting from investee companies. This should focus on the company's long term strategy and material ESG risks. The IA already has Long Term Reporting guidance, setting out our members expectations for reporting on productivity, capital allocation, human capital and material ESG factors. The IA will continue to work with members and wider stakeholders to develop and promote this guidance, to help facilitate more consistent reporting and better long term decision making.

Looking forward, a better market for stewardship can be created by:

- **Improved and more consistent public disclosure of stewardship activities and outcomes by investment managers**. By being more open about how they conduct stewardship, investors can help to create awareness of the value of stewardship and allow clients to identify the different approaches of different investment managers.
- **Clearer alignment of incentives** across the investment chain to focus on long-term value creation. A more demanding and discerning client base and better inclusion of stewardship in asset owners' expectations of investment managers will help increase competition in the industry and drive forward best practice in stewardship.
- **A clearer focus on long-termism** in line with the investment horizons of beneficiaries. This will help to ensure that stewardship considers the issues that will impact on the ability to generate sustainable value over the short and long term.

AN INVESTMENT PROCESS WHERE SUSTAINABILITY AND STEWARDSHIP MOVE TO THE FORE: NEXT STEPS

- Firms are adapting their product sets and investment processes in the context of a fast-changing set of expectations on sustainable investment from customers and policymakers. Through a near term focus on definitions, labelling and disclosure, the industry can work effectively with government, regulators and other stakeholders to provide customers with clearer products and services.
- Stewardship plays a central role in generating sustainable value for beneficiaries. The market for stewardship can be improved by a shared agenda between the industry, government, regulators and companies, based on enhanced disclosure, clearer alignment of incentives and a clearer focus on long-termism.
- The current review of the UK Stewardship Code is an opportunity to re-establish the UK as a global leader in this area. In addition, the Stewardship Working Group of the Asset Management Taskforce will develop concrete proposals to promote and enhance the UK as a centre of excellence for stewardship.

[10] https://www.theia.org/public-register

A DYNAMIC, RESPONSIVE UK INVESTMENT FUND REGIME

The UK investment fund industry has grown significantly in recent years as domestic demand has increased. Historically, the UK funds industry has been less visible in mainstream pensions culture than, for example, US mutual funds as part of 401(k) pensions. In the context of the shift to DC provision and more choice in the area of retirement income provision, this may change going forward.

In this new environment, it is more important than ever that our industry is underpinned by strong customer protection and the highest standards of fund governance and disclosure. There is also a fundamental question of how to ensure that investors can access investments beyond more liquid, public markets, especially at a time when the number of publicly listed companies is falling in the UK and elsewhere (see p.9). Increasing such access will both meet savers' greater demand for different sources of income and return, while ensuring that capital is able to flow to companies and infrastructure projects looking to raise finance for sustainable long-term investment.

This in turn raises wider questions about the role of daily liquidity and the extent to which it may be necessary and/or appropriate, depending on different asset classes and customer preferences. In the DC pensions environment, there are also other issues that restrict the range of investment options expected and supplied, with regulators currently reviewing the permitted links rules that are a longstanding challenge.[11]

Our view is that there is a clear and important role for daily priced, daily traded funds, providing customers with access to a wide range of investment strategies and asset classes. At the same time, some asset classes do not lend themselves to daily liquidity. After consultation with customer groups and wider stakeholders, we also propose a new kind of fund for illiquid assets, a Long-Term Asset Fund, and will be publishing a detailed blueprint later this year.

WHAT DO WE MEAN BY LONG-TERM ASSET FUND?

The time horizon of most investors is inherently long term: they are saving for their futures, and increasingly for their pensions. They will often hold investments, including shares and bonds, for many years, if not decades. These investments themselves may be liquid, i.e. can be bought and sold easily, notably in public markets such as stock exchanges. Some investments will be much more illiquid, but can still be high quality. These include 'real assets' such as property and infrastructure, where investors may own the actual buildings, bridges or houses. They also include private equity and private debt, which may be used to finance companies as well as 'real assets'. We refer to these illiquid assets as 'long term' in our Long-Term Asset Fund proposal.

