Written Evidence submitted by the Investment Association (IA) (FSMB40)

Financial Services and Markets Bill

The Investment Association is pleased to be able to give evidence to assist in the scrutiny of this important Bill.

The investment management industry plays a central role in the economy, channelling savings into long-term investments in order to deliver returns for a wide range of clients, from individual savers in the retail market to large institutions such as pension schemes.

A thriving investment management sector is integral to the prosperity of the economy, and this Bill presents an opportunity to build on this success.

This sets out our priorities in the FSM Bill which will help to strengthen the UK's position as a leading financial centre in the interests of consumers, businesses and the wider economy.

IA Key Priorities

1. **Secondary objective of growth and competitiveness:** We fully support the inclusion of a new secondary objective for competitiveness and growth. This is a reform that we have been advocating for some time and will be key to building a regulatory environment which enables us to provide the best possible service to our customers in the UK and globally. Competitiveness boosts our international standing, helping us to directly support the economy in terms of tax revenue and jobs.

2. **Effective oversight of our regulators**: Greater accountability and oversight of our regulators will be vital as they play an increasing role in shaping rules specifically crafted for the UK market.

3. **Revocation of EU law**: The FSM Bill will usher in a new phase, where our regulatory structures are shaped specifically for the UK market and legacy EU regulation is reassessed. This is most welcome. But the high volume of expected change means that both the timing of and resources allocated to issues will be crucial. We look forward to working with government and regulators to make sure that this vast programme is prioritised in a way which supports consumers and competitiveness.

4. **Advice Gap and financial wellbeing**: We ask that the FSM Bill facilitates changes to be made to the 'advice vs guidance boundary' to unlock the barriers facing individuals when they look to secure their financial futures and the difficulty of accessing appropriate help. We also call for **financial inclusion and wellbeing** to be more at the fore of regulation, enabling consumers greater access to the most suitable products to better support their financial wellbeing.

5. It is vital that a new regulatory architecture is fit for purpose and allows consumers and businesses to reap the benefits of regulatory framework designed for the UK environment. **We ask that government and Parliament press ahead with the Bill without delay.**

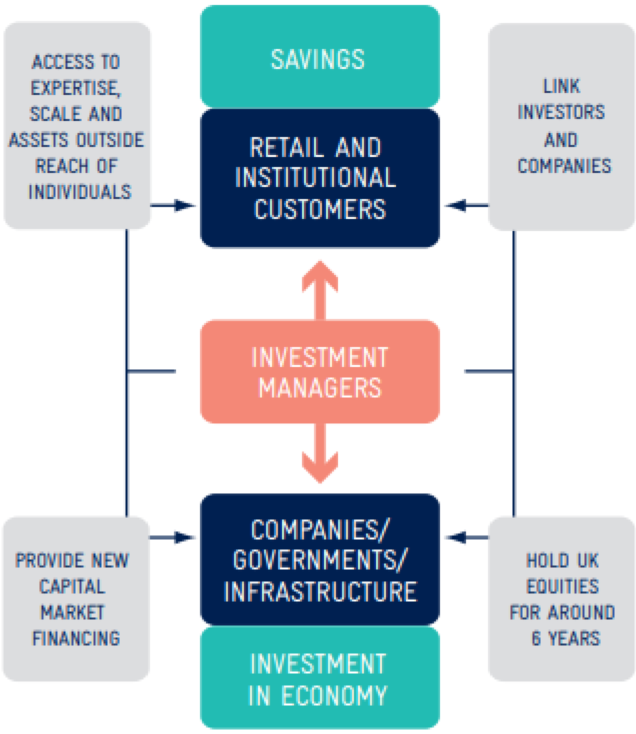
Investment Management: Powering business and financial wellbeing

Having a world leading investment management sector right here in the UK makes it easier for British savers to access the very best products and expertise which helps them to become more financially resilient. Overall, **three quarters of UK households use the services of an investment manager** to help them invest their savings and, in particular, to plan for their later life.

