UK SECTOR SIZE AND SCALE

- The value of assets under management (AUM) managed by members of the Investment Association (IA) stood at £8.8 trillion in 2022. This is a 12% decrease on £10.0 trillion recorded in the previous year, mainly attributed to asset depreciation, with broad-based declines in equities and bonds internationally. The fall in AUM is the first since 2008 and comes after a 9% compound average annual growth rate over the period saw AUM nearly triple.

- In the context of resurgent inflationary pressures, a change in monetary policy stance globally has raised uncertainty about the direction of markets and hence the near-term outlook for total AUM through 2023-2024. Both IA and external data shows that investment performance is a fundamental underpin for AUM.

- Total AUM in Scotland by IA members fell faster than the industry average to £500 billion by the end of 2022, which takes total AUM back to the same level in nominal terms as a decade earlier. This represents 6% of total AUM, with Edinburgh the largest investment management centre outside London.

- IA members account for an estimated 85% of total AUM by the UK investment management industry. Including non-IA members, we estimate total assets under management at £10.3 trillion.

UK INDUSTRY IN A GLOBAL CONTEXT

- Global AUM fell 10% to $98 trillion during 2022, with North America falling 14% and the European fund market (ex UK) down 10%. With 11% of total global AUM, the UK continues to be a leading centre for excellence in investment management – the largest industry in Europe and second only to the United States worldwide.

- Some 48% of UK AUM is now managed on behalf of overseas clients. Between 2012 and 2018, overseas client assets averaged 39% before rising steadily since then. However, there is a range of drivers in this data. The latest increase through 2022 results from overseas client AUM falling less significantly than domestic AUM over the year, amidst significant market and exchange rate effects.

- The majority of overseas client assets are European (56% of the total), with North American clients being the second largest group (20%) and Asian clients rising marginally to 16% in 2022.

- The strong growth in assets managed for overseas domiciled funds, relative to the size of the domestic fund market, continues. Since 2012, the share of assets in overseas domiciled funds has increased from less than half (45%) to just over two thirds (67%) of all fund assets, partly reflecting significant growth in the ETF industry.
MAINTAINING INDUSTRY COMPETITIVENESS

While the data continues to be positive on the UK's international position as reflected in client behaviour, sentiment across the UK industry is more cautious. The most important detractor in sentiment has been the incremental cost and complexity of the UK regulatory environment. In the context of the wider pressures in the operating environment, the scale of regulatory change over the past five years is of significant concern. It has already led some firms to look differently at the role the UK plays in their global operations.

In considering current challenges and opportunities, we look at the industry competitiveness agenda through the lens of six themes:

1. Stimulating innovation
2. Facilitating cross-border business
3. Focusing on the cost of doing business
4. Modernising the regulatory process
5. Calibrating risk appropriately
6. Targeting regulation effectively

The industry is also closely engaged in the wider capital market reform discussion, supporting efforts to improve the UK as an attractive listings environment. This in turn links to the wider debate around strengthening the UK as a renewed source of domestic risk capital alongside overseas investment.

IN 2022, THE VALUE OF ASSETS UNDER MANAGEMENT MANAGED BY IA MEMBERS STOOD AT £8.8 TRN
The primary purpose of investment managers is to deliver good outcomes to their clients, whether these are individual savers or institutional entities like pension schemes. This includes providing expertise in areas such as risk management, achieving economies of scale, and providing access to a wide range of assets that would normally be out of reach for individual investors. The ultimate goal is to provide customers with a well-rounded portfolio consisting of shares, bonds, and other assets, such as property, which can generate returns over the long term while mitigating undue risks.

Beyond facilitating the investment process, the role of the industry includes ensuring the efficient functioning of capital markets. Investment managers play a pivotal role in maintaining properly priced markets and effective transactions between buyers and sellers. Efficient markets are essential for the growth and stability of market economies. They allow for accurate pricing of information, which is crucial for informed decision-making and fair value determination. Investment managers thus contribute to sustainable economic growth by actively participating in and promoting the efficiency of capital markets, benefitting their clients but also the broader society at large.

Investment managers are not alone in their efforts to enhance capital market efficiency, as other financial institutions and individuals also play a role. However, the investment management industry has traditionally been central to the long-term allocation of capital, whether through stocks, bonds, or other assets. As long-term holders of investments, UK investment managers hold UK equities for approximately six years. The industry therefore carries a significant responsibility to engage in stewardship activities with the companies they invest in to safeguard the value of their clients’ investments. As we discuss in Chapter 2, this responsibility now extends beyond traditional considerations to encompass broader issues such as environmental sustainability and executive remuneration.
INDUSTRY SIZE AND SCALE

Total assets under management (AUM) in the UK stood at £8.8 trillion at the end of 2022, almost double the level a decade earlier, but a drop of 12% from the record level of £10.0 trillion seen in 2021. This fall comes at a time of intensifying dislocation and uncertainty in the global economy, partly reflecting a much more unstable political and security environment.