This new type of fund would have the ability to invest in less liquid or illiquid asset classes, and importantly to move away from daily dealing in units to reflect the nature of the investment strategy.

The fund would be open-ended, able to receive new money to invest and for investors to redeem at appropriate time intervals, and would co-exist with alternative forms of funds, notably closed-ended funds.

The fund would have high standards of customer protection, while helping to ensure that evolving customer needs in key markets, notably the DC pensions and retirement income market, can be better met.[12] It is unlikely to be offered in the mainstream retail fund market without requirements for advice or appropriateness tests.

[11] We explore these wider issues in our 2018 paper, Putting Investment At The Heart of DC Pensions.

[12] This work has taken place under the auspices of the HMT Asset Management Taskforce, which invited the Investment Association to establish a Working Group – the UK Fund Regime Working Group (UKFRWG) – to help ensure that the UK fund environment could most effectively serve both domestic and international customers. The output from this group will be released later in the year.

OPEN-ENDED AND CLOSED-ENDED FUNDS

There is no right or wrong approach to building a fund. Some funds are open ended, which means that they can expand or reduce their investments according to customer demand. The price to buy or sell a unit is calculated to reflect the value of the underlying investments. New units are created or cancelled directly in response to customer demand.

A closed-ended fund, such as an investment trust, raises specific amounts of capital to invest and issues shares to investors. Those shares rise and fall in value according to the investors' view on the outlook for the fund. This may result in the shares being worth less or more than the value of the investments held.

Both open-ended and closed-ended funds are used by investors in the UK and internationally. Some investors may have a preference for open-ended funds because they wish to hold a fund whose value is as close as possible to the underlying value of the stocks, bonds or other assets such as property in which it invests. The challenge is to match the time horizons of investors with the nature of the assets being held. Various mechanisms exist to achieve this effectively.

The new Long-Term Asset Fund would provide investors with an open-ended option in a form that key customer groups, such as DC pension schemes, can access.

International dimension

At an international level, the UK has not matched its success as an investment management centre with the same level of success as a fund domicile. There is an opportunity to address this, while recognising that Dublin and Luxembourg, in particular, will continue to remain leading jurisdictions in which to base investment funds.

In the context of international competitiveness, a **new onshore professional investor regime** should be put in place to help ensure that the UK positions itself as a go-to destination internationally for more professional investors looking to access the widest range of investment strategies. This new regime will also provide domestic investors with wider choice.

A DYNAMIC, RESPONSIVE UK INVESTMENT FUND REGIME: NEXT STEPS

- Industry has developed an action plan to ensure that the UK policy and regulatory framework is able to facilitate and foster innovation in fund delivery, aiming at domestic and international customer markets, and the widest range of asset classes.

- Our proposals include two new fund structures. The first – a Long-Term Asset Fund – is designed to facilitate investment in illiquid assets. The second – an Onshore Professional Fund - is to ensure that the industry can better serve international and UK professional investors.

- A range of tax and regulatory enhancements will also ensure greater consistency and better outcomes for customers.

TECHNOLOGICAL ADAPTATION TO DRIVE INNOVATION, EFFICIENCY AND PROTECTION

Technology clearly has the potential to transform every aspect of investment management activity, from front to back office and all the way through the distribution chain. As we outline in Part One, many aspects of technological development will be for individual firms and will be the subject of intense commercial competition. There are also areas where collective mechanisms are already helping to facilitate innovation to the ultimate benefit of customers, helping to drive efficiency and improve information through the delivery chain:

- **Integrity and consistency of data delivery** in the complex new world of PRIIPs, MiFID II and UK regulatory change is being facilitated by a new generation of machine-readable frameworks (MRFs). MRFs provide open source standards for transmission of data through the delivery chain between investment managers and customers. The goal of the MRF is to help firms, intermediaries and their customers achieve greater consistency and efficiency in accessing information about investment products and services.

