2 KEY THEMES IN A MORE UNCERTAIN WORLD

KEY FINDINGS

1. NAVIGATING A DIFFICULT ECONOMIC ENVIRONMENT

- The investment management industry and our clients are facing a number of economic headwinds including rising interest rates, the possibility of permanently higher inflation, potential for significant de-globalisation and and an overall more challenging environment for market returns and economic growth.
- Rising geopolitical tensions that may contribute to a de-globalisation of trade are of particular concern to the increasingly international UK investment management industry.

2. INVESTING RESPONSIBLY AND SUSTAINABLY

- Buoyed by a run of good performance, investor demand for sustainable strategies continued to rise in 2021. IA members have cited improved data quality and reclassification of assets as the primary driver of this growth. Of the £10.0 trillion of assets under management (AUM): just under half (47%) were integrating ESG in the investment process, 28% applied exclusions to their portfolios, and 8% were managed within sustainable-focused strategies. Impact investments remain niche with just 0.5% of AUM sitting within these strategies.
- Views were mixed on the impact that rising geopolitical tensions and near term economic uncertainty will have on the climate agenda as governments navigate very challenging conditions. Many see rising tensions, including the war in Ukraine, as further evidence for the need for the energy transition and see a push towards commitments to net zero.
- Regulation is focused on raising standards around disclosure as well as developing taxonomies to bring about consistency and clarity around definition of sustainable economic activities.

3. ONGOING FOCUS ON PRIVATE MARKETS

- Total assets in private markets reached $10 trillion in 2021. In 2021, less than 3% of the almost £10 trillion AUM was invested in private markets. However, we anticipate investments in private markets to increase as the market environment for returns becomes more challenging and regulation changes to allow wider access to private markets.
- Access to private markets has historically been easier for certain parts of the institutional market. A new fund structure in the UK, the Long-Term Asset Fund (LTAF), aims to give DC pension and retail investors broader access to illiquid assets. The first LTAFs are expected to be launched through 2022-2023.

4. ACCELERATING PACE OF OPERATIONAL MODERNISATION

- The pandemic triggered an accelerated move towards digitalisation across the investment management industry in the UK - from operations through to product design and customer interaction.
- The industry is eager to work with regulators on an ambitious technological agenda to facilitate the evolution of the funds industry. Many IA members are developing Distributed Ledger Technology and exploring the tokenisation of assets.

5. OPPORTUNITIES FOR GROWTH

- IA members have identified a number of opportunities for the UK to retain its standing as a leading international centre for investment management. A continued focus on innovation, both in terms of technological advancement and new product offerings such as the LTAF, will be critical. Sustainable finance also presents a huge exportable opportunity in terms of products, human capital and regulatory developments.
- While optimistic about opportunities for growth, the industry remains cautious to potential threats to its international competitiveness which include the rising cost of doing business in the UK and growing regulatory burden.

6. ENHANCING DIVERSITY & INCLUSION ACROSS THE SECTOR

- In 2021, the industry has broadened its focus on the diversity agenda to recognise that 'equity' and 'inclusion' play a key role in recruitment and advancement of diverse talent. While the industry has made progress on recruitment, more needs to be done around retention and many IA members are working on creating a culture of belonging.
- A key focus for the industry over the next few years will be collecting diversity data, setting goals and measuring progress.

1. NAVIGATING A DIFFICULT ECONOMIC ENVIRONMENT

The UK has faced three major shocks in the past five years – Brexit, Covid-19 and the economic implications of Russia's invasion of Ukraine. In different ways, these have demonstrated the limits of the assumptions around enduring and deepening globalisation, while also contributing to supply-side interruptions that have fuelled a growing concern about the potential impact of inflation upon capital markets and investors. For the investment management industry, this creates a number of uncertainties for both the near and longer term about economic conditions as well as the assumptions underpinning an industry whose investment activity is profoundly global. The headwinds can be summarised in four main themes:

- Likely consequences of rising interest rates
- Possibility of permanently higher inflation
- Potential for significant de-globalisation
- Overall implications for market returns and economic growth

"Investors have had to deal with so many issues over the last few years. You've had Brexit, the pandemic, the impacts of supply chain disruption, the impact of a ground war in Europe and now you've got this huge cost-of-living crisis and inflationary challenge."

For some we spoke to, the big risk is that structural shifts in the global economic, political and security environment create inflationary pressures that are permanent rather than transitory. This in turn will lead to a higher interest rate environment than has been seen over the past two decades.

