THE
INVESTMENT
ASSOCIATION

Investment Management: Powering the UK Economy

Budget Submission

March 2024

Introduction

Investment management sits at the heart of the economy, connecting long-term investors looking to grow their money with the businesses and infrastructure projects seeking capital. The industry has the potential to contribute further to the economic growth of the UK while delivering on the long-term financial resilience of our clients, through the opportunities identified in our Budget submission.

The Investment Association (IA) represents UK investment managers, and our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Collectively, our 250 members manage £8.8trn on behalf of clients, own around one-third of all UK equities, and invest in UK Government debt, as well as thousands of unlisted and high-growth companies, and various projects that bring us closer to net zero and fuel our social infrastructure.

The industry also provides over 126,000 highly skilled jobs, manages £1.4trn which is invested directly in the UK economy, and is responsible for 5.5% of the UK's total exports in services. Therefore, a thriving investment management sector is integral to the health of the wider economy.

Investment managers share the Government's vision of an open, sustainable, and technologically advanced financial services sector that is globally competitive and helps people around the world achieve their financial goals and enjoy prosperous retirements.

In line with the Government's ambition to raise business investment in the UK by £20bn per year over the next decade, we have outlined a series of incremental improvements that would contribute significantly to unlocking important additional capital for UK businesses. These measures should be aligned to achieve the following objectives:

1. **Making the UK a more attractive jurisdiction for the global investment management industry to choose to establish and expand their operations.**

2. **Growing the opportunities and incentives for the UK public to invest for the long-term.**

3. **Re-energising UK capital markets.**

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Executive Summary

The IA has identified the following measures which would enable our industry, working closely with Government and regulators, to contribute towards the Government's plans for growth. These measures would enable the UK to build on its reputation as a leading financial centre, increase the level of investment by the UK public, and enable more investment to flow into UK assets.

1. The UK as a destination for investment and growth

A combination of the difficult global economic environment and rival jurisdictions improving their offer to investment managers means the UK's market share is coming under increased pressure. Certain immutable advantages like location, language, and legal system have served the UK well as it has grown into an international leader in investment management. However, against increasing competition from challenger jurisdictions and efforts to constrain the UK industry's ability to offer products and services cross-border into key markets, this position can no longer be taken for granted.

It is therefore crucial that the financial regulators' new secondary objective for competitiveness and growth is executed effectively, that they are held accountable for it by the Government and Parliament, and that measures are taken across the government to support the UK's global competitiveness. To enable the UK to be a destination for investment and growth for investment management, the IA submits that a number of targeted tax measures need to be taken, including:

- The UK's internationally anomalous **VAT treatment of fund management should be addressed,** and UK-domiciled funds should be zero-rated to improve the environment for fund domicile in the UK. Independent research commissioned by the IA has shown that **for every additional £1bn of funds domiciled in the UK, an additional £1m is raised in taxes**.

  However, while included in the recently concluded VAT in Fund Management review consultation response, the Government has yet to take forward this proposal. We, therefore, request that this be reviewed as soon as possible. The trend for domiciling funds outside the UK continues to accelerate and is increasingly resulting in the UK missing out on important employment and tax revenue.

- With the reliance on EU jurisprudence diminishing from January 2024, HM Treasury must **provide clarity and certainty to the industry on the meaning of the term 'management' which until now has been derived based on a combination of EU and UK case law**.

  To maintain the UK's competitiveness as an investment management location, it is critical that the UK take a sensible and pragmatic view recognising the modern ways in which investment management services are utilised and delivered; and that the UK policy is clearly consulted on and published.

- **Tax simplification and certainty** must be delivered by maintaining a **comprehensive UK Tax Roadmap** to provide UK investment management firms with certainty around the scale and direction of tax reform and simplification. With the introduction of the Global Minimum Tax Rules, we would encourage a reassessment of the need for the UK's existing Diverted Profits Tax rules and Controlled Foreign Companies Regime.

2. Growing the levels of investment by the UK public

Investment plays a fundamental role in securing long-term financial resilience for individuals, whilst providing firms with the capital they require to grow, and infrastructure projects with the necessary finance. The levels of investment by UK individuals are significantly below other jurisdictions, such as the US[1], and evidence is clear that people are not investing enough to provide for their retirement, despite the success of automatic enrolment in increasing overall participation in the private pensions system[2].