- Ensuring that the **transfer and re-registration process** works effectively across the long-term savings and pensions industries will help to facilitate customer switching, thereby driving competitive pressure and helping to drive up customer confidence in the operational integrity of the system. The Industry Transfer and Re-Registration Group (TRIG) has established a strong foundation for moving forward in this area.[13] A parallel project, the Fund Trading and Settlement (FTS) Initiative, aims specifically at establishing common standards to facilitate more efficient fund distribution, thereby contributing to wider market confidence.

- Advancing **Digital Regulatory Reporting** (DRR). The outlook of the FCA is that reporting will eventually change and should become more automated where possible. This can increase efficiency but the automatic gathering of data highlights the importance of using data appropriately and ethically.

- **Bringing information together for customers** in a more accessible way will also be incredibly important. The new *Pensions Dashboard* will be a valuable resource for millions of UK savers seeking to better understand how to prepare for later life, drawing on models internationally which have been highly successful. At a broader level, the *Open Savings and Investment* initiative seeks to make saver and investor account portability easier. There is scope for other initiatives to help bring together information about wider savings and investment, subject to data protection rules in the relevant jurisdiction.

In all these areas, data security, privacy and resilience must be incorporated by design. This should also be intrinsic to firm culture as people remain the first line of defence and potentially the biggest threat should they not use technology appropriately, whether maliciously and/or unwittingly.

Role of Velocity

Looking to the potentially radical transformative role of FinTech more generally, the IA has set up Velocity. Officially launched in October 2018, Velocity was created as the FinTech innovation hub and accelerator for the investment management, capital markets and the wider buy-side industry with the objective of increasing the rate and extent of tech adoption for the benefit of businesses and their customers.

The hub has now expanded to encompass over 110 FinTech firms covering all aspects of digital innovation and emergent technologies applying to our sector including AI, big data, cloud-based infrastructure, distributed ledger technologies (including blockchain), social mobile tech and robotics and automation. This community is expected to grow to more than 200 FinTechs over 2019 into 2020 making it the largest tech community focused on the buy side globally.

[13] https://www.abi.org.uk/globalassets/files/publications/public/lts/2018/trig---industry-wide-framework-for-improving-transfers-and-re-registrations---final.pdf

At the heart of Velocity is an accelerator programme that connects a cohort of selected FinTechs with the industry on an intensive 6 month rolling programme. Selection is made with the support of a 25 strong advisory panel comprising industry experts drawn from across the investment management industry and related financial and professional service sectors and includes chief digital, innovation, strategy, customer and operational functions from a wide range of firms.

The first cohort of FinTechs graduated in Spring 2019 and a new cohort was announced and publicised to the industry:

velocity
ACCELERATING FINTECH GROWTH

Cohort One (Oct 2018 – April 2019)	
Util	Uses big data and machine learning to maximise environmental and social returns on investments
ResonanceX	A digital marketplace based on blockchain allowing retail investors to build bespoke portfolios
Essentia Analytics	Combines behavioural data analytics with face-to-face insight to help fund managers improve performance of funds for investors
Hivemind	Specialises in analysing unstructured data, helping companies improve research capabilities
9Fin	AI powered financial data platform for the bond market, allowing finance professionals to easily find information on bonds

Cohort Two (May 2019 – December 2019)	
AxeTrading	A specialist Fixed Income Execution Management System (EMS) delivering technology toolkits for trading connectivity, bonds pricing engine and multi-layer data aggregation: purpose-built for Fixed Income markets automation and generating trading alpha
BlueFire AI	Cost-effectively unlocks Chinese capital markets to foreign institutional investors by delivering a deeper understanding of Chinese onshore companies and their assets
CUBE	An enterprise-scale platform that delivers regulatory intelligence and regulatory change management, smarter, faster and cheaper
HUBX	White-label solution for private markets advisors helping them to track, distribute, and execute their private deals
Qwill Messenger	A single persistent chat app for everyone, allowing clients of multiple firms to safely engage with their staff representatives within a branded space, fully controlled and coordinated by each firm

TECHNOLOGICAL ADAPTATION TO DRIVE INNOVATION, EFFICIENCY AND PROTECTION: NEXT STEPS

Industry, government and regulators all have a role in ensuring that the UK is able to provide the most digitally-enabled fund and competitive investment management environment:

- Velocity, the IA's FinTech innovation hub and accelerator, will evolve further, creating regional, national and international buy-side FinTech bridges with key innovation hubs and stakeholder groups.

