2 EMERGING FROM THE PANDEMIC: KEY THEMES FOR THE UK INDUSTRY

KEY FINDINGS

Our analysis sets out five key themes that are shaping investment management industry activity both in the UK and internationally.

1. INVESTING RESPONSIBLY AND SUSTAINABLY

- Responsible investment has seen significant growth in 2020, with the Covid crisis providing further impetus in this area. Data collected based on the IA's framework illustrates that almost half (49%) of the £9.4 trillion in assets were integrating ESG in their investment processes in 2020, up from the 37% reported in last year's report. Assets managed within sustainability focused strategies have more than doubled, albeit from a much smaller base, to 2.6% of industry assets.
- Investment managers recognise they are to play an important role in the global initiative for a transition to net zero emissions and have published seven industry commitments to realise this ambition.
- As part of these commitments, there are industry-wide efforts underway to develop a consistent set of definitions and classifications around RI products with a view to improving disclosure and customer understanding of a rapidly-evolving product set.

2. WIDENING SOURCES OF INVESTMENT RETURN

- Interest in private markets has grown in the last few years, driven both by the growth of market-based finance outside public markets and by investors looking to further diversify their investment portfolios.
- Proposals for a new fund structure in the UK, with wide investment powers and the ability to use long notice periods, aims to give DC pension and retail investors broader access to illiquid assets. This will also help to address broader regulatory concerns about liquidity mismatch in investment funds, which have been wider expressed in the aftermath of the market experience during the first months of the Covid crisis in 2020.

3. TRANSFORMING THE OPERATING CULTURE

- IA member firms remain committed to embedding an operating culture within firms that ensures the delivery of good outcomes for customers. This combines a focus on oversight, communication and transparency with an accelerating priority to ensure Diversity and inclusion (D&I) and wider cultural issues are addressed.
- D&I has been a high priority theme for the industry for a number of years, but the pandemic has focused firms' minds on the issue even further. Firms are increasingly looking beyond gender diversity and adopting a more holistic approach which looks at the intersectionality of different aspects of a person's identity.
- A primary focus emerging as a result of the pandemic is around staff mental health and wellbeing. Core to the discussions on the future world of work is how to establish this as a longer-term component of firm culture moving forward.

4. EMBRACING TECHNOLOGICAL CHANGE

- Remote working has accelerated the adoption of, and investment in, new technology across the industry at every level, including idea generation, investment operations and fund delivery. Some firms are focusing on utilising technology for mass customisation while others have developed innovative ways to communicate with customers.
- A recent IA roundtable discussion with financial advisers, investment platforms, and fund research houses highlighted the importance of technology and digital delivery in engaging a new generation of investors. One particular area of focus is the need to promote trust in the industry in order to persuade younger generations to embrace fund management, building on an evident interest in trading and cryptocurrency among many.

5. ADAPTING TO THE POST-BREXIT LANDSCAPE

- The UK investment management industry is adapting to a new post-Brexit environment and remains vigilant to the potential threats to UK competitiveness regarding the future treatment of delegation and the appropriate balance between convergence and divergence with EU regulation and international standards, more broadly.
- Looking ahead, the industry has outlined three key elements to maintain a competitive landscape for fund delivery internationally: opportunities for innovation, improving the operating environment, and support for competitive delivery.

This chapter provides a broad overview of the key wider themes shaping current industry activity in the UK. In most cases, they are also highly relevant internationally. We provide further commentary and data on some of the areas - eg. responsible and sustainable investment - in other parts of the report. As always, our analysis is intended to identify the areas of overriding importance, rather than provide a comprehensive account of the broader environment.

LOOKING AHEAD FROM THE 2020 CRISIS

As the global pandemic accelerated through 2020, resilience was a critical theme for the industry and featured heavily in last year's report. Firms we spoke to this year for our Survey emphasise that the investment management industry in the UK and internationally was able to adapt very quickly to the unprecedented challenges, both from an operational and investment perspective. Certainly, there are lessons to learn, but overall firms stress the speed of adaptation, level of staff commitment and extent of continuity in customer delivery. There is also clear acknowledgement of the important role played by policymakers, both on the fiscal and monetary side.

"I know our industry is often portrayed as though we put our interests in front of our clients, but we have learned during this process that everybody went the extra mile, the extra hour, stayed late, started early in order to ensure that the client got the good outcome."

"The robustness and resilience of people, systems and firms came to the fore. The other lesson was how the policy response was very coordinated and very effective. Whether it was central banks cutting rates or the Treasury organising the furlough scheme, using fiscal and monetary weaponry at their disposal to sustain the economy until we get back onto a more even keel was helpful."

FIGURE 6: DEFINING INDUSTRY THEMES 2020-2021

How does the industry **deliver for customers**...

and for the **wider economy and society**...

in an **exceptionally challenging operating environment**?

Five defining themes for the industry in the UK and internationally

1. **Investing responsibly and sustainably** in a policy context characterised both by accelerating concern about the environment and an evolving social agenda that is challenging political and economic orthodoxies.
2. **Widening sources of investment return**, providing greater access to private markets and additional funding for economic growth.
3. **Transforming the operating culture** both in terms of customer delivery (alignment, transparency and value) and the future world of work, with a particular emphasis on diversity and inclusion.
4. **Embracing technological change** at all levels of delivery: product evolution; distribution and operations.
5. **Adapting to the post-Brexit landscape** both in terms of continuity of delivery and the future competitiveness of the UK.

In the summer of 2021 amid positive signs of stabilisation in the pandemic and international economies, we focus particularly on five themes as outlined in Figure 6. None of these are new and have been clearly flagged in previous editions of the Investment Management Survey. However, the salience of some of the themes has clearly increased as a result of the Covid-19 experience. For example, the pandemic has provided a unique opportunity to accelerate the 'transition' to a green economy, while the 'future world of work' brings together themes around both culture and technology.

"As we reflect on the Covid-19 period in the summer of 2021, there are differences with previous crises. The focus on "building back better" signals that there has been a shift in terms of sustainability considerations. There is also a clear pivot [by the Government] towards the investment management industry as we come out of the crisis and look to rebuild the economy."

At the same time, the UK industry continues its adaptation to what is now a post-Brexit environment following the end of the transition process in December 2020, and there is close engagement with the UK competitiveness and regulatory reform agenda. This in turn creates an important set of challenges and opportunities, notably:

- The ongoing importance of maintaining delegation[12] as an organising principle for the delivery of products and services.
- The appropriate balance between convergence and divergence with EU regulation and more broadly, international standards.
- The future shape of the UK regulatory architecture to ensure both effective domestic delivery and facilitate international competitiveness.
- The scope for the UK to develop further as an investment and fund management export centre.

Putting all of this together, firms are facing an intensely demanding change process on multiple levels, and this is resulting in some concern about the scale of regulatory activity. There is an elevated risk for firms – particularly small firms – that they will not be able to digest in the near term all the issues that will affect their businesses and customers in the long-term.