The FCA's Consumer Investment Strategy notes that 15.6m UK adults have investible assets of £10,000 or more. Of these, 37% hold their assets entirely in cash, and a further 18% hold 75% in cash[3]. This is not in the interests of individuals who are missing out on better long-term returns, nor is it in the interests of the wider economy.

Last year an IA commissioned survey revealed only 39% of the UK adult population actively invest beyond their pension. More positively though is that 42% of that population are under the age of 35. As such there is a significant opportunity to get more people investing which would improve their long-term financial resilience and release more capital for investing productively in the economy.

The IA submits that more opportunities and incentives be provided to people within the UK to invest productively in the economy in order to better secure their long-term financial resilience and barriers to investing could be removed through the following deliverables:

- HM Treasury and the FCA should prioritise reforming the **advice/guidance boundary**. Increasing the ability of financial services providers to improve customer outcomes and improving access to advice is the best way to break down barriers to consumer investment and increase resilience. We are encouraged by recent progress, as reflected in FCA DP23/5.

- While there are practical challenges, we favour a **rebrand of the 'Stocks and Shares ISA' to Investment ISA** to reflect more fully the fundamental purpose and range of asset classes available to consumers. Subject to appropriate consultation on the detail and design, a "UK ISA" providing an additional allowance for domestic investment could catalyse new capital flows to UK companies, including small and mid-caps.

- **The Long-Term Asset Fund (LTAF)** will soon be available within the Innovative Finance ISA wrapper which is a positive first step in encouraging investment in a broader range of assets. Longer term, we would like to see **the LTAF included within Stocks and Shares ISAs**. The Innovative Finance ISA is a far less well-known product which FSCS does not cover. There are in the region of 17,000 Innovative Finance ISA accounts as opposed to 4 million Stocks & Shares ISAs. Commercial access to the LTAF should mirror its regulatory designation as a product suitable for retail investment.

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[1] New Financial Report – Unlocking the capital in capital markets
[2] PLSA research shows that 13.6 million people are at high risk of not savings enough to achieve the Pension Commission's Target Replacement Rate.
[3] FCA Financial Lives Survey 2020

- Alongside a focus on retail market participation, a clear timetable for **increasing contribution levels in auto-enrolment DC pensions** is an important next step to solidify and advance the success to date in dramatically increasing participation levels.

3. Re-energising UK capital markets

Historically, UK institutional and retail allocations to domestic equity have tended to be at higher levels than today. The erosion of so-called 'home bias' has now gone so far that there is a growing concern within the industry about the consequences, both for the domestic economy in terms of cost-of-capital and long-term investment, and for the international competitiveness of UK capital markets.

Resolving this issue is challenging and there is no silver bullet. However, as reflected in a range of Government and private-sector initiatives, a range of levers are available to remove barriers and change incentives. The IA welcomes the steps made in the Mansion House reforms and are eager to work with HM Treasury and the regulators to ensure the reforms are implemented swiftly. We have outlined five key deliverables to remove existing barriers:

- Build on the momentum from the **Mansion House Pension reforms** to further unlock UK pension capital for investment into unlisted equities and other private assets through:

    - Replacing the focus on cost in DC investments with a focus on value – or more specifically - net future returns for members.
    - Resetting the norm around daily dealing to break down liquidity barriers faced by DC pensions.
    - We also strongly advocate increasing contribution rates under auto enrolment above the current level of 8%.

- We **welcome the Autumn Statement focus on getting DC schemes to voluntarily increase allocations to unlisted equities**. However, we think the focus should actually be broader and **encompass other private asset classes e.g. private credit, infrastructure**. These asset classes also provide return and diversification benefits to DC members and will be important in helping the UK upgrade its infrastructure and make the energy transition.

- **Reform Stamp Taxes on Shares** to reduce the transaction costs of UK listed asset prices. The current regime is out of sync with other jurisdictions and therefore puts the UK at a competitive disadvantage. The IA would welcome a consultation on abolishing Stamp Duty and SDRT on UK listed equities, as detailed below.

- The UK has the potential to lead the world in green finance. The Autumn Statement emphasised the Government's ambition to **unlock investment and seize green growth opportunities**. For the UK to attract investment there needs to be a solid pipeline of opportunities for investors to support and grow the economy. The Government must maximise dialogue and information flows between private finance and all government departments to ensure investment supports orderly transition and sustains economic growth. The Budget should signal the Government's support for the Environmental Audit Committee's recommendations on tracking green investment flows and overcoming barriers to investment.