- The industry will work alongside regulatory initiatives, including FCA Innovate, which aims to support innovation in FinTech, RegTech and WealthTech.

- Collaborative models such as the Trade Association Cyber Information Group (creating high level coordination between the industry, FCA and other financial services trade bodies) and the Open Savings and Investments initiative, will provide a foundation for further work in key areas.

- The IA is developing a new cyber threat intelligence platform – TITAN – to facilitate the sharing of information throughout the industry by collating data from law enforcement, government agencies and open source research, alerting members of key cyber risks that they need to address.

- Initiatives to support operational modernisation in the middle and back office will intensify to help ensure that the retail market adapts more quickly to the needs of customers, particularly in the area of switching providers.

IMPORTANCE OF THE DELIVERY ENVIRONMENT

Successful delivery in the areas outlined above in turn depends on a range of critical factors relating to the way in which firms operate and engage with customers, as well as the wider and policy regulatory environment in a more inter-connected and competitive world. Starting with culture, we set out a range of actions for industry, looking also at how policymakers and regulators can work with firms in both a domestic and international context.

A HEALTHY CULTURE ALIGNED WITH CUSTOMER NEEDS, EMBRACING DIVERSITY AND INCLUSION

Culture and governance have been at the heart of regulation for many years and are inextricably intertwined. Regulators have recognised that culture has been at the heart of many financial scandals and are seeking to address the root cause before consumer detriment occurs or market integrity is impacted. The extension of the Senior Managers and Certification Regime ("SM&CR") is the latest concrete example of how this is expected to work on a practical level within firms.

Another example of the focus on governance is the outcome of the FCA's Asset Management Market Study requiring independent members of an authorised fund manager's governing body. Those independent members will play an important role in shaping the new value assessment and reporting exercises which will be required from September 2019, helping to strengthen governance and oversight across the UK fund management industry.

Culture is much more than a regulatory risk, it has a real impact on a firm's reputation and sustainability and can be a source of competitive advantage. A firm's culture is shaped by a number of tangible and intangible elements and, while there can be variation between firms as to what encompasses a healthy culture, there are certain common components, for example: leadership, purpose, diversity, inclusion, psychological safety, governance and approach to rewarding and managing people.

Diversity and Inclusion

There is an increasing body of research showing that diversity results in better decision-making and long-term financial performance. Diversity works against 'group think' and enables a greater understanding of the needs of customers. It is important that the workforce is made up of the best people for the job, regardless of age, disability, ethnicity, education, gender or social background.

The perception that the investment management industry is not diverse and inclusive are harmful to reputation, potentially posing challenges to effective recruitment as well as affecting how the industry is seen to align with customers and wider society. A number of initiatives are underway to increase diversity, including Investment20/20 and the Diversity Project.

INVESTMENT20/20

An award winning sector led investment management careers service, leading the industry in diversifying entry level talent through an early careers programme.

Trainees join our industry through a 12 month trainee scheme that can sit alongside firms' existing programmes. They participate in centrally-organised training, development and networking with other trainees from across the industry.

Investment20/20's careers and talent strategy facilitates access to those from wider socio economic, ethnic and subject backgrounds encouraging an open and diverse culture. Working with over 3,700 schools, colleges and universities, they reach, inspire and attract school and college leavers, and graduates, who had not previously considered a career within investment management.

Over 40 investment management firms participate in Investment20/20 and 75% of trainees are offered a permanent role at the end of their traineeship.

More work is still needed. A number of steps have recently been outlined in the IA report, *Closing the Gap: Addressing Gender Pay Gap*,[14] as well as *Black Voices*, which focuses on how we can build a more inclusive workplace for black people in investment management.[15]

IA TALENT AND D&I STRATEGY

The strategy sets out how it will support members to attract and develop people with the skills, knowledge and competencies the investment management industry needs. The strategy covers the career arc from entry point to c-suite and has been developed following extensive discussions with IA members about the skills needs of the industry now and in the future. It is structured around three key themes: attraction, advancement and environment with considerations around diversity and inclusion underpinning each one.

