New City Initiative

Decentralising Fund Management

Encouraging Regional Growth

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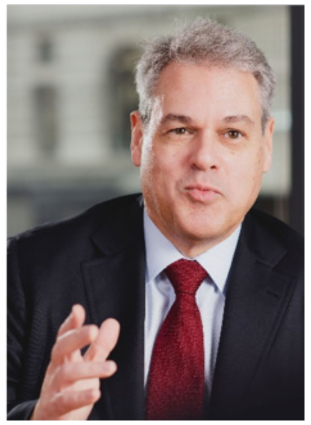
Foreword



I am pleased to introduce this paper on the opportunities for decentralising fund management in the UK and encouraging regional growth.

Innovation by entrepreneurial UK asset managers in delivering access to investment markets via collective investment schemes has gone hand in hand over the years with the development of ever wider investment expertise. The lawyer Philip Rose founded The Foreign & Colonial General Trust in 1868, and Ian Fairbairn and George Booth launched M&G's First British Fixed Trust in 1931 to replicate the resilience and popularity of mutual funds in the United States. Adaptation and evolution have continued over the years to allow UK asset and wealth management firms to remain competitive in delivering their investment expertise to different categories of client. Unit Trusts have morphed into OEICs, and front end charges and bid/offer spreads have disappeared.

Both fresh and familiar challenges, from the COVID economic shock to Brexit, are emerging which make the UK ripe for a new generation fund structure which could also be a catalyst for industry and job growth in servicing the assets invested in a new UK domiciled fund structure.

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Chairman, New City Initiative
Partner & Chairman, Dalton Strategic Partnership LLP

A new funds' regime for the UK

Since 2017, the New City Initiative (NCI) has been campaigning vigorously for the UK to develop a new branded fund structure based on globally-accepted best practices, which could potentially compete and improve upon the EU's widely regarded mutual fund wrappers, principally UCITS (Undertakings for the Collective Investments in Transferable Securities) and AIFs (alternative investment funds). While Brexit might be quite disruptive for UK asset managers, precluding them, for example, from distributing their investment products inside the EU, it could provide an excellent opportunity for the UK to create its own bespoke fund structure. Such a development could facilitate the onshoring of more asset servicing roles such as fund administration which have traditionally been based in Ireland and Luxembourg. In turn, this could help generate new jobs, especially in the UK regions.

Getting it done

Such a fund structure would provide investors – both retail and institutional – with more choice, allowing for competition to thrive. So how could such a structure differentiate itself? If a UK fund brand is to accumulate capital, it needs to incorporate the investor protections presently enshrined under the UCITS and AIFMD (Alternative Investment Fund Managers Directive) regimes. However, there is scope to improve upon them. For instance, the UK's Financial Conduct Authority (FCA) has publicly stated that some of the prescriptive liquidity arrangements mandated under UCITS need tightening in light of the Woodford episode in 2019. Such reforms could help promote the UK as a leading centre for investor protection.

Alternatively, the UK could also follow some of the recommendations made by the Investment Association (IA) and develop a long-term asset fund, a structure that would put an end to daily redemptions at investment vehicles trading illiquid securities in what could help minimise the risk of liquidity mismatches. Other potential changes could include loosening the capital requirements currently imposed on UK asset managers or strengthening the existing depositary oversight model in a bid to support better client protection. In order to gain traction, UK retail and institutional investors currently invested in UCITS need to be given the opportunity to convert their holdings into such a new UK fund structure To facilitate this, managers should make switching as easy as possible. As incentive, early stage converters could be given fee discounts in the new fund vehicle.

Creating a new fund structure will not be a straightforward exercise and will require both commitment and a willingness to implement major changes to regulation and taxation. Most importantly, the UK would need to simplify its existing tax treatment rules for foreign investors. A number of UK fund structures such as the unit trust and open ended investment company (OEIC) have struggled to attract international investors because the country's tax regime is excessively complicated. As such, the UK should consider adopting a policy of tax neutrality in a way not too dissimilar from onshore fund hubs like Ireland and Luxembourg.

Such taxation reform could include:

Exempt non-UK investors to UK tax on investments
Insulate non-UK investors from any withholding taxes on payments from their funds

This could also help re-onshore UK assets currently held in Luxembourg and Ireland. For instance, crude estimates suggest that 42% of investors with exposures to UK asset managers with Irish-domiciled funds are based in the UK. Not only could this tax reform stimulate foreign investment in UK asset management firms, but it might also help promote employment in the wider financial services industry as well, especially outside of London.