This is vital right now, because our industry must serve a nation experiencing a cost of living crisis. The effects of rising inflation will have an immediate, and long term impact on the ability of people to save and have a decent standard of living in retirement. Our industry has a key role to play in mitigating the long term impacts of inflation on the financial resilience of the nation.

Because this global industry is based here at home, investment decisions are made close to UK businesses and infrastructure projects which rely on the capital channelled into them by investment managers. In total, **IA members have invested over £1.6trn in the UK economy by investing in companies, buying their debt, financing property and infrastructure construction,** and buying UK government gilts.

Our competitive strength is founded on high standards. High standards of investment expertise provided to our customers, high standards of products and innovation which respond to changing needs; and high standards of regulation that provide reassurance and trust.



About the Investment Association

The Investment Association (IA) represents UK investment managers, whose 250 members collectively manage over £10 trillion on behalf of clients. Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity and help the achieve their aspirations
- Enable people to maintain a decent standard of living in retirement
- Contribute to economic growth through the efficient allocation of capital
- Invest in new, high growth and "blue chip" companies to help them innovate
- Invest in infrastructure to help modernize the economy
- Attract international investment for the UK economy

For further information please contact politics@theia.org.

The Financial Services and Markets Bill

Clause 1 – 7 and Schedule 1 Revocation of Retained EU Law

A transparent and predictable regulatory structure is essential to supporting consumers and helping businesses to thrive. We are therefore calling for a clear prioritisation system to be established and adhered to.

This section of the Bill will revoke all retained EU law relating to financial services, with the regulators replacing it with the appropriate regulatory requirements in their own rulebooks.

This is a vital step towards creating a legislative and regulatory system specifically designed for UK consumers and businesses, and the financial industry which serves them.

We support the application of the FSMA framework approach to areas covered by retained EU law. This is based on the existing model of UK financial services regulation introduced by the Financial Services and Markets Act 2000 (FSMA). This approach delegates broad powers to the FCA and PRA to make detailed rules that apply to firms, within a policy framework set by government and Parliament. As such, it allows for clear division of responsibilities and democratic input while recognising the technical expertise of the regulators.

The steps outlined in this Bill will initiate a significant programme of work now and over the years to come. **During this it will be vital to consider**:

- **How changes are prioritised**. The enormous volume of legislation – (over 250 pieces)[1] - to be revoked, replaced and revised means that careful consideration will need to be given to how activity is prioritised. A sequenced and smooth transition will be important to avoid disruption to businesses and any negative impact on customers.
- **The pace of change**. The scale of this review means that businesses will need to work hard to implement updates in a timely and accurate way. We are also mindful of the demands on regulators while they focus on their core role of protecting markets and consumers. Extensive engagement and consultation with government and regulators will be required to fully map-out the implications of any changes.

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[1] This includes 32 EU regulations, 189 SIs and all provisions made under 25 EU directives.

Consultation/Cost Benefit Analysis. Clause 6 of the Bill allows regulators to avoid the usual consultation and cost-benefit analysis process in some circumstances (if the rules being replaced are materially the same as what is being revoked). It will be important to have clarity on this, and on the situations the exemption will apply to avoid new rules being brought in without effective consultation, to ensure they are fit for purpose and do not bring unintended consequences.

Clause 8 – Designated Activities Regime

It is important to ensure that any such new measures are given the appropriate time for consultation and implementation to allow firms to make necessary changes and engage in discussion as to the appropriateness of the addition of a new activity.

The Designated Activities Regime is a new legislative framework (amending FSMA 2000) whereby the Treasury can 'designate' activities connected to financial markets (e.g. exchanges, instruments, products or investments). Once designated, regulators can make rules relating to those activities without needing those conducting the activity to be authorised.

Those conducting a designated activity will be required to follow the rules for that activity unless exempt. This is a significant departure from the current model in the Regulated Activities Order which is based on authorisation of an entity (not the designation of an activity they carry out). Given the potential significance of this change, further clarity will be needed on how the new regime will be monitored and firms supervised.