"The biggest risk is that it is a secular move towards a more inflationary environment, in part caused by the decrease in globalization and characterised by higher rates for a long time."

This creates significant challenges both in predicting the direction of markets and delivering the kind of returns that many investors have become used to over the past 30 years. A number of those we interviewed also highlighted other facets of these challenges. For some, this relates to the importance of drawing on the experience of those used to managing through this kind of environment.

"Central bank support has meant that we've been in an almost artificial economic environment. Economic data from the last 20 to 30 years is not necessarily going to be a good guide to the future. We really need to be thinking about scenario analysis and different ways of thinking about risk."

For others, it was notable that technology, including social media, was driving a completely different pace of information dissemination, which meant in turn that client expectations also adjusted accordingly.

"Clients have access to online technology and information in real time and they're seeking answers. Leadership as an investment manager means you have to have opinions on these and lead from the front or be willing to say we don't know yet and we're figuring this out."

2. INVESTING RESPONSIBLY AND SUSTAINABLY

Reflecting intensifying concerns about the climate, as well as broader environmental and social considerations, sustainable and responsible investment (S&RI) has become a dominant theme within the investment management industry.

The strong performance of these products in 2020 may also have accelerated demand. While inflows remained consistently strong through 2021, typically such funds tend to underweight oil and gas companies and overweight technology companies, a strategy which has dampened performance into 2022. Although the underlying momentum behind S&RI investing is likely to build in the long-term, a number of firms that we spoke to this year are expecting that recent performance may slow near-term demand for S&RI products, which is certainly reflected in lower Q1 2022 net retail sales.

"My fundamental belief is that if you buy any asset class and make it greener, that is a source of alpha, but we need a longer time horizon so we can prove that."

A COMPLEX DEBATE ABOUT INTERPRETATION AND APPLICATION

At the same time, there is a recognition that the war in Ukraine has stimulated a wider debate about how precisely to define S&RI and that the economic consequences have potentially weakened some of the consensus and momentum.

"The war in Ukraine has highlighted the challenges of ESG assessment in a big way. Clients are asking how we look at countries like Russia and China from an ESG assessment perspective and how we get rid of our dependency on oil in the short-term."

This in turn has served as a reminder about what is often a more fragile international consensus than sometimes appears from a UK or broader European perspective:

"There is huge political pressure on governments around the world to make sure that any short-term fixes don't negatively impact this longer-term view of sustainability, particularly as clients are already on a sustainability journey and are continuing on this journey. As an asset manager, we are still under the same pressures as before from our clients to continue to enhance our sustainable capabilities."

Others within the industry remain optimistic that the climate agenda remains front of mind and that the ongoing war between Russia and Ukraine has highlighted the need for energy security and could accelerate the transition away from oil and gas to more renewable sources of energy.

In the context of Ukraine and the application of sanctions, investors are also increasingly aware of how complex the application of ESG principles is to sovereigns, especially where multiple competing priorities may have to be juggled.

"Understanding the ESG ramifications or risks of holding sovereign debt are not black and white. The line is often not as clear and is subjective. One of the critical active management decisions that we need to make as a fund manager is where that line is and it will vary by different countries depending on the everchanging landscape."

BOX 2: RISING IMPORTANCE OF CLIMATE CHANGE AGENDA

Climate action failure has been identified as the most severe risk to global economic growth[8]. In late November 2021 the UK hosted COP 26, the UN conference on climate change in Glasgow. The nations represented are parties to the Paris Agreement to limit global warming and achieve net zero greenhouse gas emissions in the second half of this century. This can only be achieved with significant changes to the nature of economic activity. Investment managers, as agents of capital, will have a role to support governments in financing solutions to mitigate and adapt to climate change. This includes support of the Government's first Green Gilt issues, and also acting as stewards to scrutinise the preparedness of the companies and other assets they invest in for the transition to net zero.

In the lead up to COP 26, the UK Government issued its first Green Gilt to finance green projects, raising £16 billion. The Debt Management Office has said that a further issuance of at least £10 billion is expected in 2022, as the Government seeks to establish a deep and liquid green gilt market. Issuances so far have been heavily oversubscribed, reflecting significant investor demand for green sovereign bonds. Going forward, investors will be closely monitoring reporting from the Government as to the allocation of proceeds from the issuances, and the impact they have had.