Promoting the regions

A number of leading service providers (i.e. asset servicers such as fund administrators and custodians; accountants; law firms, consultants, technology specialists) are located in EU onshore locations (e.g. Luxembourg and Ireland). For example, the financial sector in Luxembourg – which includes private banking and investment funds, contributes to approximately 1/3 of the country's entire GDP. As a result, the roll-out of an effective domestic UK fund structure could materially strengthen this country's financial services industry, potentially offsetting some of the job losses caused by Covid-19 and Brexit.

With the incumbent government now prioritising regional economic development, NCI believes the asset management industry could help facilitate this. If the UK is able to develop a popular fund structure, it could result in a huge upsurge in asset servicing roles. Many of these functions do not necessarily need to be carried out in London. In fact, a number of leading fund administrators already have thriving offices across several regional UK cities including Birmingham; Bournemouth; Belfast; Glasgow and Liverpool. If more professional services firms establish themselves in the regions, local economies will flourish.

Case study 1: Technologists in the regions

Some of the largest global banks have a long-track record of recruiting technologists outside of London, including Citi (Belfast); Deutsche Bank (Birmingham); JP Morgan (Glasgow); Morgan Stanley (Glasgow); and Bank of America Merrill Lynch (Chester). More recently, it was revealed that Goldman Sachs is looking to acquire 60,000 sq. feet of office space outside of London with Manchester or Birmingham as being the likely candidates.

In addition, it does not just have to be asset servicing/support roles that relocate. Asset managers, for example, are facing sizeable cost overheads as a direct result of increasing operational and regulatory spending. This is making it increasingly difficult for start-up fund managers to establish themselves. Moreover, the industry as a whole is likely to find itself under severe revenue pressure as a result of Covid-19, and its impact on performance.

In response, it could make far more economic sense for start-ups or existing managers to set up offices outside of London, where cost overheads and office rents are markedly lower. In fact, this trend is already happening. Chris Sier, the Fin-tech envoy at the Northern Powerhouse, acknowledges a growing number of asset managers are now incentivising their sales and relationship management staff to relocate outside of London.

The regional rebalancing act

Although London remains the dominant financial services centre for the UK, the regions have been experiencing impressive growth nonetheless. For example, financial services/ related professional services jobs in Wales grew by 11% between 2016 and 2017, while Yorkshire and the Humber had a 17.8% increase.[1] Similarly, the East of England and West Midlands also saw a 7.3% and 7.2% respective increase in the number of financial services/related professional services roles.[2] According to The City UK, two thirds of the 2.3 million jobs in financial/ related professional services in the UK are currently located outside of London.[3]

1 The City UK
2 The City UK
3 The City UK

Region	Number of jobs in financial and related professional services
London	776,000
South East	249,000
North West	239,000
East of England	177,000
South West	165,000
Yorkshire and the Humber	159,000
East Midlands	88,000
Wales	61,000
North East	47,000
Northern Ireland	35,000

[4]

The cost benefits

A number of regional development professionals told the NCI that the cost benefits of being outside of London is one of the biggest factors attracting businesses into their local areas. Research by CBRE found that London's West End and City were the two most expensive markets for commercial real estate in the whole of Europe. According to CBRE, prime office occupancy costs in the West End average around £175/square foot per annum while it stood at £110/square foot per annum in the City.[5] In contrast, data from Savills Research highlights that prime rents in central Manchester cost around £36/ square foot. In Birmingham, prime rents are approximately £34/square foot, while it is £30/ square foot in Leeds. As a result, more financial institutions are looking beyond London for office space.

Similarly, the cost of talent is also much lower elsewhere than in London. According to Glassdoor, an assistant vice president in Birmingham at Deutsche Bank earns £55,000 compared to £75,000 in London. Again, these are not unsubstantial savings. Sier also emphasises there is an abundance of talent in regional cities owing to their excellent universities and higher education facilities. "A number of financial services firms are also encouraging people living in London who are from regional cities to move back to their home towns and work in subsidiary offices. The quality of life and buying power in regional cities is much greater than in London, and that is also proving to be a major pull," says Sier.

