Capital Markets Industry Taskforce Conference: workshop discussion summaries.

On 7 July, CMIT hosted over 200 market participants from across the UK capital markets ecosystem, including investors, companies, intermediaries, regulators, and policymakers. Over the course of the plenary sessions and workshops, several suggestions were put forward by the participants to further develop the UK's capital markets to best serve growth in the UK economy and the UK's place as a global financial centre. Please find below a summary of these discussions.

Please note that the event took place under the Chatham House Rule and this summary should not be taken to represent the views of any speakers, participants or CMIT.

CMIT will now work with market stakeholders to refine the conference participants' ideas to inform policy recommendations and the Capital Markets of Tomorrow report.

Unlocking additional sources of capital for UK companies, including from pension funds and insurance

Focus: Making it easier for capital to flow in the direction which generates greatest benefit, supporting UK companies and providing pension and policyholders and savers with strong long-term returns.

Risk culture and skills

- Many noted that in recent decades the UK investment ecosystem (from investors, to government, regulators and society) seems to have forgotten that risk and return are directly connected. There has been instead a focus on minimising costs rather than maximising net returns, with a consequential negative impact on long term returns for UK investors. For example, it was noted that pension funds have now far less risk appetite than individual investors and this partly stems from regulators' guidance which often is designed to address the possibility of worst-case (though low probability) scenarios. This has occurred despite pension funds, in many cases, having the advantage of scale over individual investors.
- Potential solutions could include commissioning a review into how investment risk, uncertainty, returns and liquidity are all considered and managed within the system. Alternatively, an external independent oversight body could consider whether the system is delivering the right outcomes for consumers (by incorporating a holistic approach that includes assessing the risks to long-term returns, as well as risks to capital).
- Many suggested that financial literacy is critically important for the good management of pension money. This is both necessary at the individual policyholder level and at the trustee level. There is a need for a skills review in the UK and alignment of long-term objectives between policyholders and those managing their money. Children should be educated about the value of risk vs return at school. Adults contributing to pensions should be taught about the different approaches taken globally, and how, for example, US policyholders have been benefitting from access to successful private equity investments in UK companies, whilst UK policyholders have not.
- On the role of trustees specifically:
    - We need better education and recruitment practices across our pension schemes. In some cases, we do not have the right mix of skills doing the job.
    - Where trustees do not have sufficient financial education or investment experience, they rely on investment consultants (who are largely unregulated). The role of these consultants has expanded from advising on basic fund metrics, like life expectancy of policyholders, to helping with asset allocation and in some cases, providing investment vehicles. This scope creep may not always be appropriate or achieving the best outcomes for policyholders.
    - Where trustees do not have the necessary scale or expertise to ensure best outcomes for policyholders, they should be required to consolidate and upskill.

Consolidation of pension funds

- There was broad support for consolidation of Defined Benefit (DB), Defined Contribution (DC) and Local Government Pension Scheme (LGPS) schemes to build scale and allow for more diversified investments.
- Suggestions included an exercise to learn from examples of better consolidated / scaled pension funds in other countries, such as 'Supers' in Australia, but also other means such as exploring the use of the Payment Protection Fund or a Sovereign Wealth Fund to support investments at scale.
- However, it was noted that consolidation by itself will not be enough without addressing the structural challenges that accompany this consolidation and the broader issues around investment culture.
- There was acceptance that increased scale in pensions should help consumers achieve greater value for money. However, it was noted that a key component of this value for money was in achieving access to the best investments and not just the cheapest investments. Increasingly aggressive pricing in market for new DC pension mandates was cited as an example of fee pressure which may ultimately lead to worse outcomes for consumers.
- At an individual level, many supported the view that policyholders should be better educated in how a DC pension scheme operates to ensure they understand that DC pensions are, in effect, a long-term savings and investment plan akin to a stocks and shares ISA. It was noted that whilst many individuals know how much money is in their bank accounts, they are unaware of how much is currently in their pension fund or how those funds are invested. There should be greater transparency on the governance and performance of pension funds and wider usage of pensions dashboards. Many individuals in the UK will accumulate multiple plans during their lifetimes which means there is a need for greater education and simplicity of rules.

  Many noted that the cost-of-living crisis meant it was a difficult time to suggest that individuals contribute greater amounts to their pensions but recognised that the current default 8% contribution to pension schemes in the UK is not enough to ensure a comfortable retirement for most people.