Since 2016, the UK investment management industry has navigated a series of significant domestic and international shocks, notably:

- **June 2016** – EU referendum result and uncertain terms of exit from the Union ahead of the December 2020 Trade and Cooperation Agreement.
- **February 2022** – Russian invasion of Ukraine.
- **September 2022** – UK Fiscal Event and aftermath for the UK gilt market.

“I remember when crises seemed to happen once a decade. We now seem to be operating in an environment where every year there seems to be something new and systemic happening.”

Despite the increasing level of turbulence, it was not really until last year that total assets and funds under management start to signal the more challenging environment with the Russian invasion of Ukraine, rising inflation and a decisive turning point in the global interest rate cycle.

Unusually, returns turned negative across both bond and equities over the year as markets adjusted to higher interest rates and quantitative tightening (see Box 1 for more detail on capital market performance). In response to rapidly rising inflation, we have seen an ongoing and intensifying shift in monetary policy globally. In the UK, the Bank of England raised rates eight times over 2022 from 0.25% to 3.5% and a further four rate rises followed in 2023, with rates reaching 5.25% by late summer. Central bank commentary also shifted from an original narrative of transient inflation (and hence a shorter period of monetary tightening) towards a ‘higher for longer’ expectation even as headline inflation started to fall back.

**FIGURE 2: WHO ARE THE RESPONDENTS OF THE INVESTMENT ASSOCIATION’S SURVEY?**

Respondents to the survey can be broken down into **five broad groups:**

1. **Large investment management firms** (both UK and overseas-headquartered), which may be independent or part of wider financial services groups such as banks or insurance companies. They undertake a wide range of investment management activities across both retail and institutional markets and manage substantial amounts for overseas clients in the UK. Such firms will typically be managing >£100 billion from the UK, but a number of international firms have a smaller UK footprint.

2. **Small and medium-sized investment management firms** primarily focused on UK and/or European clients, which undertake a diverse range of activities, of which investment management is a constituent part.

3. **Fund managers** whose business is based primarily on authorised investment funds.

4. **Private wealth managers and specialist boutiques** typically with a specific investment or client focus.

5. **Specialist pension scheme managers** both Occupational Pension Scheme (OPS) managers running in-house investment management services for a large scheme, and Local Government Pension Scheme (LGPS) pools, supporting the LGPS investment process.
CHART 1: TOTAL ASSETS UNDER MANAGEMENT IN THE UK AND IN UK FUNDS (2007-2022)

“It feels more like a changing of the guard, a more permanent change in the economic weather of markets than previous crises which might have seen short term spikes before things settle down again.”

“The speed at which we went back to a world where money had a price again was a shock to the system. From an industry perspective, we will need to relearn how to operate effectively and serve our customers and our shareholders back in the world many of us recognise from 20-25 years ago.”

The 12% decrease in AUM between 2021 and 2022 is the highest year-on-year fall since the IA started collecting data over 20 years ago and is in stark contrast to the 9% compound average growth rate for the prior ten years. The only other annual fall in AUM was during the Global Financial Crisis (GFC) in 2008, which saw an 11% drop before recovering through 2009.

The value of UK investment funds under management (FUM) also fell through 2022, ending the year at £1.4 trillion, 14% lower than the £1.6 trillion recorded at the end of 2021. This year-on-year contraction is eclipsed by the 23% fall in FUM recorded in 2008.

Chart 1 tracks the evolution of industry AUM and FUM over the past two decades. We observe a trebling of industry assets over the post-global financial crisis (GFC) period. In 2022, as central banks hiked interest rates and began unwinding asset purchases, the critical question arises as to the extent to which further or sustained tightening may impact upon global economic activity and market returns and the potential timing of any easing.

While we do not have historic flow data for the institutional market, IA UK investment fund data suggests that portfolio performance accounts for two thirds of the total increase in funds under management over the two decades since 2002, with a significant element therefore determined by underlying market performance. Boston Consulting Group suggests an even stronger performance-related driver at global level, calculating that some 90% of returns since 2006 have been market rather than flow-driven.

The deterioration in AUM during 2022 illustrated the limits on assumptions around the industry’s ability to continue growing at the pace that we have seen over the last two decades. In an environment where recession risk continues to loom, firms must adapt to an increasingly unpredictable return environment, at

1 More information on FUM performance and trends in 2022 available in chapter 5 on the UK retail market (page 74).
least in the near term. However, among those we spoke to, the view of 2022 being an exceptional year was not universally shared, with some industry figures placing it alongside dislocations in earlier periods.

“There will always be something periodically. You go back to the Global Financial Crisis, the Asia debt crisis, the Eurozone crisis, dot com crisis—pick a period. Our job is to navigate through those moments of intensity on behalf of our clients—that is the deep, profound, fiduciary obligation that we have. In that sense, I don’t think last year was different. It was just its own version of a very intense phase.”