4 The City UK
5 CBRE

Beyond the regional cities

By encouraging the asset management industry to widen its geographical footprint within the UK, it could result in a trickle-down economic effect with wealth becoming more evenly distributed from affluent regional cities to nearby towns, which are among some of the country's most depressed areas. If less well-off towns are to thrive moving forward, however, there needs to be more government investment in core transportation links and infrastructure. Julian Wells, director at Whitecap Consulting in Leeds, says that railway infrastructure needs urgent improvement in the north although he is confident HS2's green-lighting could help facilitate that.

A more ambitious approach could be to encourage asset managers and other financial institutions to invest in some of the UK's deprived regions by offering them tax incentives. One local expert concedes that this would be a long-term initiative. "Financial institutions need to be located in areas where there are strong links to universities. In many of the more deprived parts of the UK, there are obvious talent shortages, and that will prevent firms from relocating there. That said, if financial services firms and other organisations were motivated to invest in further education, skills-development and infrastructure in these deprived regions, then that could yield positive results albeit over the long term," he says.

The Covid-19 effect

Since this paper was initially drafted, the Covid-19 pandemic has caused a revolution in working practices, as financial institutions were forced to implement their worst case scenario business continuity planning (BCP) arrangements. The overwhelming majority of people in financial services are now working remotely from home with limited overall disruption. However, financial institutions – irrespective of whether they are banks or asset managers – are expected to come under revenue pressure far greater than what was seen in 2008. With firms looking to incur savings, some may try and relocate their main offices outside of London.

Moreover, working from home has become normalised and accepted, even among some of the most conservative institutions. Similarly, the surging use of video conferencing technologies is expected to continue, resulting in fewer physical meetings and interactions. Again, this is a trend which could potentially outlast the pandemic itself, and will likely mean demand for office space in London (and elsewhere) could be subdued for some time.

Sier believes that while home working is increasingly ubiquitous, regional hub offices are expected to become more prolific too. "Remote working from home is causing connectivity and broadband problems, and I would imagine companies will start setting up regional hub offices whereby people can access superior levels of internet service," he says. Public health factors could be a driver in this as well, with more organisations implementing split-working operations to safeguard staff. As such, this could result in employees being told to work in alternate shifts across their central and regional offices over certain prescribed time periods.

Others concur. ""It is possible that the 'new' working practices emerging from the Covid-19 crisis will help break down geographical boundaries, which may provide a helpful boost to the regional economy. If video conferencing, virtual meetings and digital events become more prominent, this could encourage more London-based organisations to consider remote working and / or a regional office presence as they seek to identify potential sources of efficiency and effectiveness in their operating models," says Wells.

Proposals

- In order to stimulate asset management and asset servicing jobs following Brexit, the UK should create its own fund brand. This is something which NCI is willing to engage with the government on.

- If this fund structure is successful, it could spark further growth in UK asset servicing and asset management roles. The government should encourage these businesses to launch outside of London.

- Similarly, incentives – potentially tax benefits - should be given to financial institutions to invest in infrastructure and education in especially deprived parts of the UK. This could help promote long-term economic regeneration.

- NCI is willing to facilitate conversations between the industry and regional economic bodies to help support the funds' industry development outside of London.

New City Initiative Members

UK Members

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About the New City Initiative

NCI is a think tank that offers an independent, expert voice in the debate over the future of asset management.

Founded in 2010, NCI counts amongst its members some of the leading independent asset management firms in the City and the continent. The NCI gives a voice to independent, owner-managed firms that are entirely focused on and aligned with the interests of their clients and investors.

Over the last decade, a traditional “client-centric” approach has enabled entrepreneurial, owner-managed firms to emerge as an important force in a financial industry dominated by global financial giants. Now, more so than ever, these firms play a key role in preserving the stability and long-term focus of the financial sector, which is of benefit to society at large.

About the Author

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Charles Gubert is a consultant to the NCI. He is founder of GTL Associates, a research, copy-writing and marketing consultancy to financial services institutions, and a contributing editor at Global Custodian Magazine. Prior to this, he was a research manager at Thomas Murray IDS, a consultancy and editor at COOConnect, an online title aimed at chief operating officers at alternative and long-only fund managers. He started his career as a reporter at Risk Magazine and Hedge Funds Review.

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