The UK's role in hosting COP 26, and the one-year delay to the conference, helped to build interest in the UK-based industry and created a sense of momentum behind net zero commitments including Net Zero Asset Managers and the Net-Zero Asset Owners Alliance, which culminated in the formation of the Glasgow Financial Alliance for Net Zero (GFANZ).

IA member firms with AUM in the UK of more than £7 trillion (almost three-quarters of UK AUM) have now signed up to the Net Zero Asset Managers commitment. This is a significant industry commitment to support the goal of net zero emissions by 2050.

The initial postponement of COP 26 also allowed time for UK policymakers to advance plans for domestic measures, including a UK green taxonomy, TCFD reporting across the economy, a sustainable disclosure and labelling regime for financial products, and corporate transition plans. Much of this work was merely launched in Glasgow and the detailed work of implementation is ongoing despite a drop in the levels of Government-driven publicity since COP 26, and uncertainty following Boris Johnson's replacement by Liz Truss as Prime Minister.

The last year has seen jockeying between the world's leading economies to set the standard on greening the financial system. The EU, with the establishment of SFDR and a green taxonomy, has been seen as a frontrunner in this area but the UK, as host of COP 26 and in a spirit of post-Brexit competitiveness, has also wanted to stake a claim to being the world's first "Net Zero-Aligned Financial Centre". The US, under the presidency of Joe Biden, has been keen to signal its renewed commitment to climate diplomacy.

This is a global issue and for a global industry like investment management, international regulatory coherence will be vital. There are signs that this is being sought through the G20 and the establishment (also at COP 26) of a new International Sustainability Standards Board (ISSB). GFANZ will also have a role as a global, industry-led group, in seeking to influence the adoption of consistent and high-quality standards. There are some concerns within the industry that rising geopolitical tensions and increasingly difficult macroeconomic market environments could see some of these commitments falter as governments seek to address some of the nearer term challenges.

[8] The Global Risks Report 2022, World Economic Forum.

SIZING THE MARKET FOR SUSTAINABLE AND RESPONSIBLE INVESTMENT

The data presented in Chart 6 is based on the IA's Responsible Investment Framework which was published in 2019. This data includes assets subject to both firm level and individual fund or mandate level responsible investment approaches. Although we now have three years of data, it is very difficult to make year on year comparisons. IA members ability to extract data from their systems and their interpretation of IA definitions is evolving as we move towards greater consistency. As such, year on year changes are a combination of genuine rising allocations, but also improved data quality.

Chart 6 shows that assets within sustainability focused strategies have risen quite substantially from 2.6% in 2020 to 8.1% in 2021. Assets subject to firm level or product level exclusions have seen a two percentage point rise to 28% in 2021. Meanwhile, ESG integration stood at 47%, down from 49% in 2020. Impact investing remains a niche area of investment with a very small number of firms involved in these types of investments. Total assets represent just 0.5% of industry assets and have remained at a similar percentage over the last three years.

The majority (77%) of industry assets are subject to stewardship activity. Oversight goes beyond just voting, and as such, the 77% figure includes holdings across asset classes.

CHART 6: PROPORTION OF ASSETS UNDER MANAGEMENT BY RESPONSIBLE INVESTMENT CATEGORY (2019-2021)

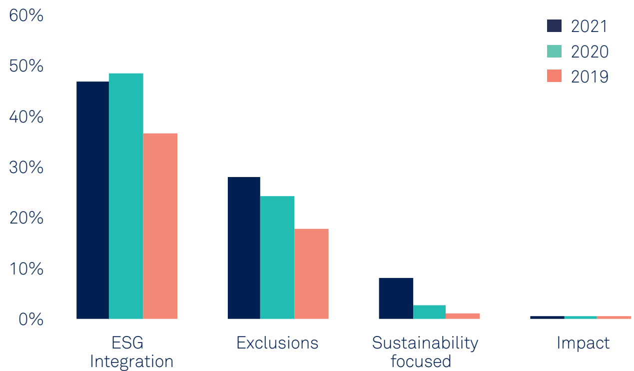


TABLE 2: DEFINITIONS BASED ON IA RESPONSIBLE INVESTMENT FRAMEWORK[9]

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.
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).
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.

[9] The IA RI framework is avalailable at: https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframework.pdf.