“On a 10–20-year view, the long-term trends that support the continued growth of the industry and the continued need for us to serve our customers into channelling their money to the real economy haven’t changed.”

To some extent, these differing viewpoints highlight the challenge in predicting what happens next, and the potential impact upon total assets under management. A more permanent ‘higher for longer’ environment could see a further downward adjustment in AUM, based on the interaction of several factors:

- Lower market returns, driven by a combination of higher discount rates and weaker economic growth expectations reflected in forward valuations.
- Constraints on new money flows derived from higher cost of living, notably higher mortgage rates.
- Competing products (bank, building society accounts, annuity contracts) leading to redemptions, notably in the retail funds market.

Alternatively, a softer landing on inflation and cuts in interest rates could lead to a different trajectory. Some firms also point out that the fall in a number of markets, especially the UK equity market, also offers up significant opportunities for longer term investors.

“We’re starting to see clients put their toes back into the water with equity growth strategies. We think it will accelerate, but it will be a slow burn.”

IA member experiences of investor behaviour was varied depending on the types of clients served and the asset class composition of those firms. Clearly, 2022 presented some exceptionally difficult moments, most notably for LDI managers and their clients in the Autumn (see chapter 4 on the UK Institutional Market). However, overall firms that we spoke to felt that the investment management industry as a whole had weathered the storm well to date, with redemptions in the retail market often a result of challenges around cost of living rather than concerns related to market performance and distrust.

“I didn’t pick up a sense of distrust in the industry or that the industry let investors down, whether among wholesale retail or institutional clients. Because of the breadth of capability that the industry now offers, we could continue to remain relevant even in an environment where the status quo has been turned up in the air.”

“We’re seeing more cost of living-oriented behaviour. We’ve seen the same number of people making monthly contributions, but the amount they’ve saved has decreased by 40%. The question is: how much of that is they just had excess cash in the pandemic and we’re just seeing “back to normal” or how much of that is the cost of living crisis impact? It is hard to parse that out.”

“We feared a huge percentage of our clients would be seeing their first market downturn. All of our clients that have started investing in the last three years have seen a net decrease in their portfolios, but they have not made one move. Less than 2% of our clients traded out of the market.”

“Many markets on a mean reversion basis look cheap. The reality is that if you’re a retail investor, investing on a 20–30 year time horizon, it looks like there are a lot of appealing market entry points.”
Chart 2 highlights the 2022 performance of selected regional equity and bond market indices. Both equity and bond markets turned negative amid geopolitical conflict and rising inflation. Russia’s invasion of Ukraine in February, and subsequent sanctions, had a particularly large impact on energy and food prices globally.

**EQUITY MARKETS**

In a very challenging macroeconomic environment, most major regional equity indices recorded negative returns in 2022. Global equities fell 7%, contrasting with the 20% return recorded in 2021. UK equities were the only exception and remained marginally positive at 0.3%, the first time in a decade that the UK outperformed global and US equity markets.

The relative resilience of UK equities is largely a reflection of a higher weighting towards certain sectors such as energy and healthcare. By contrast, US equity returns were down 9%. High growth tech stocks, which make up a substantial proportion of total US equity market capitalisation, had a particularly difficult year.

European equities fared marginally better than US equities, down 7% in 2022. The continent’s reliance on Russia for natural gas caused energy prices to spike sharply in the middle of the year exacerbating inflationary pressures and impacting economic growth.

Asia Pacific and Japan exhibited the worst performance of 2022, ending the year with negative returns of -10% and -9%, respectively. Much of the downturn was driven by the poor performance of Chinese equities. When China retired its zero-Covid policy in Q4, Asia Pacific equities rallied, though not enough to recover earlier losses.

**BOND MARKETS**

Investors – and portfolio constructors – have become used to an inverse relationship between equity and bond prices. In 2022, equity and bond prices moved down in tandem. The Bloomberg Global Aggregate index for global bond markets recorded negative returns of -6% over the year.

It was a particularly difficult year for the UK bond market. UK Gilts and UK Non-gilts recorded market returns of -25% and -18%, respectively. Although exposed to the same headwinds of rising inflation and rising interest rates, investors in UK bonds were also faced with exceptional turbulence following the Fiscal Event on 23 September. Central bank intervention brought some stability, but yields remained elevated.

**BOX 1: GLOBAL CAPITAL MARKET PERFORMANCE IN 2022**

These are presented on a total return basis. Total returns include income distributions through dividends or share buyback as well as the rise and fall of stock or bond prices that are measured through capital returns.

**CHART 2: TOTAL RETURNS ON SELECTED INDICES IN 2022**
SCOTLAND AS A MAJOR CENTRE

While London continues as the undisputed investment management centre in the UK, the second most important city remains Edinburgh, reflecting the wider importance of Scotland as a centre for the industry. The share of UK assets managed from Scotland fell by one percentage point between 2021 and 2022, accounting for 6% of UK AUM. However, this masks quite a sharp fall in nominal AUM year-on-year from £700 billion to just under £500 billion, almost 30%, reflecting differential operating experiences across UK-based firms through recent volatility.