"With so much change happening at the moment, there is a real challenge that firms simply cannot fully engage to discuss the issues and their implications. We are long-term investors, so I worry about that."

WIDER ISSUES

On the investment and macro-economic side, the return of inflation is a key theme as firms and their clients digest the implications of both Covid-19 and the potential consequences of recent monetary and fiscal policy. Views among those in the investment management industry differ on the extent and duration of any inflationary threat, reflecting the range of opinions seen in the broader economic debate. To some extent, there is an echo of the period ten years ago when quantitative easing and low rates after the Global Financial Crisis led to concern about the potential for rising prices. The other ongoing theme is the 'hunt for yield' as rates have been pushed down further again through Covid-19. As we explore in other sections of the report, this is one factor helping to drive allocation decisions towards private markets. Our analysis of the UK fund market in Chapter 5 offers a detailed look at retail investor behaviour in the context of current economic uncertainty.

[12] The ability to delegate portfolio management is a long-established international norm, which is essential to the efficient functioning of the EU's AIF market, and the investment industry more broadly. It allows savers to access global expertise and investment opportunities, whilst benefitting from increased choice and high levels of investor protection due to strict adherence to EU rules, oversight, and supervision.

1: INVESTING RESPONSIBLY AND SUSTAINABLY

We observed last year that initial expectations that responsible investment (RI) and sustainability commitments might take a backseat in the context of the Covid-19 economic dislocation have been proved wrong. As Chapter 5 shows in more detail, sales to RI funds through the crisis have in fact accelerated significantly. Firms have emphasised a strong interest both in the investment themes themselves and performance. There has also been a rise in expectations with respect to the sustainability credentials of investment management firms delivering RI products, particularly with significant new regulation coming into force. The pace of change will intensify as the government outlines sector-specific pathways to help the wider economy achieve net zero emissions targets.

"A big trend has been the uptick in the interest in ESG, including on behalf of individuals because Covid-19 has really brought the E and the S to the fore. The end investor is starting to think more about how they want their own values reflected in their portfolios and want to choose accordingly. So, they're starting to look for portfolios that are managed towards environmental goals or social goals, but they are also increasingly looking at how the firms that are managing their portfolios are doing with respect to ESG."

"We have been able to prove through the data that the companies that have done best financially are those with the best ESG scores across all areas. It is good to see this correlation, especially as it reinforces areas of citizenship and stewardship."

SIZING THE MARKET FOR RESPONSIBLE INVESTMENT

The data presented below is based on the IA's Responsible Investment Framework which was published in 2019. This data comprises assets subject to both firm level and individual fund or mandate level responsible investment approaches. There is often an overlap with firms using a combination of approaches outlined in the framework. Chart 5 shows that the majority (77%) of industry assets are subject to stewardship activity. Oversight goes beyond just voting, and as such, the 77% figure is not restricted to equities and includes holdings across asset classes. ESG integration stood at 49% in 2020, up from 37% in 2019.

Although starting from a low base, assets within sustainability focused strategies have almost doubled from 1.4% of industry AUM to 2.6%. As we will discuss below, the environmental sustainability agenda has come into sharp focus in 2020 and firms are adjusting to large scale regulatory changes which centre on meeting ambitious net zero targets. Impact investing remains a very niche area of investment with a small number of firms managing impact investment strategies. Total assets in impact investment strategies represent just 0.5% of industry assets. Assets subject to exclusions also increased in 2020, reaching a quarter (25%) of AUM, up from 18% in 2019.

CHART 5: PROPORTION OF ASSETS UNDER MANAGEMENT BY RESPONSIBLE INVESTMENT CATEGORY (2020)

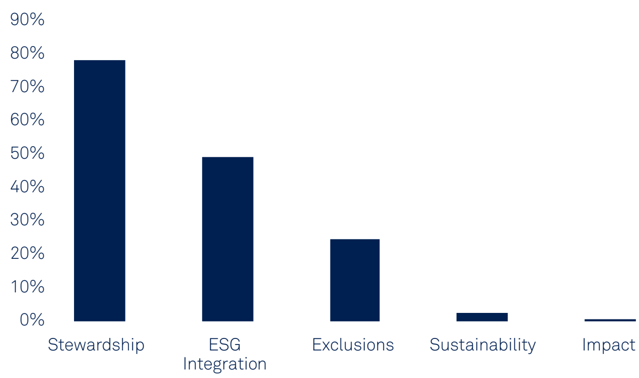

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TABLE 3: DEFINITIONS BASED ON IA RESPONSIBLE INVESTMENT FRAMEWORK

Category	Definition
ESG Integration	The systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions. ESG Integration alone does not prohibit any investments. Such strategies could invest in any business, sector or geography as long as the ESG risks of such investments are identified and taken into account.
Exclusions	Exclusions prohibit certain investments from a firm, fund or portfolio. Exclusions may be applied on a variety of issues, including to align with client expectations. They may be applied at the level of Sector, Business activity, products or revenue stream, A company or Jurisdictions/countries. Exclusions determine that a fund or mandate does NOT invest in certain things. It does not constitute an approach that is characterised by proactively allocating capital to specific assets. It may involve excluding investments from a certain sector or investments that derive a portion of their income from the sale of certain specified products.
Impact Investing	Investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. There are four key elements: 1. Intentionality: Impact investments intentionally contribute to social and environmental solutions. This differentiates them from other strategies such as ESG investing, Responsible Investing, and screening strategies. 2. Financial Returns: Impact investments seek a financial return on capital that can range from below market rate to risk-adjusted market rate. This distinguishes them from philanthropy. 3. Range of Asset Classes: Impact investments can be made across asset classes. 4. Impact Measurement: A hallmark of impact investing is the commitment of the investor to measure and report the social and environmental performance of underlying investments.
Stewardship	The responsible allocation, management, and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.
Sustainability Focused	Investment approaches that select and include investments on the basis of their fulfilling certain sustainability criteria and/or delivering on specific and measurable sustainability outcome(s). Investments are chosen on the basis of their economic activities (what they produce/what services they deliver) and on their business conduct (how they deliver their products and services).

RISING IMPORTANCE OF CLIMATE CHANGE AND GREEN AGENDA

With respect to the environment, climate change is clearly a predominant concern and the transition to net zero is an initiative supported by governments globally. IA members have made significant corporate commitments to net zero but also recognise that as investment managers, they can play an important role in supporting companies that are currently large-scale emitters in the transition to becoming carbon neutral.

As we move along the path to achieving net zero, the role of investment managers as agents of change in pushing firms to reduce emissions should not be understated. Divesting too quickly from companies with high emissions risks leaving these assets stranded and there is a significant opportunity to invest in companies to support transition and to cement the UK's position as a leader on climate change.