The strategy is designed to complement and support members' own internal talent strategies and focusses on those areas that will have greatest benefit for our members. The priorities identified in the strategy will provide the foundation for a programme of work for the next three years, and will be reviewed on an annual basis.

The IA has developed a Talent and Diversity and Inclusion (D&I) Strategy, which includes broader questions around skills needs. The next decade will likely see changes in the type of skills needed by the industry, especially in the area of technology, and in the nature of work and the workplace. A key challenge will be how to attract and retain staff and firms will need to be able to demonstrate they have a culture that appeals to those they wish to recruit and do business with.

The inability to use the Apprenticeship Levy as part of a talent strategy continues to be an issue for firms. The IA has set out how the current system can be used more successfully and has called on the government to repurpose the Levy to maximise the opportunities the Levy offers to promote productivity and raise talent levels within the investment management sector.

A HEALTHY CULTURE ALIGNED WITH CUSTOMER NEEDS: NEXT STEPS

- Industry-regulatory collaboration is important, through initiatives such as CutureSprint bringing together a range of experts from multi-disciplinary perspectives, exploring ideas and developing solutions to challenges.
- The industry is driving a range of inclusion initiatives, including Investment20/20, and working with firms to help translate regulatory policy on culture and diversity into practice. One key output will be a flexible culture toolkit that will provide practical steps to consider in order to secure, develop, and maintain a healthy culture.
- Supporting home-grown talent remains an important priority. Alongside operationalisation of the IA Talent Strategy, the industry and government should run a pilot scheme funded by the Apprenticeship Levy enabling the IA to offer a pooled and more agile approach to the provision of apprenticeships.

[14] https://www.theia.org/sites/default/files/2019-04/20190327-genderpaygapreport.pdf
[15] https://www.theia.org/sites/default/files/2019-06/20190611-blackvoices.pdf. Black Voices outlines ten positive ideas to foster better practices in many workplaces not just in investment management.

A MORE ACCESSIBLE FORM OF COMMUNICATING TO ENGAGE AND SUPPORT CUSTOMERS

The shift from DB to DC pension provision internationally, especially when combined with automatic enrolment, is taking the investment management industry beyond traditional customer groups in the institutional and retail markets, and creates a number of distinct challenges in terms of public accessibility and confidence:

- For many individual savers, the investment management industry is still something of a 'black box', both in terms of the product set provided by firms and how the industry is differentiated from other parts of financial services, notably banks and insurance companies. This holds true, even in jurisdictions such as the United States and Australia, often cited as successful examples of engagement and effective individual decision-making.

- In an environment where direct customer engagement with product literature is already low, disclosure initiatives have an uphill battle for impact and may be difficult to engineer effectively. In seeking to provide customers with a way to compare different kinds of product, the experience with the EU Packaged Retail and Insurance-based Investment Product (PRIIPs) Key Information Document (KID) has clearly illustrated the challenges of accessible disclosure. The risks in getting customer disclosure wrong are not just risks of misleading customers, but of missing an opportunity to explore new ways to foster greater levels of engagement.

- Perceptions of financial services are also negatively impacted by the wider socio-economic context, with trust at low levels in the UK and a number of other European countries in the aftermath of the 2008 Global Financial Crisis. Internationally, the picture is very mixed with opinion in parts of the developing world, notably India and China, far more positively disposed towards financial services than in Europe or North America.[16]

In the United Kingdom, both industry and regulators are taking action to improve communication with customers and potential customers:

- In the investment fund universe, the FCA has called for much greater clarity around objectives, delivery and cost. The IA has responded through a collaboration with the Wisdom Council designed to encourage firms to use a different vocabulary within fund disclosure. Based on customer testing, the intention has been to help shape a change in mind set about the use of language across the industry rather than lay down prescriptive rules.[17]

- The industry continues to work closely with regulators, intermediaries and other stakeholders across the market to ensure that charges and costs are transparent and consistent. The latest project, the Cost Transparency Initiative (CTI) in partnership with the Pensions and Lifetime Savings Association (PLSA) and Local Government Association (LGA), will deliver an institutional disclosure framework designed by the FCA's Institutional Disclosure Working Group.