IMPROVING DISCLOSURE

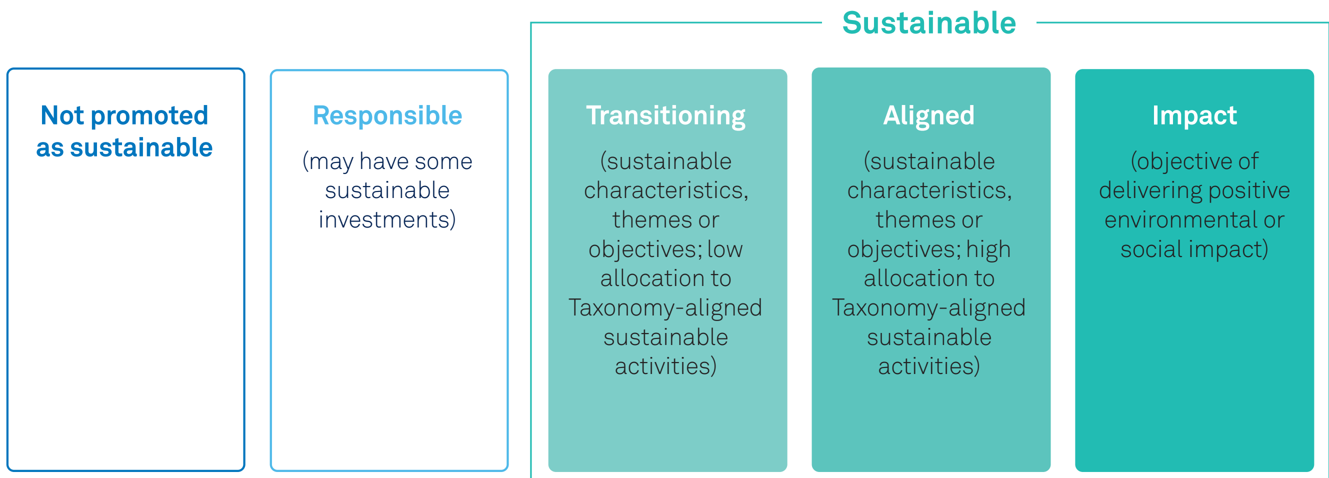
Globally, regulators are paying significant attention to rising investor interest in responsible and sustainable investing. Regulators are keen to prevent 'greenwashing', promote a well-functioning sustainable investment market and to set higher disclosure standards for sustainable investment products. The Sustainable Finance Disclosure Regulation for European domiciled funds, and the proposals outlined in the UK's Sustainable Disclosure Requirements, are partly designed to give investors' greater confidence that the sustainable products that they invest in match their preferences and expectations.

"Some of the focus on sustainability is regulatory-driven as well. The regulation is not going away. In fact, it's coming at a thundering pace, and we all have to keep abreast of that, particularly here in Europe."

"Labelling is so important today to explain the differences in how funds operate so that consumers can make their own choice. If they want an ethical fund that excludes oil and gas, or if they want a fund that will try and change oil and gas stocks to make them greener, they need to be able to clearly understand that. The need for clear labelling has never been more important."

Clear disclosure is the central tenet of the FCA's Dear AFM Chair Letter of summer 2021 on improving quality and clarity of authorised ESG & sustainable investment funds. The FCA builds upon the principles outlined in the letter in its Discussion Paper 21/4, published in December 2021, whilst also setting out proposals for a UK sustainable fund labelling regime. Investment managers will have to demonstrate good quality of governance and stewardship, a robust sustainable investment process and provide clear communications and disclosure to meet the sustainable label criteria. Consultation on SDR is likely to conclude by Winter 2022, with rules to be published in 2023.

FIGURE 7: THE FCA'S POTENTIAL APPROACH TO A SUSTAINABLE PRODUCT CLASSIFICATION AND LABELLING SYSTEM[10]



Note: The five blocks in this Figure represent potential categories of product in the classification and labelling system. Each would be supported by clear definitions and criteria.

[10] As pictured in the FCA's Discussion Paper 21/4 released November 2021.

IA investor research into sustainable labels showed that investors welcomed the concept of a label, preferring a clear and simple framework that helps them to more easily navigate the expanding sustainable fund market. However, the development of label criteria and proposals around setting thresholds for 'sustainable' assets has highlighted challenges regarding the availability of data and common metrics to assess sustainable investment outcomes.