Clear guidance on the nature and speed of the UK's transition to net zero from the government will help the investment management industry to focus on the sector-specific actions necessary to achieve these ambitious targets. The industry is keen to work with policymakers to identify clear pathways to transition for different sectors of the economy and help tackle the gaps between the intention and delivery of the Paris Agreement goals. An appropriate level of detail in these sector-specific pathways will enable companies in all sectors to better understand the trade and investment risks and opportunities which follow from the transition to a low-carbon economy.

In 2020, the IA published an industry climate change position which committed to take action alongside government, businesses, and our clients to realise the ambition of reaching net zero emissions by 2050. The document contained a number of policy commitments by industry, as set out in Table 4, alongside a series of asks of policymakers.[13]

TABLE 4: SEVEN INDUSTRY COMMITMENTS SET OUT IN THE IA CLIMATE CHANGE POSITION 2020

1	Engagement with investee companies on climate- related disclosures	We commit to helping our members to continue to engage with listed companies to improve the quality of climate-related disclosures and to support companies to make an orderly transition.
2	Collaboration with pension fund clients to help them meet their climate-related disclosure requirements	IA members commit to working with their pension fund clients to help them meet their own climate-related disclosure requirements. This includes helping them find solutions to issues on data quality and consistency, including in relation to standardisation efforts and accessibility of data and information.
3	Development of investment managers' TCFD disclosures	The IA will support its members in developing a full set of Task Force on Climate-Related Financial Disclosures (TCFD) at entity level in the 2021/22 reporting round.
4	Support for the improvement of sustainability-related disclosures at fund-level	The IA is committed to supporting its members to improve their sustainability-related disclosures at fund level, finding the best way forward for clients at present, considering the practical implications of providing disclosures that are decision-useful to investors, and based on robust investment data.
5	Link with advanced initiatives to support Disclosure of Paris-Alignment of Portfolios	The IA is convening representatives of initiatives that have progressed work on Paris-alignment methodologies to date in order to identify where the industry can learn from, build on and develop work already undertaken.
6	Support for the FCA-PRA Climate Financial Risk Forum work	The IA continues to actively support the work of the joint FCA-PRA Climate Financial Risk Forum (CFRF) and is committed to sharing knowledge from the CFRF Handbook with our membership and building on its work to date.
7	Support the creation of investable opportunities	We are committed to working together with UK government to create the investable opportunities necessary for the Transition.

[13] Investment Association Position Paper on Climate Change, 2020.

With the UK hosting the COP26 climate summit in November 2021, the industry has closely engaged through 2021 in building momentum in this area.

This has included initiatives to improve company reporting on the climate-related risks they face and to achieve a more coherent and co-ordinated global approach to sustainability-related disclosures. Specifically, the industry is asking for global support of the IFRS Sustainability Standards Board; commitment to implementing mandatory economy wide TCFD reporting; developing common standards on green gilts; and setting out high level sector specific pathways. Ahead of the G7 summit in summer 2021 the industry asked that G7 countries do more to improve sustainability-related disclosures by businesses and investors while ensuring a coordinated global approach.

As the UK government continued its commitment to sovereign green gilts, the industry has set out the features that it would like to see to meet both the needs of those investing in green gilts and the government's funding needs. These focus on seven areas in particular:

- **Strict use of proceeds:** legal documentation for green gilts should explicitly note how the proceeds are used to ensure that financing goes to projects aiming to achieve an environmental and social benefit.

- **Medium to long dated:** green gilts should be medium-long dated, matching the likely timelines of the projects they are invested in. This would also allow investment managers, such as those managing pension funds, to meet the long-term investment needs of their customers.

- **Forward-looking:** gilts should be forward-looking, providing a long-term financing path for future projects.

- **Social impact element:** investment managers support the integration of a social investment element into the green gilt, with funding for environmental projects with social co-benefits. The integration of social impact investing would demonstrate the UK to be a world leader on social and environmental financing.

- **Use of an audit committee:** in line with the ICMA Green Bonds Principles, the government should set out their sustainability objectives, the process for determining eligible projects, the eligibility criteria covering any exclusions and the process for environmental and social risk due diligence. Scrutiny of this process should be carried out by an Audit Committee consisting of market and government representatives.

- **Mandatory verification:** The IA expects verification of green gilts to be mandatory, in line with the requirements of market standards such as the Climate Bond Standard and proposed EU Green Bond Standard.

- **Reporting:** The Government should report annually on allocation of proceeds as well as the impact of investment.[14]

Early in July 2021, the IA was announced as the first supporting partner to the Net Zero Asset Managers initiative (NZAM), along with the latest round of signatories. From a standing start in December 2020, IA member firms with AUM of more than £6.1 trillion (two-thirds of UK AUM) have now signed up to the NZAM. This is a significant commitment to support the goal of net zero emissions by 2050.

IMPROVING DISCLOSURE

With respect to the disclosure agenda, a key sub-theme this year has been the ongoing need for greater clarity around definitions and classifications as the industry, its distributors and customers grapple with the challenges of agreeing on a shared language and set of definitions around RI products. In practical terms, this is playing out in two immediate contexts for UK firms:

- Across the EU, implementation of the Sustainable Finance Disclosure Regulation (SFDR) is raising questions on how funds are classified according to the Article 6, 8 and 9 requirements.[15] Many UK firms and global firms with major UK operational centres have cross-border European business and therefore remain heavily affected by SFDR post-Brexit.

[14] IA Position on Green Gilts, 2021.
[15] EU regulation on sustainabilityrelated disclosures in the financial services sector was published 27 November 2019. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN

- In the UK, the Government has set out an expectation that it will develop a Sustainability Disclosures Requirements (SDR) framework. This will include a new sustainable investment label that will sit alongside the FCA Principles on design, delivery and disclosure of ESG and sustainable investment funds, published in summer 2021. These focus on both disclosure and the alignment of process and disclosure, and were accompanied by a strong message to the UK industry from the regulator about the importance of getting this area right for retail investors.

There is also the separate but related question of specific incoming requirements for reporting on key climate metrics across the investment value chain through the Task Force on Climate-Related Financial Disclosures (TCFD). TCFD will start to be implemented for UK pension schemes from October 2021 and investment managers from January 2022.

As pension schemes invest in assets globally, international adoption of TCFD would be the ideal outcome, as well as adoption across all asset classes and not just equities, so the full impact of portfolios is more accurately reported. This does not look likely in the near term given the variety of approaches currently being taken. However, the impending launch of an International Sustainability Standards Board in the run-up to COP26 may prove critical in the establishment of global reporting standards over the longer term.

“Our hope is that we have a consistent set of disclosures globally to help level the playing field so, for example, you could more easily compare an American cement manufacturer in Iowa with one based in mainland China. A more level playing field should lead to better-informed decision making, which is our priority when it comes to investing on behalf of clients.”

FINANCE AND NON-FINANCIAL OBJECTIVES

One of the key definitional distinctions, seen in Article 9 of SFDR as well as classification systems such as the IA Responsible Investment Framework, is between those strategies aiming to make a non-financial impact and those incorporating different forms of sustainable and responsible investment criteria within what is effectively a financial objective.