Detailed Proposals

1. Making the UK a more attractive jurisdiction for investment managers

Global investors recognise the UK as one of the pre-eminent locations to manage their assets. With £8.8trn of assets managed by our members, the UK is the second largest investment centre in the world, following only the US in scale, and bigger than France, Germany and Switzerland combined. Of that £8.8trn, overseas clients' assets account for 48% of total assets under management in the UK.

Being the home of a globally successfully investment management industry brings immense benefits to the UK, as the scale and success of the industry contributes directly to the economy, with the industry responsible for £9.4bn of net exports in 2021, 5.5% of the total UK exports in services. It also means that investment decisions are made in the UK leveraging UK based skills and local knowledge of the UK economy and society.

As investment management sits on the "buy side" of financial services, its success also has great multiplier benefits for the UK's broader financial services ecosystem. Therefore, making the UK an attractive place to do business, will have a significant positive impact on the overall economic picture for the UK.

VAT on management of UK domiciled funds

In the recently published HM Treasury's response to the consultation on the VAT treatment of fund management, we are disappointed to see that the proposals to consider VAT zero-rating on fund management has not been considered further at this stage. The narrow scope of the VAT consultation does not meet the Government's stated aim of making the UK a preferred home for fund domicile, that is, where investment funds are located from a legal, regulatory and tax perspective. We strongly urge that VAT zero-rating is reconsidered at the earliest possible opportunity to protect the UK's position as a fund domicile location.

The trend of domiciling funds outside of the UK is accelerating. The IA's latest data shows the total assets in UK-managed investment funds stood at £4trn. However, over two-thirds (67%) of these assets sit within overseas-domiciled funds, and of that, 82% are in funds domiciled in the EEA, primarily Ireland and Luxembourg. Creating the environment to boost the UK's place as a home for fund domicile has the potential to bring significant economic benefits, including increasing tax revenues and creating highly-skilled jobs across the UK – many of which are likely to be located outside London. Our latest research shows that a higher proportion of roles in operations and fund management are based either in Scotland (21%) or elsewhere in the UK (21%), compared to London (14%)[4].

[4] IA's Investment Management Survey Data. Domiciling funds in the UK supports jobs in Operations and Fund Management. These skilled jobs are more likely to occur outside London for a number of reasons. There is no business requirement for them in be based in high-cost locations such as London, yet investors value fund administration occurring in the same time-zone as the fund and performed by people with local knowledge of the market. The expansion of working from home during the national lockdowns exposed investment management firms to a wider, national talent

One of the key reasons that the UK is currently losing out on fund domicile activity is our internationally anomalous VAT treatment. The introduction of VAT zero-rating for UK management of funds would level the inconsistent VAT treatment between UK and non-UK funds. It will also send an important signal of intent which, together with wider policy and regulatory measures, has the potential to reset industry perceptions of the UK as a fund domicile.

An IA commissioned independent third-party analysis, previously shared privately with HM Treasury, shows the likely benefits of a more competitive UK funds regime, including VAT zero-rating, to the UK economy through increased activity, growth, and jobs in the form of:

- An increase in UK funds under management by up to £683bn after five years of change in the regime.
- An increase in total tax revenue by up to £693m after five years of change in the regime due to the additional economic activity it would generate across the UK.

Overall, the analysis indicates that for every £1bn of funds domiciled offshore, which could have been or could in the future be domiciled in the UK, around £1m per annum in total tax revenue has been lost by the UK Exchequer.

Such a move would also be crucial to securing the UK's leadership across investment management activity in areas that are key to the UK's future success, notably green finance and the digitalisation of the financial markets.