There is not yet a clear quantitative methodology to determine a sustainable asset. In the EU, the development of a taxonomy could help investment managers to map the revenue alignment of companies to environmental activities, but the taxonomy is unfinished. In the UK, a taxonomy is being developed but is not available yet. Even then, metrics will have an environmental focus and whilst an EU social taxonomy is being planned, it is not yet under development. This makes it difficult to set allocation thresholds according to environmental, social and governance criteria until more comprehensive data and consistent metrics become available.

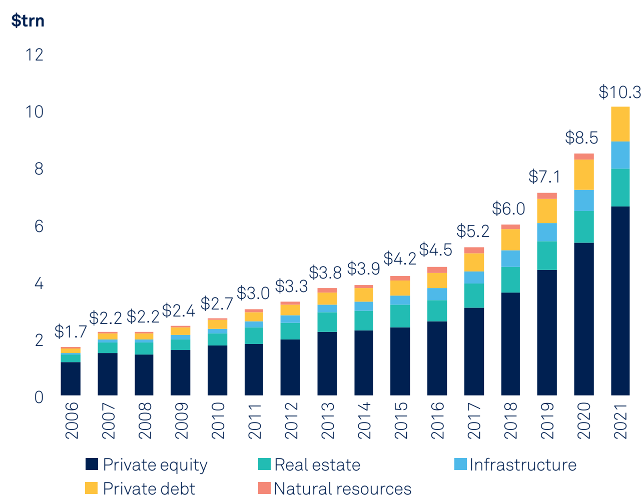
Investors may be better served by a first generation of sustainable fund labels that require fund managers to demonstrate sustainability through the intentions of the investment process. If a fund can prove that it is selecting stocks or bonds based on financial and non-financial criteria and can evidence and explain this effectively to customers, this could be a good starting point for a label.

"Reporting and measurement and making sure that there is consistency is really difficult when you're pursuing different sustainability goals. Metrics that look at who achieved their goal and by how much will level the playing field."

3. ONGOING FOCUS ON PRIVATE MARKETS

Global assets in the private markets have increased significantly once again, rising 22% to over $10 trillion in 2021. Private equity remains the most significant asset class in the alternative investment space, accounting for almost two thirds (or $6.6 trillion) of global AUM. Although significantly smaller at $950 billion, total AUM in infrastructure assets has seen the most notable growth over the last decade, growing 16% on average each year compared with a compound annual growth rate of 13% for total private market assets.

CHART 7: GLOBAL ASSETS UNDER MANAGEMENT IN PRIVATE MARKETS (2006-2021)



Source: Preqin

The growth in private markets is driven by both demand and supply-based factors. On the supply side there is increasing interest in market-based finance – including in the context of financing the UK's transition to net zero. At the same time, as Chart 8, we have also seen a fall in the number of companies that are publicly listed. Increasingly, we see companies choosing to stay private for longer. The number of unicorns – privately held companies with a valuation in excess of $1 billion – increased by 71% between 2019 and 2022 alone, according to data provider PitchBook. This means that investors will need to increasingly look at private markets if they want to benefit from some of these high growth companies.

CHART 8: NUMBER OF UK LISTED COMPANIES OVER FOUR DECADES (1976-2021)

Source: World Bank, London Stock Exchange.

Although IA member firms have expertise in private markets, large parts of the market, notably private equity, lie outside of the IA's membership. This year, the IA collected data on the level of investments in private markets by IA members. While overall exposure is quite low at approximately 3% of total AUM, many industry leaders believe that the current market environment will see demand for alternatives accelerate. The number of IA firms offering private market solutions remains concentrated for now, with some cautious about entering what they see as a specialised space. As the market cycle turns, there is also increasing caution about valuation, which further emphasises the previous point.

"You're going to see things like alternatives play a bigger part of the investment landscape. I would caution the industry- we need to play to our strengths. If you are a firm that hasn't done these types of things before, enter carefully."

ACCESSING ILLIQUID ASSETS

Access to private markets has historically been much more straightforward for institutional investors than for those in the private wealth, retail and DC pension markets. As private markets continue to grow and become an increasingly significant part of the economy, there is an ongoing debate about how to widen access, including expansion of the range of fund vehicles available. In the wealth management space, IA research has found that among the pool of wealth managers that are not invested in private markets, 40% cite a lack of appropriate fund structures as a barrier to investing.

In November 2021, the rules for the Long-Term Asset Fund (LTAF) – a new form of investment fund using notice periods – were finalised and the first LTAFs are expected to be launched through 2022-2023.