Over the past decade, the share of Scottish AUM as a percentage of UK AUM has fallen by almost half (11% in 2012). This in part reflects some major changes in the corporate, and in consequence, operating structure of the Scottish asset management industry. It also reflects differential growth rates. Over the same time period, the total value of UK AUM has more than doubled. This suggests that the overall decrease in the proportion of UK AUM directly managed in Scotland is a reflection of faster relative growth in London and elsewhere in the UK, rather than a significant fall in Scottish managed assets in nominal terms.

Chart 3 looks at the regional distribution of assets managed by firms headquartered in the UK. Over the past ten years, there has been a gradual decrease in the share managed by firms headquartered in Scotland, from a quarter in 2012 to 16% in December 2022. Over the same period, firms headquartered in London have come to manage 81%, up from 70% in 2012.

The concentration of assets managed in the UK to firms headquartered in London fits in with a broader pattern we see in our employment data. Specifically, business operations have become more centred in Scotland, while portfolio management has become increasingly concentrated in London.3

CHART 3: UK-MANAGED ASSETS BY UK REGIONAL HEADQUARTERS (2012–2022)

Source: The Investment Association

3 Data on regional employment trends available in Chapter 6: Operational Resilience (page 98).
The Investment Association’s membership is diverse and far-reaching. Together, IA members are responsible for an estimated 85% of all investment management industry assets managed in the UK. Firms not covered in this report will belong to one of the following two groups:

- **Firms specialising in alternative investments**: The majority of firms not captured in the report typically specialise in alternative investments, including: hedge funds, private equity funds, commercial property management, discretionary private client and private debt management, and natural resource management firms.

- **Firms outside full IA membership**: Investment management firms that sit outside the IA membership other than those listed above is a difficult group to accurately size due to the lack of consistent third-party data.

Using third-party data and proprietary estimates, we estimate the wider industry at £10.3 trillion, down from £11.6 trillion in December 2021. Figure 3 provides estimates and illustrates how wider parts of the industry contribute to total assets under management in the UK.\(^5\)

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\(^4\) Additional information on IA membership and industry trends regarding the type of firms that make up the investment management industry available in Chapter 6: Operational and Structural Evolution (page 93).

\(^5\) A large share of IA member firms are active participants in the industry niches featured in Figure 3, so please account for a minimal degree of overlap between the wider industry figures.

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**FIGURE 3: WIDER UK INVESTMENT MANAGEMENT INDUSTRY IN 2022**

- **IA MEMBERSHIP**: £8.8 trillion
- **ETF OPERATORS**: £530 billion
- **PRIVATE CLIENT**: £780 billion
- **UK COMMERCIAL PROPERTY MANAGERS**: £540 billion
- **HEDGE FUNDS**: £300 billion
- **PRIVATE EQUITY**: £250 billion
- **TOTAL ASSETS MANAGED IN THE UK ESTIMATED AT**: £10.3 trillion

Source: The Investment Association, Pitchbook, Preqin
THE UK IN GLOBAL CONTEXT

The impact of a tough macroeconomic environment was not confined to the UK investment management industry. Global assets under management in 2022 fell 10% from $109 trillion to $98 trillion. The UK still maintains its position as the world’s second-largest investment management centre, overseeing 11% of global assets under management. Assets under management in the US, which account for nearly half of global AUM, fell 14% year-on-year to $47 trillion.

Estimates for the European funds market (ex UK) suggests that total European fund assets were down around 10% through 2022 in local currency terms. Together, the US, UK and Europe are responsible for over four fifths (86%) of global AUM. Japan stands out as a significant centre for investment management in the rest of the world, itself responsible for 7% of global AUM.

![Figure 4: Assets under management in European countries (December 2021)](image)

### Table 1: Global Assets under Management in 2022

<table>
<thead>
<tr>
<th>Country</th>
<th>Assets under management (local currency)</th>
<th>Assets under management (£ equivalent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>$47 trillion⁶</td>
<td>£39 trillion</td>
</tr>
<tr>
<td>Europe</td>
<td>€28 trillion⁹</td>
<td>£25 trillion</td>
</tr>
<tr>
<td>Japan</td>
<td>¥888 trillion¹⁰</td>
<td>£6 trillion</td>
</tr>
</tbody>
</table>

Source: HMR Revenue & Customs, Boston Consulting Group, EFAMA, Nomura Research Institute

At a European level, the UK’s investment management industry has a market share of 37%¹¹, which is equivalent to that of the next three largest European markets combined. As illustrated in Figure 4, the UK is followed by France (16% of European AUM), Germany (11%) and Switzerland (10%). Since entering the ranks of the top five largest European investment management centres in 2020, the Netherlands remains the next largest centre (7%).