Ensure a clear and consistent UK VAT Policy

While VAT Zero-Rating would be a welcome first step, there remain a raft of other urgent areas needing attention to ensure that the UK VAT regime meets the needs of the UK economy and helps protect the UK's position as a successful financial services and investment management location. For the investment management sector, outside of VAT zero-rating, there are three critical elements to consider:

(a) Clarity and certainty on the meaning of the term "**management**" for UK VAT purposes ensuring that this both offers certainty of existing case law, while also being dynamic enough to cope with evolving commercial arrangements and business models. This should specifically consider and recognise outsourced services of fund management and any technology spend which facilitates the performance of these services. We are disappointed that the recently concluded review of VAT in fund management did not consider this important question despite overwhelming support and request from the industry. Consequent to the Repeal of EU Law Act (REUL), EU jurisprudence has become merely advisory from January 2024, which in the absence of specific definition of 'management' in UK VAT legislation, has been a key factor in helping the industry and indeed HMRC determine the meaning of this term. In the absence of any actual policy decision and clear communication regarding the nature or form of "management" by HMT, this presents a well of uncertainty for our sector.

(b) Given the recent closure of the **VAT in Fund Management review** and abandonment of the EU concept of a *"Special Investment Fund"*, we would urge the Government to

pool as fund administration roles can be performed remotely. Government programmes such as the Scottish Financial Enterprise which provides skills and training courses has helped Scotland grow as an employment destination for investment management.

set out a framework for how future fund vehicles can make their case for access to the VAT fund management exemption. Relying wholly on a list-based approach, as set out in Items 9 & 10, Group 5 of the VAT Act 1994, has its advantages and we welcome the certainty and security that it provides. However, without being open to including new fund vehicles, such as the Reserved Investor Fund, for instance, will likely see such funds fail to compete against existing more VAT efficient investment products. We ask for a commitment that the Government be both open and available to discuss the merits of extending the exemption at the beginning of every new fund vehicles' design to ensure that VAT does not prove to be a limiting factor in their future success.

(c) In the case of investment research, this is a perfect opportunity for the UK to change its VAT policy and extending the VAT exemption to investment research, resulting in making research less expensive, increasing the supply of research and improving conditions for UK based research providers. This will promote the effectiveness of UK markets.

Tax Simplification & Certainty

The Chancellor's Mansion House speech rightly identified the need for greater simplicity within financial services.

As the UK and most of the rest of the world transition to the Global Minimum Tax Rate Rules under the OECD's Pillar Two project, we would urge the Government to take this once in a generation opportunity to consolidate and simplify many of its soon to be redundant taxes and reporting regimes currently employed by the UK.

We would like to see HM Treasury reassess the following taxes and regimes as the objectives of both clearly fall within the Global Anti-Base Erosion Model Rules ('GloBE') which will allow the UK to align behind a single, international standard:

- The Diverted Profits Tax, introduced in 2014 to counter exploitation of the permanent establishment rules and tackle financial arrangements that lack sufficient economic substance.
- Regimes like the Control Foreign Companies (CFC') charge and anti-avoidance provisions designed to prevent diversion of UK profits to low tax territories.

Removing these regimes and the myriad of other tax-related reform required to put the UK onto a more competitive footing will be necessary but could in the short term be disruptive if not done carefully.

It is important that the Government minimises the level of disruption any tax reform takes. To support this, we would welcome clearer communication from Government on what their plans are and when industry input will be required. This could be facilitated by the Government publishing and maintaining a comprehensive UK Tax Roadmap, setting out HM Treasury's and HMRC's vision for remaking of the statute over the remainder of the current, and into the next, Parliament.

A roadmap would provide UK investment management firms certainty around both the scale and the direction of change they face in order to allow them to plan and contribute accordingly.

2. Growing the levels of investment by the UK public

Reform of the advice guidance boundary and simplified advice

We are pleased to see the continued focus on the need to review the boundary between regulated financial advice and financial guidance. The publication of DP23/5 in December was an important step and it is crucial this momentum is not lost.

In 2012 the FCA introduced the Retail Distribution Review, which increased the quality of advice in the UK, Unfortunately, it also led to a more pronounced advice gap in the UK. There are 38 million UK adults who are not getting formal support with financial decision making.

HM Treasury has an interest in the economic opportunities that arise from a population which is better served, seeing improved outcomes and are more financially secure and in which greater productive finance is made available for investment in UK businesses. As Defined Benefit (DB) entitlements decline and Defined Contribution (DC) plans become more common, the risk of consumer harm grows.

The current regulatory regime, which is intended to support good consumer outcomes is currently creating consumer detriment. We believe that the proposals laid out in DP23/5 will go a long way to both enhancing customer service and allowing firms to intervene more strongly when a scam is taking place.

Furthermore, the FCA needs to create a new advice regime, which is more accessible, and can help customers with simpler investment needs.