"Private markets, including infrastructure and property, really were the domain of the institutional market and they're becoming much more needed in the retail, advisory and wealth management market. This is where the Long-Term Asset Fund comes in."

The LTAF better aligns the liquidity of the underlying asset class that the units are invested in with the dealing frequency of the fund so that units can only be sold at set intervals, for example every 3 or 6 months, or even less frequently.

There are three sets of challenges facing the LTAF as it starts to develop in the UK:

- Regulatory barriers, given tight initial rules on distribution which focus the LTAF on the DC pensions market rather than private wealth and retail. This may start to change following regulatory consultation in the second half of 2022 about widening retail access to the LTAF.
- Operational frictions given that investment platforms are primarily geared towards daily dealing and generally need to adapt to support the use of notice periods.
- Commercial behaviours, partly driven by regulation, notably the DC default fee cap, which are resulting in a very cost-focused assessment of value in the UK investment management market. IA research found 46% of wealth managers think that costs are one of the top three barriers to investing in private markets. This may be a big barrier for the most cost sensitive investors and product providers will need to be able to communicate the value proposition of their product.

Regulatory reforms in the institutional market could also lead to increased allocations to private markets. In Spring 2022, HM Treasury began consulting on proposed reforms to Solvency II, the framework governing the prudential regulation of UK insurers. One of the core objectives underpinning the review is to support insurance firms to provide long-term capital to promote growth, including investment in infrastructure, venture capital and growth equity, and other long-term productive assets, as well as investment consistent with the government's climate change objectives. The broadening out of eligible asset classes could see insurers, who make up 11% of the industry's client base, increase allocations to private markets.

4. ACCELERATING PACE OF OPERATIONAL MODERNISATION

The Covid-19 crisis highlighted the need for the fund management industry to accelerate the move away from paper towards digital, having previously been slower than other parts of the financial services industry to move in this direction. There are a variety of reasons for this, some operational, some regulatory. However, the industry recognises that the fundamental impetus needs to come from within, and the pandemic has both triggered new and intensified existing initiatives for change. These are addressing some of the more obvious frictions that still exist in the customer experience, for example the comparatively slow pace of fund transfer when moving to or between investment platforms.

Looking ahead, the industry is keen to work with regulators on a more ambitious, broader agenda across multiple areas, from operational process through to product design and customer interaction. A major focus in all eventualities will need to be the digitalisation of communication and disclosure, which remains anchored in paper-based regulated documents that heavily impact current information and design requirements. However, there is also scope for a more significant evolution of the funds industry. A recent IA paper, 'Investing for the Future', highlighted potential ways in which utilising new technologies and adopting tokenisation could fundamentally change the way in which the industry operates. It uses the concept of Investment Fund 3.0, a new stage of fund development, to explore potential scenarios for the future.

"The case for tokenisation is pretty strong. It's the delivery mechanisms that have an opportunity to continue to improve and decrease the overall cost for consumers. To the extent that technology can take out friction in the middle, I think that's a huge advantage."

"We've been a laggard in adoption of key technological trends and I think that's going to change. Digitalisation and tokenisation of the product will definitely come."

At the most radical end, a transformative shift could instead provide a much more interactive and participatory experience for investors via hyper-customisation. Risk and return exposure could be tailored by customers at individual stock and securities level, rather than at the fund level. This level of customisation is achieved through changing the relationship between the customer and their portfolio, increasing participation and altering the nature of delegation to a professional investment manager.

The creation of personalised ETFs today offers a glimpse of the future. Increasingly this high degree of tailoring will link together with Distributed Ledger Technology and the tokenisation of assets. Tokenising less liquid assets such as property would enable them to be held more easily in open ended funds such as ETFs. Beyond funds, we will see further personalisation of the portfolio in its broadest sense by providing access to a range of financial products that meet investors wider needs. For example, portfolios could hold rainy day savings accounts and protection products such as life insurance. The standard off-the-peg approach will no longer suffice. The investment management industry of the future could look very different from todays.

"We've taken advantage of the generous opportunities created by Fintech innovation here in the UK. We make good use of the rich ecosystem of new service providers on the investment research, technology, operations and back-office arenas. We've had lots of opportunity to experiement with and adopt several new providers."