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⁹ EFAMA, Our industry in numbers (data estimated as of September 2022).
¹⁰ Japan’s Asset Management Business 2022-23, NRI (data as of December 2021).
¹¹ At the time of publication, 2022 data is not yet available on a pan-European basis. These estimates are as of December 2021, based on data published by EFAMA.
MULTIPLE DIMENSIONS OF INTERNATIONAL ACTIVITY

A key driver of the scale of total assets under management is the international nature of the UK investment management industry, both in terms of the customers and businesses served and the underlying assets. Figure 5 highlights four key metrics that illustrate the extent to which the UK investment management industry is highly international – and becoming more so over time:

- Assets managed on behalf of overseas clients
- Assets invested in overseas markets
- Overseas assets delegated to UK based portfolio managers
- Assets managed by firms headquartered overseas

OVERSEAS CLIENT MARKET

UK retail and institutional investors continue to account for the majority of AUM in 2022, contributing £4.6 trillion to total UK managed assets, while assets managed on behalf of overseas clients stood at £4.2 trillion. As a proportion of total assets, AUM for overseas clients rose two percentage points and now account for almost half (48%) of total assets.

Identifying drivers of change in the overseas client number is challenging in the absence of flow data at AUM level. It will reflect a series of factors, including client behaviour, operational decisions regarding investment management capabilities, capital market returns and exchange rate movements.

In the case of the 2022 increase from 46% to 48%, the main driver appears to be the differential rate of change in overseas and domestic customer AUM. While assets for both UK and overseas clients fell over the year, UK client assets fell by 16% compared with a 7% fall in assets managed on behalf of overseas clients.

Looking back over the past five years, Chart 4 shows the consistent rise in the proportion of assets managed on behalf of overseas investors since 2018, following a period during which overseas client AUM averaged some 39% of total AUM.
The distribution of the £4.2 trillion of overseas client assets by region is illustrated in Figure 6. In terms of the top three regions:

- European clients continue to make up the majority (56%) of overseas client assets, from 59% in 2021. Of the £2.4 trillion managed on behalf of European clients, the majority (91%) is managed on behalf of clients in the European Economic Area, approximately £2.1 trillion.

- North American clients account for approximately 20% of the UK industry’s overseas client base, broadly unchanged in relative terms from 2021.

- The share of total overseas client assets for Asia-Pacific clients increased by one percentage point over the year, accounting for 16% of assets as of December 2022.

Assets managed on behalf of clients from other regions experienced little change between 2021 and 2022. Middle East client assets continue to account for 6% of overseas client assets. Latin American and African client assets continue to each account for approximately 1% of overseas client assets.
Taking a slightly longer perspective, Chart 5 illustrates how the distribution of overseas client assets has evolved over the past five years. Broadly, assets managed for European clients (down two percentage points to 56%) and Middle Eastern clients (down two percentage points to 6%) have both decreased in relative terms. In contrast, North American (up from 17% to 20%) and Asian (up from 13% to 16%) client assets have increased.

Looking back over the last ten years, Chart 6 highlights the growing significance of the UK as a centre of excellence in portfolio management for international investment funds, relative to the scale of the domestic funds market. Since 2012, the share of assets in overseas domiciled funds has increased from less than half (45%) to just over two thirds (67%) of all fund assets.

It should be noted that our funds data includes assets in open ended funds, investment trusts, ETFs, hedge funds and money market funds (MMFs). Some of these products, most notably institutional MMFs and ETFs, are almost exclusively domiciled overseas. While we have seen assets in UK domiciled funds increase in nominal terms over the last decade, the significant growth of ETFs over the past five years has significantly contributed to the growth in the share of assets sitting within overseas domiciled funds (see Box 4 for more detail on trends in the ETF market).

Services to Overseas Funds

Total assets in UK-managed investment funds stood at £4.0 trillion at the end of 2022, marginally down from the £4.1 trillion reported in the previous year. The majority (67%) of these assets sit in funds domiciled overseas, with the portfolio management taking place in the UK:

- Ireland is a key location for overseas domiciled assets accounting for a third (33%) of total fund assets, the same proportion of assets that sit in UK domiciled funds.
- Luxembourg is the third largest country of domicile accounting for 15% of total fund assets.
- The remaining fifth of assets sit in funds domiciled in the EEA (8%) and outside the EEA (12%)
IMPORTANCE TO UK SERVICE EXPORTS

The internationalisation of UK investment management presents an important opportunity for the industry to export its services globally. This is supported by the continued growth in assets within overseas domiciled funds where portfolio management is delegated to UK based portfolio managers in addition to the industry’s increasingly international client base (see charts 6 and 4, respectively).

Chart 7 looks at the investment management industry’s contribution to the UK’s total export earnings since 1996. Once adjusted for inflation, the contribution to the UK’s total export earnings stood at £9.4 billion in 2021, which is marginally down from £9.7 billion in 2020. The revised ONS data show a consistent increase in the value of exported services from 1996 to 2008 (from approximately £1.2 billion to £7.6 billion). Post-2008 the data show more fluctuations but overall, the value of exported services has grown to reach £9.4 billion.