Retail investment

- Many believed there is a need for a societal shift in the UK to ensure individuals take ownership of future savings and investments, in the same way they take responsibility for buying a home and paying a mortgage. There needs to be a drive to invest in economic growth, not just capital preservation, or cost management. Improvements to financial literacy and early incentivisation for younger people to invest in equities was important to ensure their future financial wellbeing.
- A concerted effort to improve awareness of what is available, and the returns available, could help towards achieving this. Some saw that the current trend in ESG investment as an opportunity to inspire greater investment by younger generations.

Taxation

- There were suggestions to reintroduce the dividend tax credit to support greater investment and incentivisation in UK equities.
- Reforming the Individual Savings Account (ISA) framework, including tax benefits for investments in UK stocks or simplification through amalgamation of the different forms of ISA into one product were also suggested.
- The UK has several successful tax incentive schemes to support growth companies, but gaps exist above current investment thresholds which hinders companies' ability to obtain the necessary capital to scale.

Consumer Duty

- The Financial Conduct Authority's (FCA's) Consumer Duty was recognised as a positive opportunity, but many cautioned it lacked a definition of what should be deemed to be the "best outcome" for consumers. One potential solution would be to use the Consumer Duty to help improve the understanding of the concept of risk vs reward in the UK, so that customers are better placed to consider what the potential positive/negative implications can be of their long-term investments.

Corporate governance code and stakeholder engagement reform

Focus: Improving the relationship between companies and investors in a way that provides good quality governance and clear accountabilities, enabling UK companies to compete and grow effectively to the benefit of all their stakeholders.

Governance, stewardship and regulation

- Many agreed we should revert to first principles – where boards are recognised as representing shareholders.
- Governance and stewardship expectations should better align with the expectations of those who manage the capital that is being invested in those companies, as they are best placed to understand what company decisions matter to shareholder value.
- There is a need to create a safe space for conversations between Boards and shareholders.
- There was consensus on the need to shift the stewardship and governance codes from being a tool for adversarial engagement between investors and companies to one that is used as a mechanism to better support companies' growth and success. Changing the regime from 'comply or explain' to 'apply or explain' could help change the way the code is interpreted and therefore applied. A company that chooses to "explain" why a particular provision of the code is not applicable to them should not be seen as failing to "comply" with that provision. Both options are wholly acceptable under the code, and many were concerned that the current references to "comply" place companies using the "explain" option at a disadvantage (given the negative connotations attached to a decision not to "comply"). Using the words "apply" or "explain" would instead be seen as more equivalent alternatives that companies could choose between without fear of being unfairly penalised.

Proxy advisers

- Many considered that serious thought should be given to the role of proxy agencies in the UK investment chain, whether the current arrangement is delivering the best outcomes for the wider ecosystem and whether greater responsibility should be exercised by fund managers when managing their own investments. Some suggested that there should be public disclosure of company-by-company proxy recommendations and increased regulation and frequency of engagement between proxy agencies and companies, at senior levels, outside of the AGM period.

Remuneration

- Many considered that remuneration decisions in publicly listed companies should be a matter for the board rather than for shareholder votes. There was a need to rebuild the reputation and role of businesses in UK society, with recognition that remuneration discretion is a necessary instrument to support achieving good outcomes for companies and shareholders.
- UK non-executive Directors and Chairs should also be encouraged, with suitable controls in place, to hold equity in the company as a means of ensuring alignment of long-term interests between the role holder, the company and the wider shareholder community (akin to what already happens in private markets).

Investor engagement with companies

- Improving the two-way dialogue between companies and shareholders is key to improving the ecosystem for public companies in the UK. There was consensus on the need for asset managers to return to a focus on good quality engagement with companies over a more superficial, but high volume, level of engagement. This should be reflected in the types of questions observed on investor conference calls and direct engagement with company senior management. Good engagement between investors and company management should be a basic expectation of good stewardship and good management.

- To help build trust between companies and investors, there should be greater transparency on how investors engage with companies. For example, Boards and management should have greater transparency on how an investor has specifically engaged with their company and issues to be debated, and management (and investors) should have access to each other at senior level. It was noted by attendees that for example senior portfolio managers at index funds do not often engage with company management and it is not possible for company management to access those individuals.
- Some suggested that shareholders should only vote when it is in the company's best interest for them to do so, not as a matter of convention.

ESG

- The UK should focus on leveraging existing domestic industries (health tech, agriculture, advanced engineering) and support them becoming leaders in related ESG investing.
- There was broad support for the Government to ensure that the UK becomes the leading centre for carbon offsetting.