- There is also a focus on disclosure in the area of sustainable investment and stewardship (see p.16), which will likely broaden over time to include impact reporting. A key current focus of regulators in the area of stewardship is requiring investment managers to disclose more on activities and outcomes in order to demonstrate the impact on investee companies and ultimately the benefit which clients and end beneficiaries receive from such work.

- At a broader level, The IA is undertaking extensive customer research to map wider public attitudes to investment to facilitate better communication and understanding.

While this policy paper specifically considers communication in the context of investment management, the broader advice and guidance framework is critical in helping retail customers to make good decisions and achieve good outcomes. Ensuring a healthy and informed long-term savings and pensions culture, with access to high quality advice and guidance, is clearly a shared objective for financial services providers across the spectrum.

[16] 2018 Edelman Trust Barometer Financial Services Edition, p.23 https://www.edelman.com/sites/g/files/aatuss191/files/2018-10/Edelman_Trust_Barometer_Financial_Services_2018.pdf

[17] https://www.thewisdomcouncil.com/recent-work-with-the-investment-association/

How to get disclosure right?

There are actions for industry, government and regulators in seeking to get disclosure frameworks right. The following priorities are critical:

- **Customer testing** should, as far as possible, inform all positions taken on how to communicate effectively. This can be challenging for industry and regulators, both in terms of timelines and identifying appropriate testing points as policy and processes evolve. In the context of digitalisation, there is a significant opportunity for industry and regulators to do more in this area, ideally collaboratively.

- Regulators and industry should move away from paper-based presentation formats and **develop a clear digital disclosure agenda**. New product initiatives, for example the Pan-European Personal Pension, which has no legacy framework, could help to redefine disclosure for the next generation. This may require a focus on core components (e.g. costs and charges, risk presentation) rather than overall design, such that providers can incorporate critical information into proprietary delivery formats, including apps.

- We are still in the foothills of working to **apply behavioural insights** to help achieve better customer outcomes. Policymakers, regulators and industry are increasingly aware of the disconnect between traditional assumptions and actual customer behaviour. The disclosure debate is still frequently framed around the concept of savers acting on a wide range of data points about key aspects of a potential – or actual – purchase. More needs to be done to combine better transparency with tools to facilitate better decision-making.

- Disclosure can be a process whereby customers will dig down through different layers of products, including pensions, where there is often inconsistent and sometimes obscure information. There is a strong need to take stock of the multiple layers and **establish how best to communicate consistently** in a way that informs and protects.

A MORE ACCESSIBLE FORM OF COMMUNICATING TO ENGAGE AND SUPPORT CUSTOMERS: NEXT STEPS

- The industry focus on enhanced transparency and clarity of communication in all areas of activity will continue. Alongside the current emphasis on cost disclosure and more accessible language, specific thematic areas will include stewardship activity and the sustainability agenda.

- There is an opportunity for regulators and industry to consider in more detail how current communication and disclosure frameworks can evolve most effectively across four key themes:

  - Establishing customer testing as a norm
  - Building a digital disclosure agenda as access to information and purchasing decisions change
  - Greater use of insights from behavioural economics to help decision-making
  - Ensuring greater consistency between overlapping areas of regulation

- These building blocks complement important wider priorities on access to advice, support and education. Customers must have access to high quality advice and broader guidance as they face ever more demanding lifetime savings and investment decisions.

A POLICY AND REGULATORY ENVIRONMENT THAT SUPPORTS INNOVATION AND INTERNATIONAL COMPETITIVENESS

A key element of the attractiveness of the UK as a place to do business is the operating environment (see p.14), which has contributed not just to the growth of the investment management industry in the UK, but the broader success of financial services. Historically, this success was part accident, part design. Major reform in the 1980s put in place the conditions for modernisation and a sharp increase in internationalisation drove a virtuous cycle of evolution and reinforcement for the UK financial services cluster, together with related professional support services.