The right-hand side of Chart 7 tracks the contribution of fund manager exports to total net exports. ONS data show that, since 2018, fund manager exports account for approximately 5.5% of total UK net exports. This is higher than the average 3% recorded in the 1990s (the last period of sustained growth), but still below the 6% to 8% recorded between 2006 and 2012.

CHART 7: INDUSTRY EXPORT EARNINGS AND RELATION TO UK SERVICES EXPORTS (1996-2021)

Data revisions by the Office of National Statistics means we have seen a reversal in the trend we have been reporting for the past few years. Whereas we had been reporting a decrease in the contribution of fund managers to exported services, this has stabilised over the past five years.
MAINTAINING INDUSTRY COMPETITIVENESS

Although the data presented in this year’s report remains broadly positive on the international standing of the industry at a time of significant challenge, sentiment in the industry about the UK as a place to do business is less so. This partly reflects the scale of policy and regulatory change that has coincided with the challenging global economic, political and security environment that we explored in the earlier part of this chapter. In a rapidly changing world, there is real concern that the UK is already losing ground as firms look elsewhere to innovate and establish new capacity that could otherwise be located in the UK.

In early summer 2023, the Investment Association set out six regulatory objectives for the UK investment management industry to remain competitive:13

- Stimulate innovation
- Facilitate cross-border business
- Focus on the cost of doing business
- Modernise the regulatory process
- Calibrate risk appropriately
- Target regulation effectively

The comments made in interviews conducted for the Survey echo these objectives, but with a particular emphasis on the threat to innovation and the UK’s future as a cross-border hub for the best talent in investment management if the cost of doing business in the UK is not addressed with a more efficient and proportionate regulatory system. More positively, there is an emerging alignment between industry and regulators on key aspects of the reform agenda, notably around the need to enable technological innovation and a less prescriptive approach to important aspects of the customer experience.

STIMULATING INNOVATION

As we discuss in more detail in the next chapter, there are different drivers of innovation, with firms seeing the central importance of cost efficiencies alongside potentially significant advances in quality of decision-making, operating infrastructure and customer interaction.

“The tokenisation of assets and funds could transform this industry and make access even easier. Being able to harness AI and enhance the use, quality and access to data will be transformational.”

As part of this process, the industry is strengthening at pace the dialogue with policymakers and regulators. Notably, a new Technology Working Group was established in early summer 2023 as part of the UK Asset Management Taskforce, which will help to identify the main opportunities in areas such as tokenisation and distributed ledger technology.

Firms also continue to see an obvious link between innovation and the sustainable investment agenda, with the potential for the UK industry to lead the way in which the decarbonisation imperative is embedded into the investment and capital market delivery infrastructure. This extends from issuance – e.g. how the green bond market develops – through to use of data for investment decision-making and portfolio or fund construction.

Linking to other aspects of prioritisation, notably the importance of cross-border business for a significant part of the investment management sector, there remains limited appetite for regulatory innovation to move the foundations of the UK fund regime too far from the established UCITS standards and a widespread desire for close alignment with the EU regime. At the same time, there is a recognition and ambition in certain areas to ensure the UK has the bench strength to deliver in accelerating areas such as private markets, which requires a new generation of fund vehicle such as the Long-Term Asset Fund.

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13 Investment Association response to FCA Discussion Paper 23/2, Updating and improving the UK regime for asset management.
“The EU fund regime is an extraordinary export story for the EU and we should be extremely careful about diverging away from that. We should be as closely aligned as possible because it has been a global kitemark for 35 years for quality. It balances the ability to generate exciting investment returns with high quality investor protection. That is the gold standard.”

FACILITATING CROSS-BORDER BUSINESS

The critical importance of portfolio management at the heart of the UK investment management industry continues to be a central message from firms. They emphasise the need for ongoing vigilance and determined promotion of open borders in a global environment increasingly characterised by re-localisation and re-regionalisation and a degree of protectionism in a number of key strategic sectors.

“The part of the value chain that creates really high paying jobs and drives the economy forward is the investment management component. At the moment, even by adding cost and launching EU fund structures, we’re still able to access global investors everywhere using our UK fund managers. The most important thing is that continues.”

“The UK must not take for granted its position. We have a whole ecosystem around the investment management industry in the UK: sell side, accountants, lawyers, auditors. That ecosystem allows us to serve millions of customers globally.”

At the same time, at product level, potentially diverging UK and EU regulation is also an obstacle to effective cross-border business. This has several specific ramifications:

- For UK and EU fund products, where portfolio management takes place in the UK, different approaches can significantly complicate delivery. For example, SDR and SFDR both have requirements that impact the way in which SRI portfolios are constructed and report.