Clause 18-19 Critical Third Parties

We are supportive of the proposals and will engage with the regulators on the detail.

The Bill gives powers to HM Treasury to designate certain cloud and other third-party service providers as 'critical' giving the regulators powers to directly oversee the resilience of the services they provide to regulated firms and Financial Market Infrastructures (FMIs). FMIs allow the clearing, settlement, and recording of financial transactions. This enables millions of transactions to take place each day.

Clause 21-22 – Digital settlement assets

It is important to develop a robust regulatory architecture for cryptoassets to protect consumers and to help build the UK's standing in this space.

The Bill gives HM Treasury a power to bring digital settlement assets used for payments into the UK regulatory perimeter, including introducing a definition of 'digital settlement asset.' The government will take a phased approach and begin its focus on stablecoins, where used as a form of payment.

The investment management industry supports this as part of a wider programme to provide regulatory certainty about cryptoassets. There is growing interest in the investment case for these types of assets amongst investment managers' clients, and it is essential to ensure the UK regulatory architecture is fit for purpose - to prevent consumer harm, allow innovation to develop safely and securely and ensure the UK does not fall further behind its competitor jurisdictions.

Clause 23 – Mutual Recognition

One of the UK's key post-Brexit aims is to create a globally attractive range of funds with a variety of fund types to satisfy future client requirements at home and abroad. Mutual recognition enables this by making it cheaper and more effective for UK investment managers, including smaller firms, to sell UK domiciled funds into new markets. Expanding the UK's role as a fund domicile, as well as a location for fund management, brings with it renewed opportunities for export earnings and new jobs around the UK.

This clause will allow HM Treasury to make changes to domestic legislation to ensure that Mutual Recognition Agreements (MRAs), including the mutual recognition of funds, can be fully implemented. Mutual recognition of funds is an important part of the UK's future financial framework. Free Trade Agreements remain the gold standard for international cooperation, providing high levels of investor protection, however, the time taken to negotiate these can be an obstacle, whereas Mutual Recognition Agreements are much swifter to agree and can be an important interim step.

Clause 24 – Secondary Objective for Competitiveness and Growth

Of utmost importance for the investment management industry in this Bill is the introduction of a secondary objective for competitiveness and growth for our regulators.

A regulatory focus on the role that financial services play in growing the economy, including through international trade, is vital. A supportive regulator will be increasingly important as we face tough economic conditions, and clear objectives aligned with a change in culture will be key to achieving this. We fully support the inclusion of this new objective as part of the culture, skills and capacity change required within the regulatory system to unlock potential growth for the benefit of UK citizens.

It is right that the FCA's primary objectives to protect consumers and the integrity of the market should remain their central focus. However, an additional secondary objective for competitiveness and growth will support the UK's world leading financial services industry and power the wider economy. Implementing this secondary objective will also align the UK with the international norm of ensuring that regulators consider the impact of their decisions on the international competitiveness and economic growth of their jurisdiction.

Today, our members own a third of the FTSE and invest in many thousands of unlisted and high growth companies, infrastructure projects, and of course buy UK government debt. In addition, we provide over 122,000 jobs and are responsible for 4% of the UK's total exports in services. The new objective will help us to build on this success.

Even more fundamentally, having a world leading investment management sector right here in the UK makes it easier for British savers to access the very best products and expertise which helps them to become more financially resilient.

A regulatory focus on growth, including ensuring that people have access to the products and services which will help them to save for their financial futures, is key to boosting this.

Without the UK's strength as a global centre for investment management, investors would not benefit from the same range of opportunities to invest for later life which are specifically tailored to their needs.