“I think investors are going to care more and more about what their money is doing. I am also going to call it the impact their money is making, on ESG factors as well as financial. I think you will not see a shift towards impact funds only, funds that particularly care about the impact they are making, but I do think that managers are going to have to start managing money to two metrics: financial returns and the impact they are making on ESG factors.”

This raises a series of significant decision points for both customers and investment managers about the appropriate balance between these financial and non-financial objectives, particularly as they are likely to cross over in several areas. This again highlights the importance both of disclosure but also demonstrable clarity of process. Extensive further work on this across the industry is expected in the coming year.

2: WIDENING SOURCES OF INVESTMENT RETURN

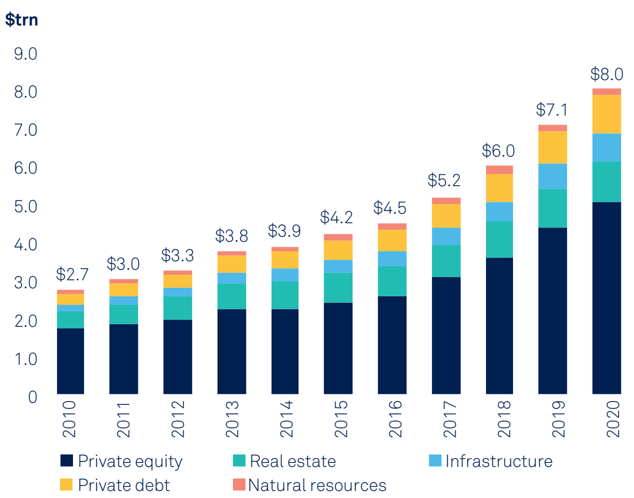
A closely linked theme to responsible and sustainable investment is the way in which investment managers deploy capital across the economy. This is reflected in an increasingly wide-ranging debate about the role of public and private markets. Over the past year, two key themes have emerged at the centre of the debate:

- How capital can be deployed more effectively into private markets on behalf of retail and DC pension customers.
- The relationship between private and public markets, including the role of special purpose acquisition companies (SPACs) and corporate governance standards more broadly.

CONTINUED GROWTH OF PRIVATE MARKETS

Over the past decade, growth in private markets has been a highly significant feature of international capital markets. Chart 6 shows AUM at global level, with assets almost doubling in the five years since 2015 from £4.2 to £8.0 trillion.

CHART 6: GLOBAL ASSETS UNDER MANAGEMENT IN PRIVATE MARKETS (2010-2020)



Source: Preqin

Private market growth has been driven by both supply and demand related factors. On the supply side, there is increasing interest in market-based finance – especially its role in helping to re-build economic and social infrastructure following the pandemic. However, there is a decreasing rate of companies being publicly listed, which has pushed private markets to the fore. Private market finance also appeals to corporates that have concerns over what they see as the complexification of public markets.

Meanwhile, demand is being driven by investors searching for opportunities to further diversify investment portfolios and seeking to achieve solid, long-term returns. Persistently low interest rates have caused bond yields to fall, causing investors to search for different sources of yield, including through private markets. Private markets have long presented an attractive source of investment opportunity for pension schemes and other institutional customers interested in diversified sources of return and income. However, private markets assets can also be less liquid than their public market counterparts, which has restricted access for a broader group of investors. In both the UK and internationally, there is an intensifying debate about how to widen access to private markets, thereby 'democratising' participation.

ACCESSING ILLIQUID ASSETS

The debate over access to illiquid assets has resulted in a range of initiatives both in the UK and EU in recent years. At EU-level, the European Long-Term Investment Fund (ELTIF) was originally intended to allow participation for all types of investors, including retail. Introduced in 2015, the ELTIF is widely seen as requiring optimisation and a review is currently underway.

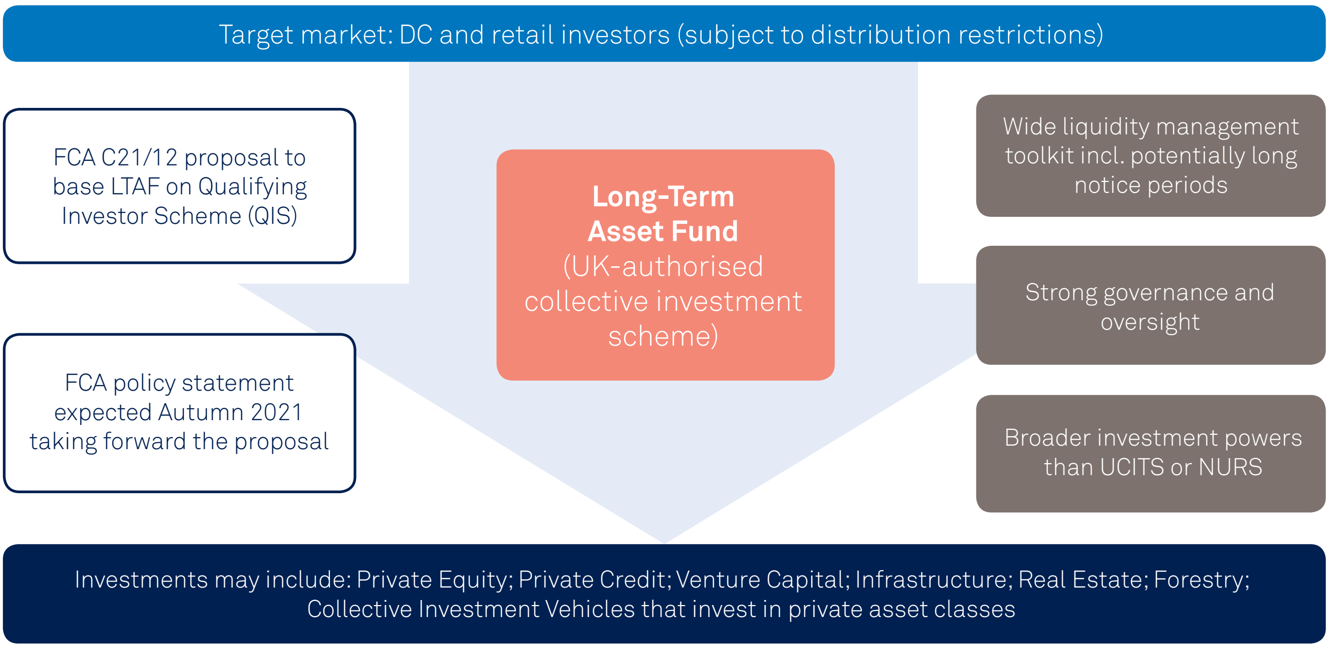
In the UK, a more recent debate has focused on how to facilitate greater access for DC and retail / private wealth investors to private markets. Almost all open-ended funds available to UK retail investors offer daily dealing and pricing, allowing investors to redeem units each day. If redemption requests rise, this can create a significant challenge for funds investing in less liquid assets and could lead to fund suspensions. The proposal for a Long-Term Asset Fund (LTAF) has been developed by the Asset Management Taskforce to provide a different type of fund structure using notice periods that offers wider access to illiquid assets, giving investors more choice.

