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Independent Investment Management Initiative submission: Financial Services Growth & Competitiveness Strategy – Call for Evidence

Dear Rachel Reeves and Tulip Siddiq,

12th December 2024

As a group of over 50 entrepreneurial specialist investment managers, predominately based in the UK, we share your vision to deliver the long-term, sustainable and inclusive growth of the financial services sector in the UK. We strongly believe that small businesses, including specialist investment firms are the engines of growth. Our membership represents over $500bn in client money and around 3000 members of staff and we work closely with the regulators, the government and the City of London supporting you with your mission to promote a competitive and world leading asset management center with client outcomes at its core.

The views that we share in this submission, are with smaller businesses in mind. Our areas of focus are on three of the policy pillars: regulatory environment, skills and access to talent and international partnerships and trade. Within this our primary focus is on the regulatory environment, which we believe could maintain its effectiveness, while better enabling growth, innovation and choice.

Regulatory Environment

We strongly believe that small businesses, including small and specialist investment firms, are engines of growth. However, there are significant costs and complexities of starting an asset management business in the UK. We are often compared with our US counterparts who have much lower barriers to entry and hence entrepreneurial businesses can be born with greater ease. Enabling the incorporation and development in addition to the scaling of small businesses should be part of the scope of this call for evidence.

Regulatory costs disproportionately impact smaller firms, given their resource and capital constraints. These raise barriers to entry and discourage entrepreneurs (unless they have access to significant pools of capital, which has implications for diversity as well as growth and innovation in our industry). It also reduces investment choice and feeds the ever-growing challenge of consolidation in our industry. We therefore welcome moves towards regulatory rationalisation, as well as harmonisation with international standards. This must, of course, be done in ways compatible with the FCA's objectives regarding consumer protection and market integrity. We see many ways in which they can be mutually reenforcing.

We have several ideas for improving UK fund structures, regarding international competitiveness and regional growth. We are cognisant of efforts to address the shortcomings in the current rules around Investment Trusts, particularly regarding costs and charges and the need for a new regime. We are working with your colleagues and the FCA to suggest improvements to the current regulatory treatment of Investment Trusts with a view to reducing any regulatory requirements that are not additive in terms of managing risk or protecting consumers.

We would also encourage regulators to consider other suitable UK fund structures for alternatives. The closest UK fund type to a "hedge fund" in terms of investment flexibility is a Qualified Investor Scheme (QIS). But there are multiple operational challenges with these which merit review.

An additional way in which regulators could better support the growth of our industry is to re-frame important questions of value. We believe that value for money, is a multidimensional concept, beyond cost. This includes consumer choice, risk management, client service, stewardship and sustainability. We see the current value for money approach for defined contribution (DC) funds, for example, as potentially narrow. This can encourage a simplistic approach to investment choices and presents a revenue challenge to specialist firms. We encourage regulatory clarity on the scope of value, moving beyond a narrow interpretation. We would also point to a body of research – including from the FCA – noting the value of active management from the perspective of systemic risk.[1]

Another potential challenge to growth is consolidation. Whilst the plans to consolidate local government pension schemes will enable greater investment in UK infrastructure, this may not be in the best interests of pensioners or asset managers. Without careful planning, this move may also reduce investment choice for pension schemes. If opportunities are only afforded to the few larger asset managers able to accommodate large capital allocations, choice may be reduced and smaller entrepreneurial firms may lose out. **We recommend consultation with a wide variety of industry participants, to guard against unintended consequences of consolidation.**

In a similar vein, in the investment consultant universe, the last decade has been categorized by consolidation and consultancies pursuing fiduciary management often without a tender process. **We welcome a more serious review of this pattern following continued adverse effects on competition despite the 2018 Competition and Markets Authority 2018 findings.** Greater regulation of the activities of investment consultants would be encouraging.

Finally, we recommend that fund platforms are also subject to greater regulatory oversight. Many platforms prohibit asset managers with smaller funds claiming that they must have client demand. However, customers are less able to access a wider variety of investment choices, including smaller, specialist funds unless they are listed on platforms causing a 'chicken and egg' scenario which is currently being ignored by the regulator.

<u>Skills and Access to Talent</u>

Attracting and retaining talent in our industry is key for growth and innovation and IIMI represents some of the most entrepreneurial businesses in the UK. With that in mind, we suggest broadening the approach to diversity and inclusion in our industry. We advocate for a re-focus towards some of the qualitative aspects of culture and inclusion (diversity of thought, employee engagement, competency of leaders, client outcomes etc.) which are lost owing to a quantitative approach (although we support that reporting is not required for companies with under 250 employees).

[1] 'Does the growth of passive investing affect equity market performance?: A literature review', 2019, Kevin R. James, Daniel Mittendorf, Andrea Pirrone, and Claudia Robles-Garcia https://www.fca.org.uk/publications/research/research-note-does-growth-passive-investing-affect-equity-market-performance

International Partnerships and Trade

We see opportunity to build on the UK's leadership role in financial regulation. **Sustainable finance is an area in which the UK has been a leader, but also one which we believe would benefit from a more international outlook.** Many key sustainability matters, notable climate change, and inherently global risks meriting coordinated solutions. However, we've seen notable regulatory divergence in this area, including with the FCA's approach to SDR. Currently, it is materially simpler to launch a Fund named 'Sustainable' in Europe than it is in the UK, despite newly tightened European fund naming rules. This is a potential source of competitive disadvantage, as well as confusion and complexity. We would urge for a focus on greater consistent with existing international standards and terminology. There is also need for harmonisation; it could be argued that the FCA's TCFD and SDR regulations could be consolidated.

Our relationship with the US is ripe for review. We would strongly advocate negotiating some form of equivalence with the SEC/CFTC regarding passporting rights.

We look forward to supporting the government with your growth and competitiveness strategy and working with the industry to position the UK as world leading with respect to financial services.

Best wishes

D. Hristova

Chief Executive Officer – Independent Investment Management Initiative