FIGURE 8: THREE SCENARIOS FOR INVESTMENT FUND 3.0

SCENARIO ONE: Business-as-usual enhancement

1

The first scenario extrapolates the enhancements of recent times into the future and produces a more efficient version of today's fund. In this baseline view which underpins the others, the industry continues its modernisation agenda, facilitating speed, scale and efficiency, utilising new technologies and adopting tokenisation to enable fund shares and underlying asset classes to be traded more effectively. Consumers will benefit from incremental improvements to customer experience and be able to interact in a more informed manner with their providers.

SCENARIO TWO: Innovative evolution

2

The second scenario builds upon these enhancements and sees an evolution of greater significance, which results in an adaptation of fund operations and product delivery to suit new investor appetites and expectations. The conventional collective investing model develops through increasing numbers and diversity of thematic and specialist investment building blocks to help construct overall portfolios which are much more tailored to investor preferences. The extent of tokenisation in this view broadens market access much more significantly in areas such as private companies, infrastructure and native digital assets.

SCENARIO THREE: Transformative change

3

At the more radical end, the third scenario imagines a transformative shift where a much more interactive and participatory experience for investors is facilitated via hyper-customisation, and where risk and return exposure is tailored by customers at individual stock and securities level, rather than at the fund level. As in the second scenario, this includes investible assets outside of the current mainstream, such as infrastructure and native digital assets. This level of customisation is achieved through changing the relationship between the customer and their portfolio, increasing participation and altering the nature of delegation to a professional investment manager.

5. OPPORTUNITIES FOR GROWTH

The UK investment management industry is a leading centre of excellence and one of the most international in the world, in terms of both the customers and businesses we serve and the assets that we invest in.

The UK has several well-documented advantages which have bolstered its position as a leader in investment management on the global stage, including time zone, language, and a stable legal system. The latest data in this report confirm the strongly international nature of the UK investment management industry, particularly when measured in terms of the overseas customer base, overseas investment activity (across both equity and fixed income) and the level of delegation to facilitate portfolio management for overseas-domiciled funds (see Figure 9).

However, there is clearly no room for complacency, either at the level of UK-EU relations or the broader macro-economic, political and security environment. This may drive a move to re-regionalisation or localisation, threatening or reversing the globalisation trends that have been so dominant over the past two decades.

"Geopolititcal risk is the biggest risk that we face as an industry. We have started to see an uncoupling of globalisation. We are seeing the breakdown of supply chains, barriers to trade going up, the inability to move labour between markets. Increased nationalism will increase barriers and lead to poorer outcomes."

IA members have identified several opportunities that will help to foster the UK's international competitive advantage in fund delivery and broader portfolio management. Innovation and sustainable finance continue be critical themes:

FIGURE 9: FOUR MEASURES OF A GLOBAL INDUSTRY IN 2021

1. A system that prioritises innovation. Innovation is partly about the practical application of technological advances, and there is clear scope in areas such as tokenisation to drive further development of both investment fund and capital markets. At the same time, innovation is much bigger than technology alone. Developments in product offerings such as the Long-Term Asset Fund (LTAF), which facilitate access to asset classes that were once out of reach for many investors, will be key in demonstrating an ability to innovate, with both domestic and international benefits.

2. Sustainable finance is seen as one of the biggest exportable opportunities in UK investment management today. The world's leading economies have committed to set the standard on greening the financial system. Whilst the EU has been first to set out a firm set of rules and regulations by establishing SFDR and a green taxonomy, the UK can learn from the challenges seen in implementing SFDR to drive better regulation. It is also taking the opportunity to capitalise on the momentum behind COP 26 to become the first "Net Zero-Aligned Financial Centre". The UK has a strong pool of talent and as demand increases for staff with sustainable investment expertise, this will further support the UK's position as a centre of excellence for S&RI.

"There is a big opportunity for the UK around the regulatory environment for sustainable finance. The UK can be a leader in terms of creating a product construct within sustainable finance that operates globally."

One of the critical ingredients in making these areas a success will be the strength of domestic talent. The success of city hubs, such as London and Edinburgh, is rooted in the broader ecosystem which includes the proximity to other market participants and fintechs, availability of broader professional services, and, critically, access to talent. Talent continues to be a key differentiator, particularly in the race to become leaders in sustainable finance, and many believe that the UK is well-positioned in terms of professional capabilities in this area.

"It's a war of talent and will continue to be so and I think the talent for sustainable finance is in the UK today. So, the question is, will that just shift straight to the US when they eventually catch up?"