This will create a broader market, with both LTAFs and closed-ended funds available. Not all investors wish to use listed closed-ended vehicles as their main access point for less liquid assets. At the same time, the LTAF can help to meet a wider policy goal to ensure that more market-based finance is available to fund both companies and infrastructure.

One of the key features of the LTAF is that rules around the buying and selling of units will be aligned to the liquidity of the underlying asset class that the units are invested in. LTAF units can only be sold at set intervals, for example every three or six months, rather than daily. This means that the investment manager has time to make enough cash available to meet the redemption requests, or in certain cases, to sell some assets at a reasonable price. The LTAF is currently subject to consultation by the FCA and is intended to enter into regulation by the end of 2021.

"The crisis has brought together industry, policymakers and wider stakeholders in a positive way. Having the Bank, FCA and Government all thinking about these things all in the same room is a positive thing. Retail investors' ability to save for their pension whilst providing perfect daily liquidity, fantastic returns and never losing money does not exist. So, it is far better to discuss the trade-offs, the relevant protections and the benefits of long-term investing."

FIGURE 7: LONG-TERM ASSET FUND

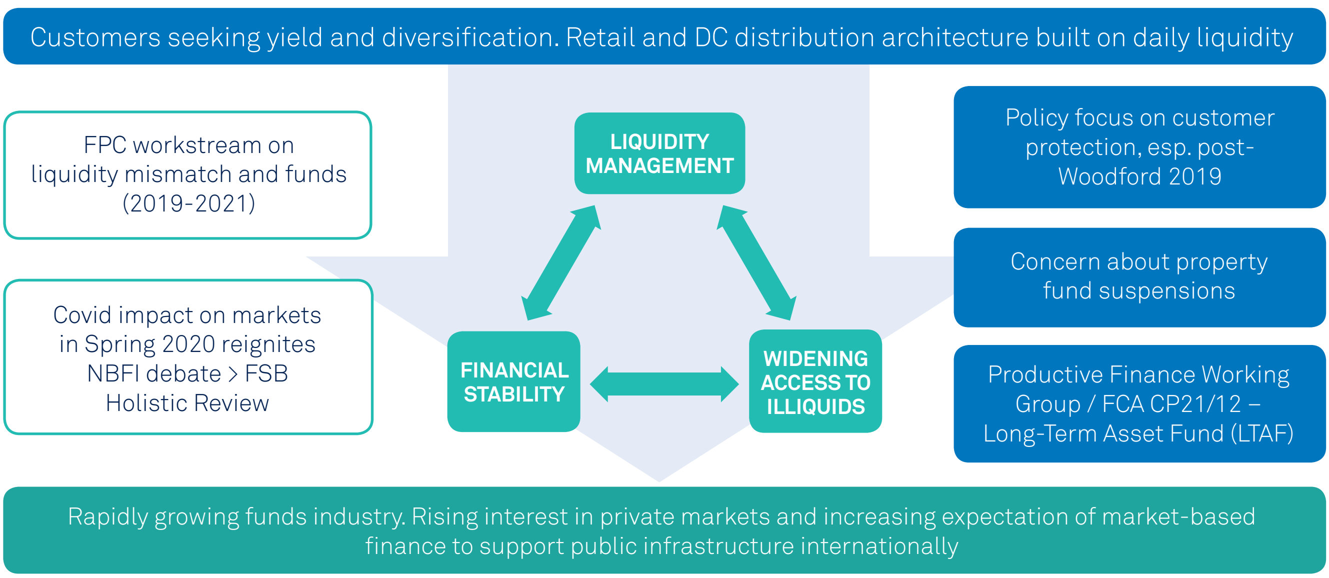


The financial stability debate has been re-ignited by the steep capital market falls in March 2020 causing policymakers to once again look for mechanisms to reduce 'run risk', or first mover advantage, at times of market turbulence. Although industry and regulatory viewpoints about the role of the investment management industry as a threat to financial stability differ in a number of respects, there is agreement on the benefits of seeking to better align the liquidity of underlying assets with the liquidity of the fund itself. Reducing the potential for liquidity mismatch is beneficial to customers and broader confidence in the funds market. The proposed use of notice periods in the LTAF will help to achieve this.

One key element in the LTAF discussion is the prevalence of operational structures that only support daily dealing in both the UK DC pensions and retail markets. As investment platforms gradually move to accommodate non-daily dealing funds, firms also point to the fact that the funds industry collectively – both manufacturers and distributors – has more to do on operational modernisation. On the other end of the spectrum from the LTAF, fund structures such as ETFs are free from the rigidity of a single daily price point and operate intra-day pricing. Different fund structures meet differing investor needs and a more flexible investment architecture is required as markets evolve.

"We all have to step back and say that a daily priced fund model in the context of artificial intelligence, tech changes and quantum computing is that it does not feel very 21st century. One way or another that model needs to move on, both in the sense of having more flexibility in terms of illiquidity and, on the flip side, a daily pricing point does not necessarily feel real time in terms of how markets on the other end work."

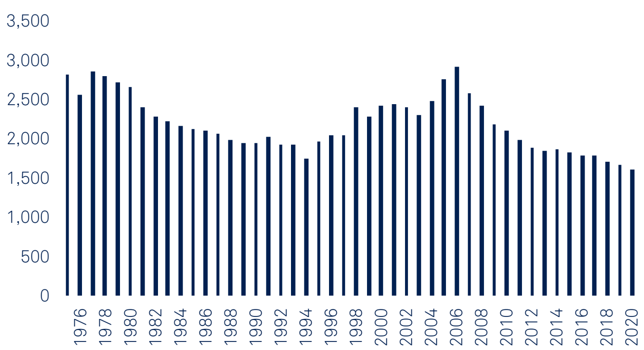
FIGURE 8: FUND LIQUIDITY, AN EVOLVING LANDSCAPE



BROADER ISSUES IN PUBLIC AND PRIVATE MARKETS

The decline in the number of listed public companies has been a distinguishing feature of the past decade internationally, alongside the rise in private market investment. Historic data show that by 2020, the total number of companies listed on UK markets was at its lowest level in almost five decades. However, there appears to be a cyclical dimension to this, with previous lows falling during the economic downturn of the mid-1990s followed by a long period of recovery in the number of listings. As is often the case with trends identified in this Survey, there are some questions about the extent to which we may be in another period of the cycle and the extent to which structural features are increasingly at work.