There is considerable support for change, including from the six leading financial services trade and membership bodies (ABI, AIC, IA, PIMFA, TISA, and UK Finance) who are working with HM Treasury and the FCA to address this issue.

Reform of the advice/guidance boundary is imperative to make Consumer Duty a success and we encourage HM Treasury to ensure the review is ambitious in its remit and scale and proceeds at pace.

Modernise the ISA regime

The ISA model has been a great success, and their approaching 25th anniversary is an appropriate point to ensure that they remain accessible, effective, and well regarded. This should include consideration of how ISAs are used in practice and how they might be used to incentivise the UK-public to invest in their long-term future.

An IA-commissioned Opinium survey of 1,000 investors on ISAs showed that a fifth of investors were motivated to invest in Stocks and Shares ISAs because it allowed them to invest in innovative companies tax efficiently. The main reason cited by 55% of those surveyed was that it would give them a better long-term return over cash and suggests ISAs could be used to unlock greater levels of capital for high-growth firms.

To build on the success of the ISA and set it on the right course for the next 25 years the IA recommends HM Treasury to look at increasing the ISA allowance and have it rise with inflation, at regular intervals, to a round number.

If HM Treasury is minded to refresh the ISA brand, the IA recommends looking to change the name of Stocks and Shares ISAs to 'Investment ISA'. While some firms may already brand their Stocks and Shares ISAs as an 'Investment ISA', having a rebrand come from the Government will send a strong signal to consumers that the ISA is a means to invest for the long-term, not just in shares, but also in other assets and in different collective vehicles such as investment funds and investment trusts. We would hope in time that this will provide access also to the LTAF (see below).

If the Government is minded to introduce a new UK-focused ISA, this should be delivered by increasing an individual's annual ISA allowance specifically for investments into it. The UK ISA should be distinct from the existing ISA options to avoid complications arising from the management of investments within other forms of ISAs. An additional allowance would also create a further incentive in a market where UK stocks and shares have recently been out of favour. The Government would need a clear definition of what constitutes a UK investment which it may wish to link to the other reforms targeted at making the UK's capital markets more attractive, including encouraging greater capital for small and mid-cap publicly-listed companies.

Given the range of differing views on a new UK-focused ISA, the need to define what constitutes a UK investment (both for shares and funds), and the need to identify the operational changes required, the IA recommends a robust public consultation before any new wrapper is launched. Any changes to the ISA regime need to be well thought through and announced well before the changes come into force, to allow for firms and platforms to change operations, and for changes to be communicated to customers.

<u>The Lifetime ISA & the self-employed</u>

The Lifetime ISA (LISA) was designed to help consumers save for their first home or for retirement, however, there has been limited take up because of the restrictive nature of the regime it was set up with. To make the product more attractive the IA recommends that the following policy changes should be considered:

- Increasing the age which consumers can save into a LISA to the Minimum Pension Age.
- Removing the LISA from the ISA allowance.

Furthermore, the IA recommend HM Treasury to consult on changes to the LISA, to reposition it as a retirement savings product for the self-employed. Proposals which are consulted on should recognise that liquidity may be an issue for the self-employed and they may therefore need to access their funds without penalty before retirement. As part of repositioning the LISA it may need to be renamed to suit the new nature of the product.

Reforming the LISA will lead to it becoming a more attractive product for providers to offer and therefore increase competition in the market.

Broaden Access to LTAFs

The Long-Term Asset Fund (LTAF) is now available within the Innovative Finance ISA wrapper which is a positive first step in encouraging investment in a broader range of assets. Longer term, however, we would like to see **the LTAF included within Stocks and Shares ISAs**.

IA member research has found that the Innovative Finance ISAs has the lowest brand recognition, with only 7% of UK adults saying they are familiar with the product.[5] There are in the region of 17,000 Innovative Finance ISA accounts as opposed to 4 million Stocks & Shares ISAs, which is equivalent to about 4% of the overall value. The product is not well understood, carries higher risks and offers limited diversification compared to the Stocks and Shares ISA. The wrapper is also not covered by FSCS. Expanding Stocks and Shares ISAs to include LTAFs, would enable more people to access investment opportunities and provide greater capital for illiquid investments.