This global success story is dependent on the right regulatory framework. **In our experience, regulators have not always paid sufficient regard to economic growth and international competitiveness resulting in a loss of jobs and tax-take.**

Regulators' impact on the financial and wider economic environment is significant. Therefore, there is merit in considering what secondary objectives are set and how existing ones may be modernised. There are calls for **financial inclusion and wellbeing** to be more at the fore. As we face unprecedented economic times, it is more important than ever that all members of the public can access the most suitable products to better support their financial wellbeing. This could involve considering what policy tools are available to expand the number of people able to save and invest, in addition to protecting those who are already able to do so. Supporting more people to save, for their future finance needs, would also bring the benefit of deepening our capital markets, further enhancing the UK's international competitiveness.

However, of greatest importance is ensuring that any regulatory objectives are effective in practice. To do so requires a significant cultural shift as well as mechanisms to measure success and ensure accountability.

Clause 25 – Regulatory Principles: Net Zero Emissions Target

We support change within the Bill aimed at aligning the FCA's regulatory principles with the Climate Change Act 2008. We must also recognise that the transition to net zero will be economy-wide and similar duties should exist elsewhere to ensure all sectors are held to the same standard.

Investment managers' long-term view means that they focus on risks like climate change which have the potential to undermine our economy. Climate change is one of the single biggest systemic risks facing society and the planet today. If this is not addressed, it will fundamentally undermine the basis on which our economy, businesses and society are founded. Policymakers around the world are recognising the need for joint action with the investment industry to plot a better course.

The investment management industry is playing a vital role in financing the transition to a cleaner and more sustainable economy. It is helping the companies we invest in to become more transparent about their impact on the environment and is supporting businesses and governments to create investible schemes that support low carbon growth.

Investment managers with £7 trillion of assets under management in the UK have now made net zero commitments, representing nearly threequarters of the AUM in the UK. Assets managed within sustainability focused strategies have risen substantially, our latest figures show this has risen from 2.6% in 2020 to 8.2% in 2021. Looking at funds specifically, assets in funds with Responsible Investment characteristics rose by 62% in 2021 to £89 billion, further demonstrating how important investing with environmental, social and governance considerations in mind has become.

Clause 40/41/42 - Cost Benefit Analysis (CBA) Panels

A new CBA Panel would help to ensure a robust and standardised methodology for assessing the cost of regulatory change. However, the scale of the challenge means that it is important that the panel's effectiveness, expertise and role within the regulatory process are considered. As the process is developed, attention should be paid to:

- **The panel's membership including how members are selected and what experience and expertise they bring.**
- **The panel's authority to oversee the FCA's approach and how it is performing its duties in preparing a cost benefit analysis.**
- **The process and criteria for assessing circumstances in which the panel will not be required**

The Bill requires the FCA and PRA to establish new statutory CBA Panels to support robust regulatory policymaking. It will also require regulators to detail their approach and methodology for conducting CBAs for new rules and amending existing rules, and set criteria for when this can be postponed.

A more rigorous process for conducting and having regard to regulatory CBA is urgently required and the investment industry supports these changes.

A recent example where we do not believe the CBA was sufficiently rigorous is the new Consumer Duty CBA which identified a significant wide-ranging set of costs for the industry incurred in a very short time period (e.g., £688.6m to £2.4bn one-off direct costs) but offered very little by way of quantifying the benefits that the new Duty would bring to consumers with regard to our industry.

Implementation of the Wholesale Markets Review

The Bill makes a number of updates to the regulation of secondary markets, based on the Wholesale Markets Review. The investment industry supports these changes which allow more effective trading and shape regulations specifically for the UK's markets, while maintaining high regulatory standards.