CHART 7: NUMBER OF COMPANIES LISTED ON UK MARKETS (1975-2020)



Source: World Bank, LSE

In recent years there have been concerted efforts to improve the governance and corporate reporting of private companies in the UK, which is especially important as asset owners are increasingly requesting greater exposure to private markets. A persisting challenge has been the asymmetric requirements on private and listed companies, which can disincentivise listing and hamper the competitiveness of the UK as a place to list. Policy makers are thereby tasked with balancing the flexibility permitted by the unlisted sector, with the need for large private companies to step up to increased expectations on corporate reporting, in line with their significance to the economy and wider society. That is why the IA has supported recent calls to extend TCFD and other corporate reporting requirements to large private companies, as without this there is a danger that the discrepancy between reporting and audit requirements for private and listed companies becomes too large to be bridged.

In November 2020, the *UK Listings Review*, chaired by Lord Hill, was launched by the UK Government, with the objective of strengthening the country's position as a leading global financial centre. The specific focus was to strengthen UK public markets. In March 2021, the Hill Report was published with 15 recommendations to improve the UK listing environment across seven themes:

- Monitoring and delivering results
- Improving the environment for companies to go public in London
- Re-designing the prospectus regime
- Tailoring information to meet investor needs better
- Empowering retail investors and improving capital raising for listed issuers
- Improving the efficiency of the listing process
- Wider financial ecosystem

Addressing these themes, and the wide range of issues they are comprised of, will require an increased commitment from government, regulators, and other stakeholders to provide resources and political support to attract new companies to list and operate in the UK and ensure that the advisory community is appropriately addressing potential demand.

Acting as a bridge between early stage, high growth companies and public capital, SPACs have the potential to support the wider listings eco-system. However, there have been very few SPAC listings in the UK, especially in comparison with other jurisdictions such as the US, where over $80 billion was raised in 2020. Recommendation 6 of the *UK Listing review* calls for a revision of the FCA's Listings Rules to ensure better investor protections and enhance the attractiveness of London as a listing destination. It is hoped that removing barriers to SPAC listings will increase the number of SPACs choosing to list in the UK, thereby providing a route to listing for high-growth UK companies.

Separately, two consultations were issued in summer 2021 taking forward individual recommendations from the Review:

- HM Treasury issued a *UK Prospectus Regime Review* – a consultation which outlines the government's proposals for overhauling the current prospectus regime.
- The FCA issued a consultation: *Primary Markets Effectiveness Review* which focuses on how primary markets can work more effectively for both companies and investors.

3. TRANSFORMING THE OPERATING CULTURE

The past five years have seen an increasing emphasis on culture, both by the FCA and within the industry. While this was initially concentrated on customer delivery – which remains a key focus – the pandemic has increased the attention being given to the change needed in internal operating norms. As part of the future world of work debate, a particular preoccupation for firms is now the urgency of ensuring a committed, energetic and holistic approach to Diversity and Inclusion (D&I).

"My personal belief is that if we do not learn anything from what has happened with flexible working and the advantage that it can have, particularly for diversity and inclusion [and] particularly for gender diversity, then we really will have missed a huge trick."

CUSTOMER DELIVERY

The focus on customer delivery, whether in the retail or institutional markets, has never been greater. For regulators, there is also a major focus on governance and communication in the wider context of an emphasis on good firm culture as the foundation.

The last three years have seen a number of changes for the industry that are designed to embed a culture within firms that supports good outcomes for customers. These include:

- Requirement for minimum levels of independent governance representation on authorised fund manager (AFM) boards.
- The introduction of the Senior Managers and Certification Regime (SMCR) for all authorised investment managers.

- Value assessment reports, published annually, which set out the AFM's assessment of how funds have delivered for customers according to a number of specific criteria. The first and second editions of the reports have been published through 2020-2021.
- Clearer communication in areas such as fund objectives, use of benchmarks and performance reporting.
- An institutional market cost reporting framework, operated on a pan-stakeholder basis through the Cost Transparency Initiative (CTI), and which is now increasingly established in the DB pensions market.

These changes, combined with wider commercial trends are already apparent in the UK and elsewhere, and are driving an increasing focus on fees and wider value.

FUTURE WORLD OF WORK

Culture clearly extends much more widely than products and services, and diversity and inclusion (D&I) is one of the themes that has come to the fore during the pandemic at a wider societal level. For the past few years, the investment management industry has been increasingly pro-active in recruitment practices, drawing on a number of industry-wide initiatives, most notably Investment20/20. However, Covid-19 has increased the urgency of the challenge and intensified the public spotlight on those parts of UK industry where D&I issues particularly need to be addressed.

"We are so far away from being able to declare victory, we will be carrying on with a massive focus on D&I for the next five years. We have diversity on the agenda in our ExCo meetings every month, so we are tracking every single programme."

There are mixed views within the industry about whether the working experience of Covid-19 for those who are already employed by investment management firms has been positive or negative for D&I. One view is that technology is, to some extent, a leveller, allowing staff to balance personal and professional responsibilities in a way that accommodates family life better than the demands of commuting.

"In some ways, conducting everything over Zoom has forced more equal processes. For example, everyone is in the room when they are on the screen in the same way. These are some of the things that we will seek to maintain when we are back in the office so that particular groups or particular people, such as those dialling in, will not feel at a disadvantage. We will all need to be very thoughtful about some of these hidden changes."

However, there are other views that some groups have been more heavily impacted through successive lockdowns and remote working environments, including those with caring responsibilities and young people with little experience in the workplace. For those with family responsibilities, juggling both personal and professional life, and maintaining some distinction between the two, can be challenging. For younger people, often living in more cramped accommodation, remote working can result in a lack of the kind of professional development and mentoring that office life can bring.

"We talk about inclusion but being a woman and having your kids at home was a challenge. I was a cook, a teacher, a cleaning lady and markets were crazy."

"We have been trying to focus on people who are joining the industry and how they are getting trained. It is really hard to learn on the job when you are remote. We opened up the office quite early and allowed people to come in, and I think that has been pretty helpful."

Perhaps the most important message to emerge from interviews and wider conversations is the need for significant further steps to tackle the challenge of diversity and inclusion across the investment management industry. The Covid-19 experience through 2020 dramatically brought wider societal issues to the fore, issues that in turn have had an impact upon the debate on the future world of work at industry level.

Firms emphasise the need to look at the full range of D&I issues, extending beyond gender into ethnicity and cognitive diversity and are increasingly looking at the significance of intersectionality (i.e. the extent to which aspects of a person's identity, such as gender, race, sexuality, class, might combine to create unique modes of discrimination and privilege). Ultimately, the question of ensuring a strong culture is seen as being able to move beyond individual sets of issues to an environment where all employees feel included.

"To me it is all about wanting to make sure that any person – irrespective of gender, sexual orientation, socio-economic background, or ethnic background – feels that they can join our organization and be successful. My one fear is that we are perhaps at risk of having so many subgroups that you lose sight of the bigger picture, which is really what you want. Everyone should just feel that they can be successful in all these organizations, and that we can attract the best talent."