From a 2019 perspective, it is regulatory evolution, not revolution, which is necessary. In particular, we suggest that UK regulators should have an additional remit which recognises the importance of global innovation and competitiveness. This is justified for several reasons:

- Patterns of domestic and international demand are aligning in ways that mean that UK customers will benefit from a regulatory perspective that specifically looks to international practice, and maintains a domestic regime that is attractive to world-leading firms. The right domestic environment will encourage international firms to build new bases here or expand existing capacity. In the process, they will import their own experience and skills, further strengthening a centre of excellence that will serve the UK industry's domestic customers as well as its international customers through exports of products and services.

- The broader UK economy will benefit from a vibrant financial services industry, which can continue to contribute substantially both in terms of direct and indirect employment and tax paid.

- There is a narrowing gap between the UK and other regional centres, notably in Asia. Over the past ten years, a key finding of the Global Financial Centres Index (GFCI) is that New York and London are no longer as pre-eminent as they once were in relation to Hong Kong, Singapore and Shanghai.[18]

In contrast to the FSA remit, the FCA has no formal reference to international competitiveness. This could be introduced by drawing on existing concepts within the Financial Services and Markets Act (FSMA), namely Article 300A. This ensures that regulators take account of both the "global character of financial services and markets and the international mobility of activity" and "the desirability of facilitating innovation." In practice, significant elements of FCA activity already recognise both these factors. Notably, the FCA Innovate initiative and the new firm authorisation hub have been welcomed by the industry.

Over time, we expect that UK customers will benefit from this changed FCA remit, with no threat to standards of customer protection. Momentum would be strengthened by a more formal recognition of the importance of this area, meaning that the FCA process, and reporting of that process, will incorporate the international dimension.

This will become especially important post-Brexit as the UK seeks to position itself as a financial centre outside the EU. In effect, the proposals above will constitute one measure of the UK's international success that could also be applied by policymakers to the broader UK business environment.

This regulatory evolution should be accompanied by a framework for enduring policy commitment that makes the HMT Asset Management Taskforce, or a version of it, permanent. From the international competitiveness perspective, one standing item on the agenda would be a joint government-industry-regulatory promotion strategy for the UK industry.

[18] GFCI is published by Z/Yen in partnership with the China Development Institute. The latest report was published in March 2019 and is available at www.zyen.com

From a domestic perspective, a forum would exist for the most senior level discussions of areas that are increasingly important for government: stewardship, sustainable investment, patient capital, pensions and savings policy.

At a broader level, rising international trade tensions and risks of protectionism are a reminder of the need for the UK to remain a champion of the kind of open, global capital markets which have enabled the success of the UK as a financial services center, and deliver benefits for customers around the world.

A POLICY AND REGULATORY ENVIRONMENT THAT SUPPORTS INNOVATION AND INTERNATIONAL COMPETITIVENESS: NEXT STEPS

As the UK prepares for the post-Brexit regulatory landscape, there are significant debates ahead with respect to future direction. In the context of themes covered in this paper, we propose two measures which constitute a recognition of the synergies and strength that come from the dual focus on domestic and international competitiveness:

- A future FCA remit should include an emphasis on the importance both of the global competitive context and the need to facilitate innovation.

- The HMT Asset Management Taskforce should be made permanent, to provide a high level forum for government, regulators and industry to exchange views on both domestic delivery and international competitiveness. Alongside this, we recommend a working-level industry regulatory forum specifically focused on investment funds.

THE WAY FORWARD

Working in partnership with government, regulators and other stakeholders, the strong foundations of the UK as a world-leading investment management centre can be developed further. Across the six key areas explored in Part Two of this paper, we have set out a range of necessary and achievable actions, building on existing momentum.

While these actions would still be important in an environment without Brexit, the need to prepare and adapt to the new reality of the UK's European and world position gives additional impetus to the debate on international competitiveness.

We will be issuing further updates on the industry initiatives through the remainder of 2019 and into 2020. We look forward to taking this agenda forward and ensuring good outcomes for the most important group of all: our customers.

THE
INVESTMENT
ASSOCIATION

The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL

www.theia.org
@InvAssoc

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