We consider that the strong investor protections built into the LTAF regulatory framework justify the inclusion of these funds within the qualifying investments for stocks and shares ISAs, notwithstanding the lower redemption frequency. The inclusion of LTAFs in the ISA regime would promote both longer term saving and investment in higher growth companies.

Funding for long-term assets across the country is acutely needed: Legal & General previously calculated there to be a £1trn UK infrastructure funding gap between 2020 and 2030. Allowing investors to access LTAFs through their stocks and shares ISAs would increase opportunities for UK investors to invest in UK assets. In particular there is significant potential for capital to be used by projects, typically outside of London, which will support in the upgrading of UK infrastructure.

However, to allow retail investors the ability to fully benefit from the access to private markets offered by the LTAF, further changes to the ISA rules are critical. As stated, LTAFs should be eligible for inclusion Stocks and Shares. Stocks and Shares ISAs should be permitted to hold investment products which are regulated and offer appropriate levels of investor protection, but that take longer than 30 days to liquidate. We have previously called on HM Treasury and HMRC to make this change.

Elsewhere more work is also needed to unshackle the LTAF from the current inefficiencies of the UK's Fund Tax regime. OEIC and Authorised Unit Trust structured LTAFs will suffer the inevitable tax drag experienced by many UK-based funds which employ mixed-asset allocation strategies, which will in-turn limit their performance through diminished distribution yields compared to their nearest international long-term capital rivals.

We would urge the Government to carry through with their commitment, promised as part of the UK Fund Regime, to address this accidental, arbitrary and anomalous feature of the taxation of UK funds at the earliest possible juncture.

[5] One ISA – Simplifying ISAs for consumers and encouraging saving, AJ Bell Policy Paper, 2023

3. Re-energising UK capital markets

Pension reforms

It is great the investment management industry continues to be recognised as a key partner in the drive to increase growth in the UK economy. We are very supportive of the laudable action the Government has taken with initiatives such as the Long-term Investment for Technology and Science (LIFTS) initiative, which will widen the opportunity for investment into smaller private companies. Yet, there remains a number of challenges to unlocking greater UK pension capital for investment into unlisted UK equities.

The focus on harnessing pension scheme investment needs to be on DC rather than DB. For well-documented reasons relating to regulation, scheme maturity and where we are with interest rates and DB funding, corporate DB schemes are going to be limited providers of risk capital. it is the DC system that is a more natural source of risk capital at this point (along with the LGPS).

Furthermore, with UK DC schemes already heavily invested in listed, liquid equities, the opportunity is to get more DC schemes to provide their members with exposure to the increasing amount of activity taking place on private markets. We therefore very much **welcomed the Autumn Statement's focus on getting DC schemes to voluntarily increase allocations to unlisted equities**.

However, the focus should be broader and **encompass other private asset classes, such as private credit, and infrastructure**. These asset classes also provide return and diversification benefits to DC members and will be important in helping the UK upgrade its infrastructure and make the energy transition.

While we recognise the aspiration for greater UK investment through the Autumn Statement, **we share the Government's view that investment should not be mandated**. As long as there are attractive UK opportunities, DC capital will find its way to them. It is important to also consider:

- **Investment consultant advice** has a significant impact on the investment management profession, specifically in relation to the demand and supply of investment products and services, particularly in the private assets space. We reiterate our call for increased regulatory oversight over the investment advice given to pension schemes in line with the recommendations of the CMA market investigation of 2017-19.
- **The application of trustees' fiduciary duty**, particularly as it applies to investment in private asset classes. Here, we reiterate a number of important observations around the operation in particular of the DC market. These focus on the combined impact on a predominantly **daily-dealing delivery infrastructure and the relentless focus on cost as the ultimate measure of value**. Taken together, these factors remain significant blockers to a meaningful move towards an investment decision-making culture that can better support private market productive finance through vehicles such as the Long-Term Asset Fund.

Addressing these factors is therefore critical in helping deliver the goals of the Autumn Statement. The IA is also strongly supportive of the Autumn Statement's confirmation that the consultation to introduce the DC value for money framework will be taken forward in the Spring of 2024.

On **consolidation**, we are broadly supportive of measures being taken to encourage it further in the UK pensions market. Scale is a necessary but not sufficient precondition for success: larger schemes generally have the governance budget to make allocations to more sophisticated asset classes. However, this scale must be sophisticated, and this can come in different forms. Pension schemes can build internal investment management capabilities, although this can be expensive. Investment management can also be outsourced, especially given the range of global investment opportunities. In reality, most large pension schemes will choose a mixture of the two approaches, recognising that is impossible to be best in class in all asset classes and investment strategies.