A standout area of focus that has emerged as a result of the pandemic has been around staff mental health and wellbeing. Regardless of personal circumstances, prolonged periods of lockdown, isolated living and working conditions and increased blurring between working and non-working hours has had a universal impact on employees across the industry. Firms spoke extensively about the resilience of staff over the last eighteen months and the responsibility of firms to provide mental health support to employees that should be embedded in firm culture moving forward.

"The focus shifted pretty quickly to staff resilience and wellbeing. That theme is still with us, there is a huge focus on work-life balance. The word wellbeing is probably now established as one of the key features of mental health."

"The majority of people have found lockdown very challenging. We invested a lot of time and effort into ensuring our employees were safe and secure and that they could continue to do their jobs remotely. Where additional emotional support was required, we mobilised many resources in support of mental health."

4. EMBRACING TECHNOLOGICAL CHANGE

Technological transformation has been an area of focus within the industry for the last decade, but the Covid-19 pandemic emphasised how vital investment and adoption of new technologies is to the industry. This is partly the result of the shift to remote working, which has concentrated minds operationally on how firms themselves can best utilise technology to deliver for customers. It is also significantly driven by the acceleration of wider trends, including changing customer expectations, investor engagement and patterns of competition in the retail market where the nature of customer experience is evolving at an increasingly high speed.

"The pandemic has turbocharged the need to invest in technology, not just to support the operating environment but also for idea generation. Most people are now completely tech based and are less afraid of using technology in other ways to enhance the client experience."

IMMEDIATE IMPACT OF COVID-19 ON INDUSTRY OPERATIONS

In terms of internal implications, there is a sense that remote working as a result of the pandemic has helped shift staff perceptions, as well as accelerate the process of technological transformation in front, middle and back office. That transformation is expected to be seen at every level –from ideas generation through to investment operations and fund delivery.

"Our employees have all had to become more tech friendly. People are increasingly using technology in the investment process versus the traditional/non-tech way of evaluating securities in active management. We have made a lot of changes in investment management but that trend is definitely being accelerated. If you are an analyst working at home, with so much information coming at you, you need technology to help filter out the noise and focus on your research."

At the level of fund operations, one of the most immediate consequences for the industry has been the relaxation of requirements around documentation concerning instructions from investors, moving away from existing practice on use of wet signatures. This is expected to drive broader customer expectations (discussed further below) about the industry's wider digital delivery footprint.

A number of transitory issues faced by the industry, such as site visits for those with oversight responsibilities (e.g. depositaries) and valuations in the property sector, are gradually resolving as the immediate crisis itself resolves.

LONGER-TERM TRANSFORMATION

At the same time, Covid-19 has accelerated the broader conversation about the transformative role that technology will most likely play over the longer term. Although the 'digital fund' – ie. a fund manufactured using infrastructure based on distributed ledger technology – is a reality, the process still has some way to go, as does operational modernisation more broadly in the funds industry.

Just how far the concept of the investment fund will change as the technology evolves is increasingly debated. For some firms, the mutual fund will remain a central organising concept, even as the delivery infrastructure changes. For others, there is a growing interest in the potential offered by mass customisation, whereby an underlying portfolio may be more precisely tailored to customer need at scale using the cost and efficiency advantages brought by developing technology.

"You do not really know where technology is going. I still believe that the mutual fund will be the building block. Technology may change how the fund is delivered, how it is bought, how it is held and how it is sold, but I still fundamentally believe that the mutual fund is going to be the building block of choice."

"There is disruption going on, exacerbated by Covid-19. Nearly everybody has gone digital. Fintechs are on the rise, and they really understand customer personalisation and customisation. There is a lot we can learn from popular takeaway and grocery delivery apps that are designed to offer great customer experience. Mass customisation is something of a Holy Grail for us as an industry."

IMPORTANCE OF CUSTOMER EXPERIENCE

There is a greater degree of consensus around the central importance of customer experience and the need to use technology to communicate and connect differently and more effectively. For many in the industry, the challenge here remains the degree of intermediation between the manufacturer and end customer, particularly in the retail and private wealth markets where investment funds are frequently building blocks for strategies delivered by others in the value chain. Some firms are addressing this by structural means, i.e. corporate activity to build out distribution and/or advice capability. This is also seeing banks re-enter the UK retail fund management space following the pullback experienced about a decade ago. However, even if firms remain primarily manufacturers, much greater efforts are being dedicated to enhancing the customer experience – for example, producing accessible digital content.

"The main source of technological disruption or adaptation is going to be around client engagement. Everyone has been talking about digital delivery for years, and we have accelerated our investment in the digital experience. I actually think the clients have enjoyed it and that trend is going to continue."

ENGAGING A NEW GENERATION OF INVESTORS

The issues of technological long-term transformation and customer experience are particularly relevant to the question of how the industry could engage the next generation of investors. In May 2021, the IA held a roundtable discussion with financial advisers, investment platforms, and fund research houses to reflect on the impact of the pandemic on the retail fund market and the longer-term outlook for retail investing, and in particular how the industry could engage the next generation of investors.

Many younger working adults employed in industries able to work remotely have been able to save more over successive lockdowns. The roundtable discussion highlighted that more young people are investing as a result of the pandemic, attracted by the strength of the growth in asset values following March 2020. The trend to gamified investing has also accelerated, aided by lockdowns as millennials have had more time and more disposable income. A critical question in this context is how the investment funds industry can attract a younger generation, potentially with new-found lockdown savings, to investing.

Promoting trust in the investment industry
Many younger investors were at school when the Global Financial Crisis hit and associate financial institutions with the economic austerity that ensued. Following the crisis, the unemployment rate hovered at around 7% until 2014, six years after the crisis, affecting graduate job prospects and real term wage growth.

By comparison, the peak of the unemployment rate during the pandemic has so far been 5.2% in October-December 2020, as the furlough scheme has helped to preserve jobs. Whilst the investment management industry was less associated with the events of the Global Financial Crisis at the time, there has been long-term reputational damage to the financial services sector. There is still a distrust amongst young people of what is perceived as the 'financial establishment'.

For young adults able to work from home and to save, there are alternatives to mainstream investing through routes such as day trading stocks and shares or cryptocurrencies that can feel more accessible and have common characteristics with gaming. These are a world away from investors buying and holding a balanced portfolio of funds for the long-term.

"What we still see in the younger cohorts is a draw to something that feels more easily accessible. There is a big job to do on that end of the spectrum around educating people about the investment management industry."

The rise of cryptocurrency investing and day trading: challenge or opportunity?
The FCA estimates that cryptocurrency ownership amongst UK adults stands at 2.3 million in June 2021, up from 1.9 million in 2020. The Regulator's consumer research into cryptocurrencies shows that consumers increasingly see them as an alternative or complement to mainstream investments.[16] Half of cryptocurrency owners intend to invest more and some investment managers have even dipped a toe into owning crypto as part of fund allocations. This is in spite of high volatility in cryptocurrency prices in 2021, as the Chinese ban on cryptocurrencies and Elon Musk's announcement that Tesla would no longer accept Bitcoin caused prices to fall sharply.