These are a key part of boosting the UK's competitiveness as a global financial centre. Specifically:

- **Schedule 2 Transitional Amendments: Removing the Share Trading Obligation.**
  This amends Article 23 UK MiFIR to remove the share trading Obligation (STO), which requires firms to trade shares on a UK exchange or one deemed equivalent. **The investment industry supports this, as the STO has prevented firms from accessing the deepest pools of liquidity while failing to provide additional transparency as intended.**

- **Schedule 2 Transitional Amendment: Removing the Double Volume Cap**
  This deletes Article 5 UK MiFIR to remove the double volume cap (DVC), which restricts trading. **The investment industry supports this: the DVC has not resulted in the hoped-for benefits to investors, but has introduced an unnecessary level of complexity.**

- **Chapter 2 – Clause 11 Rules relating to investment exchanges and data reporting services providers**

This will allow the FCA to develop a Consolidated Tape (CT): a system that would be intended to collate real-time exchange-listed data, such as price and volume. This would help market participants to analyse liquidity and to evaluate the quality of execution of their orders.

We are strongly supportive of the development of a CT but there are concerns about fragmentation resulting from differing approaches in UK and EU. To be effective, this should involve a single CT for each asset class, chosen through a competitive tendering process.

The Prospectus Regime Review

The IA supports this simplification of regulation in this area to make the process more agile and effective, as well as facilitating wider participation in the ownership of public companies and improving the quality of information investors receive.

The Prospectus Regime Review intends to boost the UK's competitiveness as a destination for IPOs and optimise the capital raising process for large and small companies on UK markets. The Bill will enable HM Treasury to replace the UK's EU inherited Prospectus Regime, in line with the outcomes of the Prospectus Regime Review.

HMT have indicated that the Regime will be among the first set of rules to be reformed. The IA looks forward to analysing the detail via consultation once FCA have been provided with the necessary legal powers.

Addition to the Bill – a call-in power

We understand that a call-in power is likely to be included within the Bill to support the government's work in ensuring that the regulators are meeting the objectives set.

We believe that this power may be helpful in ensuring that regulators meet their objectives. However, the operation of this should be carefully considered to ensure that it does not impact regulatory certainty and stability on which industry relies.

There should also be consideration of how industry is given a role in **the initiation of reviews where regulatory decisions are not aligned with the objectives set, and therefore require further consideration.**

Amendment to the Bill needed: Fixing the Advice Gap

The investment industry considers that this Bill could help to solve one of the key issues facing people when they look to secure their financial futures: the difficulty of accessing appropriate help.

Millions of UK citizens would benefit from greater access to the long-term returns that investing brings, helping them achieve lifetime goals while at the same time providing greater growth capital for the economy. This would support financial inclusion and be a vital part of supporting peoples' long term financial wellbeing. Catalysing retail participation in capital markets, even at a time of rising economic uncertainty, will help to lay a foundation which will deliver benefits for decades to come.

The FCA's strategy to reduce investment harm includes: reducing by 20% the number of consumers who could benefit from investment earnings but are missing out, ensuring a person's investment risk profile is appropriate for their circumstances and reducing the amount of money lost to investment scams. All these targets would be supported by more consumers having greater access to financial advice.

One of the central challenges in achieving such participation, whether attracting new investors or helping existing customers to invest better, is the ability to provide appropriate support at appropriate stages of an individual's life.

FCA research indicates that less than 10% of the UK adult population receive regulated financial advice. When combined with the restricted support that financial services firms are currently allowed to provide, this results in the vast majority of the population being under served and experiencing detrimental financial outcomes as a consequence.

This is not a new debate, but the current inflationary environment makes solving this problem particularly urgent: now more than ever, holding cash in low-return bank accounts rather than investing for the future has the potential to seriously impact how people will be able to provide for their retirements. This will affect not only their own futures, but also the ability of the state to support our ageing society.

This Bill is an opportunity to do two things:

- **Facilitate full financial advice to be supplemented by simplified advice services for those with less complex needs.**
- **Facilitate personalised financial guidance to help those already within the investment system.**

Taken together, these will help to unlock the strategic challenge. At the heart of the solution is a review of the definition of advice within existing legislation.

For its part, the investment management industry is committed to supporting a new regime that works to ensure good outcomes for customers, and achieves high levels of customer protection, within a broader framework that empowers appropriate decision-making.

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