<u>Pension contributions</u>
Finally, it is clear that in order to have more capital to invest in UK assets and to help ensure future pensioners have the income to fund their desired standard of living, pension contributions need to be higher than their current levels of 8%. HM Treasury alongside other policy makers should consider how best to increase contribution rates under auto-enrolment in conjunction with industry, and more generally encourage higher rates of contribution, including to non-workplace pensions. Ultimately, if contributions are too low, pension member outcomes will likely be inadequate regardless of the quality of the investment process.

Reform of Stamp Taxes on Shares

The UK, unlike many other major markets, maintains a form of financial transaction tax on the transfer of main-exchange UK listed shares via the Stamp Duty and Stamp Duty Reserve Tax (SDRT) rules. For example, the transfer of standard equity shares in the UK is 0.5%, which is higher than that of France (0.3%), Hong Kong (0.26%) and India (0.2%). The US maintains no form of financial transaction tax on either of its main exchanges.

It is ultimately a cost for businesses to consider and like any tax will influence investor behaviours. It both directly and indirectly drives-up transaction costs and lowers UK listed asset prices. This negatively impacts trading volumes and discourages high-frequency trading of asset types caught within its net.

Moreover, the reach of Stamp Duty and SDRT is not consistent across all classes of equity and can incentivise investment into synthetic rather than direct exposure of UK listed shares.

HMRC is currently conducting a project focused on modernisation of Stamp Taxes on Shares which predates much of the wider debate on the UK listings and the FCA's Primary Markets Effectiveness Review, and it would be a clear missed opportunity for the UK to simply reform this tax regime without considering its future relevance.

We believe that it is unrealistic to expect UK equities to able to compete in international capital markets unless there is a level playing field when it comes to transaction costs. To redress this long-running competitive asymmetry, the Government must look at the abolition of Stamp Taxes on Shares on UK listed equities in an effort to re-invigorate interest in UK markets.

Providing a catalyst to green growth

The UK has the potential to lead the world in green finance, which would not only attract economic activity but also play a crucial role in mitigating and adapting to climate change. The Autumn Statement emphasised the Government's ambition to unlock investment and seize growth opportunities by being at the forefront of the global transition to net zero.

A sense of long-term stability is crucial to attracting investment by giving investors confidence that the policy and political environment is conducive to providing long-term, resilient economic growth. However, investors are concerned that there may be a shortfall between the UK's legally binding net zero target and the policy measures in place to achieve an orderly transition in the assets in which they invest.

The OECD has noted that while the UK has successfully reduced greenhouse gas emissions in the past and maintains a broad political consensus on net zero, uncertainty regarding future policy stringency for achieving the transition is limiting the flow of necessary private investment.[6] The OBR has stated that a worsening assessment of the UK's ability to achieve medium-term carbon budgets increases the likelihood of higher public investment being needed in the future.[7] This places at risk the government's objective, as stated at the State Opening of Parliament, of helping the country transition to net zero without adding undue burdens on households.

For the UK to attract investment there needs to be a solid pipeline of opportunities for investors to support and grow the economy. The IA is among a coalition of business and civil society organisations supporting a 'UK Net Zero Investment Plan' to remove barriers to the private finance needed to deliver green growth in the UK economy.

The Environmental Audit Committee's recent report on the financial sector and the UK's net zero transition recommends a formal mechanism for tracking financial flows, an independent body to oversee that work, a process for reviewing financial flows against the Government's existing sector and technology roadmaps, and a review of whether further incentives or policy changes are required to encourage financial flows.[8] While the end goal of an economy-wide Net Zero Investment Plan is important, the process is essential and must maximise dialogue between private finance and all Government departments to ensure investment supports orderly transition and sustains economic growth. The Green Finance Strategy's ongoing work to track private investment must also be complemented by tracking real-world measures of capacity and delivery in the energy sector.

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[6] OECD, Economic Policy Reforms 2023: Going for Growth (October 2023)
[7] OBR, Fiscal risks and sustainability (July 2023)
[8] HoC Environmental Audit Committee, The financial sector and the UK's net zero transition (November 2023)