The median account size for cryptocurrencies is £300, according to FCA data. Given the relatively low sums of money being invested in crypto, neither the threat, nor the opportunity for fund flows looks significant in the short-term but the jury remains out on whether these investors could turn to funds.

"Average conservative investors are at home continuing what they were doing, looking for better funds and rebalancing their portfolios. There is another segment with much smaller balances looking for an easy way to earn profits."

[16] FCA, Cryptoasset Consumer Research, June 2021 – the FCA estimates that crypto asset ownership is 2.3 million (4.4% of the population), up from 1.9 million in 2020. According to the research, consumers are now less likely to cite cryptocurrency as a gamble when considering their reasons for purchase (agreement down 9 points to 38%) and are more likely to see them as an alternative or complement to mainstream investments. Half of the survey respondents that held crypto said that they planned to buy more.

In 2020, there has also been a substantial rise in trading activity and some of this represents a new cohort of day traders. Data from Compeer show record trading levels of 48 million trades transacted in 2020, 20 million higher than the previous record. 38 million of these trades were conducted through execution only brokers, which is likely to represent direct investor activity. Day traders can engage in speculating on asset prices to make quick returns, which leads to short-term market volatility. They can also make counterintuitive decisions based on sentiment. In January 2021 day traders drove up the price of Gamestop shares, a bricks and mortar videogame retailer whose business model was seen as obsolete by professional investment managers. Social media channels such as Reddit were instrumental in pushing day traders to buy shares through apps like Robinhood, driving up the value of the shares and causing the hedge funds that were short-selling the shares to lose a lot of money. For some of these traders, the motivation was both anti-establishment and speculative and the long-term buy and hold approach of investing may lack appeal.

"With social media, one tweet can move the prices of a stock or crypto.That kind of volatility is here to stay and not welcome."

Engaging the next generation

Many of those we spoke to for this year's Survey believe that there is an opportunity to convert the new cohort of day traders and crypto investors to investing in funds. This generation are being introduced to concepts that are fundamental to investing such as risk and reward. Volatility may be an opportunity for speculation but it could also mean that difficult lessons about risk taking are learnt, which could benefit funds.

"They are starting to get interested in things like risk and reward, things that are actually quite fundamental to their investment choices. Those people are not necessarily lost to traditional investment, they may actually be the people who you could convert ."

The data from platforms and the FCA suggests that this profile of investor has smaller accounts, and it can feel easier to take some risks with small sums that an investor can afford to lose. As the pool of assets grow, there is more at stake and the benefits of diversification and stable, long-term returns become more compelling.

Many day traders are also using the same online trading platforms as non-advised fund investors. These platforms can provide them with more holistic information about investing to help them make better investment decisions. Concepts such as the benefits of diversification or the advantages of collective investment vehicles can be pushed through educational content.

"People were already increasingly moving online to manage their finances and the average age of our customer base was getting younger. Covid accelerated that, so we are trying to put up as much educational content as possible."

Equally, as we outline in the previous section, there are views in the industry that the nature of funds themselves will also evolve, through processes such as greater customisation. This in turn links to the theme of responsible investing that is another important opportunity to help to engage younger investors.

"If you have the option to invest responsibly, and you see no potential difference in outcome as far as investment returns are concerned, for most people the choice is clear."

The role that investment managers can help investors to play in re-building economies and societies post-pandemic, as well as the drive to net zero and combating climate change, is a powerful message and a major priority for the industry.

5. ADAPTING TO THE POST-BREXIT LANDSCAPE

The UK investment management industry is a leading centre of excellence in both Europe and globally, second only to the United States in scale (see Chapter One). Figure 9 illustrates how it is one of the most international investment management centres in the world, in terms of both the customers and businesses we serve and the assets that we invest in.

ONGOING IMPORTANCE OF DELEGATION

The end of the Brexit transition has now passed, and firms continue to be vigilant with respect to potential threats to operating norms. Many IA members run global businesses and the ability to delegate portfolio management functions continues to the most critical area in order to serve customers internationally. Delegation is an international norm that allows investors access to global expertise and investment opportunities, whilst also benefitting from significant cost savings. As we illustrate earlier in Chart 3, delegation as a component of European investment fund delivery continues to be incredibly important for the UK industry. However, as the renewed discussion in the context of the AIFMD review has illustrated, the treatment of delegation in EU fund regulation is far from a settled issue.

FIGURE 9: FOUR MEASURES OF A GLOBAL INDUSTRY

2

CONVERGENCE VS. DIVERGENCE

The industry is also debating the question of continued convergence relative to the benefits of divergences from EU rules and regulation. Here, there are mixed views but many firms see the benefit both operationally and for customers of continuing to align with EU rules where there is not a compelling reason to do so otherwise. As we discussed earlier, there is a particular desire amongst member firms for sustainability standards to be aligned globally.

"Let's avoid divergence for the sake of divergence. The politics of how that all gets agreed between governments, translates down to regulators and ensures people are all operating sensibly to the benefit of all is not easy, but we have to move on. We should try not sleepwalk into non-convergence overnight, because that really is to the detriment of both markets."

UK COMPETITIVENESS AND LOCATION DECISIONS

While certain immutable advantages such as time zone, language, and a stable legal system have helped the UK position itself as a global leader in investment management, it is clear this alone will no longer be sufficient post-Brexit. Some have also warned that in order to ensure that the UK remains a dominant player on the international stage, regulators must create an attractive operating environment that does not place an undue burden on firms. More broadly, firms point to the importance of the wider environment for business, notably around critical points such as tax regime, immigration and broader operating infrastructure.

While the industry recognises the value of robust, customer-focused regulation, there are also examples in recent years of approaches to regulation that have made the UK increasingly unattractive for international firms. Notably, the Financial Services Compensation Scheme (FSCS) serves an important purpose, but its recent funding mechanisms have focused disproportionately on firms with little direct connection to the problems the scheme was designed to address. The result is a growing perception that the UK is a high-cost jurisdiction for international firms who may, in some cases, be primarily exporting products and services from the UK.

VISION FOR THE FUTURE

The investment management industry has continued to set out its own vision of what a competitive landscape for fund delivery internationally looks like, building on the UK's acknowledged strength in portfolio management. This has focused on three key elements:

- **Opportunities for innovation**, particularly in the area of fund vehicles such as the Long-Term Asset Fund (LTAF) and potentially a new regime for professional investors.
- **Improving the operating environment**, with a major emphasis on fund taxation alongside optimisation of regulatory requirements.
- **Support for competitive delivery**, emphasising the importance of a shared agenda between Government, regulators and the industry.

Success would see the UK being able to deploy and harness innovation in the area of investment fund delivery more effectively. Critical areas of focus are likely to be private markets (see earlier section), green investment, and the potential offered by a digital fund delivery infrastructure. The significant effort to develop the LTAF represents one very tangible step forward through 2020-2021 in this space.