- For EU fund products sold into the UK, having a different UK regime can lead to much more complicated requirements if a high degree of equivalence is needed in key areas of governance and reporting. The industry is awaiting the new Overseas Fund Regime, which will determine the parameters of the UK’s import regime in this area.

“For the UK asset management industry, the biggest opportunity is still managing assets or pools of assets that sit outside the UK. The ability to still delegate asset management into the UK is by far the biggest asset we have and that is what we export.”

Getting the regulation and the terms of trade right in this area remains a significant – and sensitive – challenge for policymakers, regulators and industry.
FOCUSING ON THE COSTS OF DOING BUSINESS

The question of costs and complexity – for example, through the layering of new regulation onto similar existing requirements – elicited the strongest response in Survey interviews on competitiveness this year. Over the past seven years, the UK has seen an unprecedented degree of new regulation affecting the sector, including:

- Implementation of MiFID II in 2018
- Senior Managers and Certification Regime (applying to sector from December 2019)
- LIBOR Transition with final use at end of 2021
- Consumer Duty (in force from 2022)
- Sustainable Disclosure Regime (policy statement expected by Q4 2023)

Regardless of size, business model and ownership type, there is a widespread view that costs have increased to a point where the UK is becoming a much more difficult place to do business as a fund management and/or investment management business.

Firms point out that there are other jurisdictions, including the US, which provide high consumer protection regulation and a lower regulatory compliance burden that could see the UK’s global competitiveness reduced, particularly in a post-Brexit environment, where access to the European market is less certain.

“I worry that the default now is to add regulation on top of regulation. It is suppressing innovation.”

“The UK part of the business is about one third of total assets under management and revenue of the global business, but my regulatory bill is around four times the rest of the organisation. What that means is if you look at me as a standalone business, I’m far less profitable than my APAC business or our North American business. A lot of that is to do with cost of regulation.”

“The impediments to success are a whole load of things from the treatment of VAT on asset management services to the regulatory agenda. If we have to jump through hoops that other countries don’t have to jump through, is it easier just to deal with different jurisdictions?”

In terms of the practical consequences of this rising cost, the risk is that innovation happens elsewhere, which has implications for the talent pool and the UK’s wider ability to attract the brightest and best as has historically been the case for UK financial services.

“There’s only a finite amount of capital available... and we could invest in generative AI for better product design or other things that I think could really benefit the UK economy and the consumer.”

“The challenge is that with cost of regulation, on top of all of the headwinds we are facing in markets and the economy, margins are going down and UK-based firms can’t invest so much back into their business. It will then be harder to retain talent and that could be quite a significant impediment. We could find that we will fall behind our competitors.”
MODERNISING THE REGULATORY PROCESS

Linking closely to the frustration over rising costs and complexity is a desire to see a different approach put in place to ensure the most effective regulatory process. One central theme, echoed already in industry calls for a new Investment Management Regulatory Forum, is the desire for better structures for dialogue between regulators and industry. At the same time, there is recognition by some that the relationship between firms and regulators is moving in a more positive direction, as reflected in a number of recent regulatory initiatives.

“We need rule-makers who listen to the industry and work with the industry to make it a competitive vibrant market. We all want good consumer outcomes. My business would go bust tomorrow if we don’t have good customer outcomes.”

“We recognise that there is good dialogue underway, a willingness to adapt, evolve and learn from some of the things that went wrong. From listing reform to the permissioning that has enabled the first LTAFs to be out in the market. All of those things underpin that embrace of the future.”

A further point, again echoing observations made over many years by the industry, is the importance of predictability and stability at a political level. Inevitably, governments will change, and elections will bring about new priorities. But for firms – and their customers – increasingly making funding commitments in areas such as energy infrastructure that stretch out over decades, it is both regulatory and political certainty that matters, such that the terms of trade do not unexpectedly change.

“We need to invest for the long term in our systems and our infrastructure. In order to do that, we need to understand and have confidence in the regulatory agenda. The regulatory agenda is in many parts driven by the political agenda. If that agenda keeps on changing, can we ever get that alignment and planning that we need?”

CHANGING RISK CULTURE

Members also highlighted that while consumer protection remains a core tenet of their retail businesses, risk is an inherent component of investment. Some felt that the direction of regulation has been to constrain the ability to take risk in some areas, which will limit investment options for consumers. At the same time, there is a recognition of progress being made in changing approach by the FCA, with industry support for the FCA’s identification in recent years of high cash holdings by some savers as a potential source of harm as a result of missing out on investment opportunity.

“If we aspire for a world which is about risk elimination, we’re not going to go anywhere. We’re in the business of taking the right risk on behalf of our clients and it’s only through that, that we will generate the returns necessary to safeguard their future financial requirements. Every now and then the zeitgeist feels quite hostile to that. We’ve got to try to reset that.”