“The UK’s investment management ecosystem is well-established and quite unique. We are generally leading on tech and FinTech and that will remain key and I see a great capacity to innovate. We also continue to see the UK as having a very deep talent pool. We need to protect that ecosystem.”

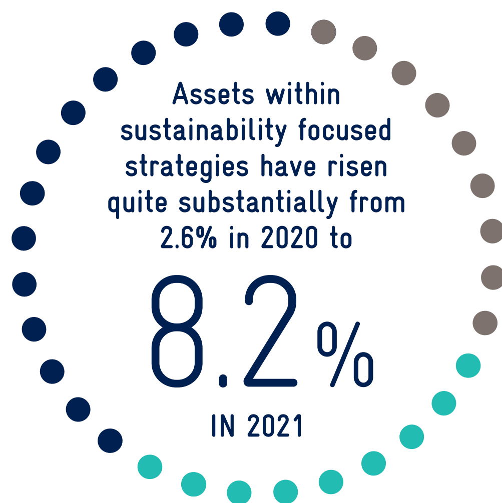
CHALLENGES TO UK COMPETITIVENESS

At the same time, there are growing concerns from the industry about the relative competitiveness of the UK as an operating environment that can both attract and retain global businesses. A range of issues tend to surface among industry participants, including the rising cost of doing business in the UK and increasing regulatory burden. The issue is not one of a trade-off between competitiveness and customer protection. Firms feel that high degrees of customer protection are wholly compatible with a policy and regulatory regime in the UK that sees international competitiveness as a net gain in terms of both domestic delivery and broader economic contribution. Rather, a critical question is how efficient, effective and adaptive the regulatory regime is in practice?

“There's a very big risk that we are launching initiatives that really are only going to be fit for purpose for a few years. They've got no way of evolving because of the way that that regulation has been set up. Really, you want propositions that can evolve as we learn.”

There is also a real emphasis across the industry on ensuring that the international talent pipeline so necessary for its success is as strong as possible, alongside further measures to foster a more diverse and inclusive recruitment culture.

“Other countries across the globe are making it a lot more friendly to do business for people who have interest in cryptocurrencies and DLT. Some countries will offer a digital visa. Is there a sensible opportunity for the UK to be doing that in any way to facilitate different types of business?”



6. ENHANCING DIVERSITY & INCLUSION ACROSS THE SECTOR

Diversity, equity and inclusion (DEI) are widely recognised as strategic priorities, as businesses shape the future world of work following the disruptions of the last few years. Businesses are responding to changes in societal expectations of creating outcomes by offering wider perspectives. This in turn reduces the risk of group think. Furthermore, firms are increasingly being evaluated against a wider set of criteria, which includes the diversity of the workforce and being able to evidence this with data across different career levels. The regulators too have expressed their expectations for businesses to take action that measures and addresses workforce diversity and inclusion as part of risk mitigation.

"When you're making a reversal of a generational long-term issue, it takes a while to build momentum, but it will build."

The ability to build and lead diverse teams has become increasingly important as leaders strive to create an inclusive work culture that develops and retains good talent. As part of this, we are seeing a shift in focus from the 'diversity' of the workforce, to include a broader recognition that 'equity' and 'inclusion' play a prominent role in helping to level the playing field for recruitment and advancement. This broader focus also helps to create a culture of employee belonging. There has been progress on diversifying entry-level talent but there is recognition that more needs to be done to ensure that our industry benefits from these efforts through the retention, development and progression of talent into senior positions. Strides have been made in addressing under representation in gender, ethnicity, and socio-economic characteristics but there is still much work to be done when it comes to including these under-represented groups in decision-making and investment roles.

"The market has woken up to the fact that we need to grow our own talent and create opportunities around the talent we have. We will see more of a shift to internal development rather than simply trying to poach other people's diverse talent."

Capturing diversity data, setting goals and measuring progress is recognised as a crucial component to achieving DEI results but more progress is needed. Businesses are shifting approach to reduce internal drivers of inequality and are taking a more holistic approach so that these issues are not addressed in isolation. More investment management leaders are now at the forefront of driving lasting cultural and behavioural change and are committed to integrating DEI into all their processes.

"We spent a long time last year collecting diversity data and it does help because you can start to measure change. Data is the first and hardest thing to get and in some countries you can't collect the data. You manage what you measure better."