The changes needed to boost the UK’s risk culture include more decisive action on resolving what has become a long-running debate over improving access to guidance alongside greater use of regulated financial advice. Again, 2022-23 has brought signs of progress with both a new consultation on simplified advice and a cross-stakeholder review, sponsored by HMT and FCA, to examine potential solutions to the advice/guidance boundary conundrum.

It is clear that the regulatory parameters need to be addressed as an initial priority. This could be particularly important in helping to facilitate the further development of regulated personalised guidance: e.g. tools to nudge investors towards certain options. As we discuss in the final section of this chapter, there is also scope for AI to facilitate enhanced customer services in this area.

14 FCA Retail Investment Strategy (2021) noted that out of 8.6m consumers holding over £10k in cash, half could potentially benefit from investing.
TARGETING REGULATION EFFECTIVELY

Finally, in an era of what may become a more principles-based regulatory environment (eg. through the Consumer Duty), firms are keen to look again at the overall rule book and see where there is scope for simplification of what has become an ever more complex set of requirements.

“There’s an opportunity to think through the rulebook and look at where do we have lack of proportionality and how can we simplify some of the regulations. If we’re going to be principles based and outcomes oriented, we have to go to the process-oriented rules that the FCA - on a day-to-day basis – does function on. Some of those processes and rules have to be simplified.”

“We have a productivity lapse in part because we have over-regulated, and we could have a productivity boost if we actually simplified some of the regulations and rely instead on the governance put in place for Consumer Duty.”

There are signs that this is starting to happen. An initial FCA discussion paper in 2022 (DP22/6) on the future of disclosure has begun to explore how to get the balance right between a consistent foundation and the scope for firms to tailor materials to customers without the kind of prescription that has characterised retail documentation. The potential for innovation and better customer outcomes recognising the needs of different individuals or groups is significant. The UK industry’s current position is to find a way to preserve the advantages of consistency (for example, a standard way of presenting key metrics such as charges or performance) while allowing greater freedom for manufacturers and distributors in how they present wider information as part of the investment process, both pre-sale and reporting.

THE FUTURE OF PUBLIC MARKETS AND THE UK LISTINGS REVIEW

Beyond sector-specific issues, the industry is also closely engaged on the wider shape of the UK’s capital markets, which are critical to long-term wider competitiveness. A central concern in the UK in recent years has been the decline of new listings in London, and in particular the loss of a number of innovative, high-growth companies to listings in other jurisdictions, notably the UK.

This concern has led to a number of reviews, including the Kalifa, Hill, Secondary Capital Raising, UK Prospectus Regime and UK Wholesale Markets Reviews, all of which have had the aim of attracting and retaining high-quality companies to the UK and unlocking more capital to be allocated to such companies.

CHART 8: NUMBER OF UK LISTED COMPANIES (1975-2022)

Source: World Bank, London Stock Exchange Group
Following these Reviews, in 2023 the FCA made a number of announcements aimed at furthering these objectives, namely a new regime for public offers and admissions to trading, and proposals for reforms to the UK Listings Regime. The FCA’s proposed new regime for public offers and admissions to trading aims to simplify and reform the current regime so that:

- Issuers can raise capital in an effective and efficient way.
- Costs are reduced for issuers and investors.
- Investors have sufficient reliable information on companies’ securities.
- There are fewer barriers to participation.
- There is appropriate monitoring and verification of issuers and securities.

The proposed reforms to the Listing Rules regime come after concerns were raised that the current Listing Regime is overly restrictive and acts as a deterrent to companies looking to list in the UK. The main proposed reform is the combination of the current premium and standard listing segments into a single segment for equity shares in commercial companies.

“We have British companies deciding to go and list in the US because it’s too hard here. You have asset managers now starting their businesses and doing any business outside the UK because it’s too hard to register and too hard to start up.”

“The challenge is finding the right balance between attracting companies and maintaining regulatory rigour – it can be the best market in the world from a governance perspective, but it’s not much use if no one will raise money here.”

The IA continues to engage with the FCA on these topics, and is broadly supportive of the reforms, but notes the need for a balance between:

- UK competitiveness.
- The needs of companies and their ability to raise capital on public markets.
- The fundamental role of investment managers to deliver sustainable returns and protect value on behalf of their clients.
- The risk appetite and needs of society and the economy to ensure the integrity of and public confidence in well-functioning public markets.

“We should definitely try to be more competitive and try to remove bureaucratic barriers to making the UK an attractive place to list. What we shouldn’t do is compromise on the quality benchmark of our standards. The Goldilocks point is standards that are high and have value to investors and investor protection whilst minimising bureaucracy and governance overhead.”

The IA is working with the FCA and other key stakeholders to identify ways to encourage high-growth and high-quality companies to operate in the UK while ensuring key investor protections remain in place.

On the demand side, the industry is also closely engaged with the 2022 Mansion House reform agenda designed to focus the debate onto the importance of risk capital for UK economic growth more broadly, whether for private or public companies (see further discussion on Private Markets in Chapter 3).