<u>Creating the best environment for the UK to produce high growth, consequential companies.</u>

Focus: Create a series of recommendations to help improve the environment in the UK for creating high growth, consequential companies. Participants discussed finding ways to increase support for entrepreneurs, change the attitude and playbook of domestic investors to risk, and more broadly to create a culture of business building and entrepreneurial success in the public and media.

Government policy

- Many noted the importance of the Government's levelling up agenda but noted that putting this into action requires recognising existing regional talents and strengths. It should recognise the value and importance of economies of scale and regional concentration of infrastructure, skills, and other key ingredients to economic success. This may mean a different approach in different regions (i.e. not every region needs a tech hub, a financial hub, etc).
- There was consensus on the need for a more developed UK industrial strategy and this should involve long-term Government investment in areas of existing UK expertise e.g. energy transition, life sciences.
- The Government should continue to support its domestic entrepreneurs through its trade missions overseas, encouraging UK founders be more ambitious – "aim for £10bn valuations, not £100m".
- UK Government procurement rules / process should be more welcoming to the concept of "buy UK" but in so doing, it should not seek to "buy UK products on the cheap". For example, they should be focused on helping build the life sciences sector just as much as getting the best price for the NHS. There is great value to our life sciences industry having a large market provided by the NHS, but a sweet spot needs to be found that works for both national assets.
- The UK Government should continue to work to make the building planning process easier in the UK, in particular to facilitate the building of labs (which some noted are currently very difficult to build).

Regulation

- Some pointed out that there was also value in having the growth/tech investment expertise of smaller, specialist, public investor funds but that they currently are subjected to the same regulatory burdens as larger funds. UK regulators should make it easier for more portfolio managers to start and operate funds in the UK who are able to provide specialist investment and insight into different

UK sectors. This would help encourage larger funds to follow their investment activity. For example, some suggested creating a different set of rules for smaller asset managers, such as those with <£150m AUM.

- There was consensus in recognising that the shift in approach to the regulatory charge cap limit for pension schemes was an inflection point. Many were positive about the opportunity this presented to increase the range and type of investments in those schemes and the overall benefit to policyholders.

Taxation

- Many pointed out that HMRC is too slow to engage with entrepreneurs and small companies, including on approving EIS schemes.
- There was broad appetite for a UK ISA with perks / incentives for investing domestically.
- Some suggested making it easier / incentivising investments above the Venture Capital Trust (VCT) investment thresholds, potentially introducing a new "Growth Capital Trust" that picks up the capital needs above those covered by VCTs, with lower tax relief.
- Some pointed to the value in a "Supercharge Entrepreneurs' Relief" for those who deliver £100m in value.
- The introduction of a tax incentive to list in London should be considered to help incentivise domestic listings and the local ecosystem that forms around them, including the retention of management in the UK, intellectual property, reinvestment, etc.
- Others pointed to the need to reverse tax changes on dividends for pension schemes and any other taxation friction points to investing in the UK.
- There should be business taper relief at the fund level.
- The Enterprise Management Incentives (EMI) should be expanded to encompass a 'Scale' stage.

The Entrepreneur Playbook

- Many recognised the need for "smarter" UK domestic capital. Whilst UK founders / entrepreneurs would value accessing greater amounts of domestic capital, what they and their companies need alongside a capital investment is access to a support network, mentoring and sound advice on how to grow their company.
- The UK needs to create better entrepreneur networks, with access to Government and policymakers, in the way other countries like France do.
- UK investors need to increase the level of support they offer entrepreneurs when investing in their companies i.e. investing with a more "hands on" approach where they support and advise entrepreneurs on how to scale their companies, providing them access to their own networks, mentoring, etc (akin to the support received from US investors).
- Both the Government and UK investors can learn how to do this by importing the skills and know-how from highly successful startup investing ecosystems like the US. The UK should focus on strengthening supportive networks and mentoring schemes that build on our existing strengths in life sciences, fintech, climate tech and AI.
- The UK Government should strengthen its partnership with universities and support directing investment into our next generation of companies and founders. This is already done at a smaller scale by specialist venture capital firms.
- There was consensus on the need for greater celebrations of success in the UK. Most people in the UK will think of Richard Branson and Alan Sugar when asked about UK entrepreneurship, there is very little visibility of other hugely successful UK entrepreneurs, particularly belonging to younger generations.

Investor expertise

- Connected with "workstream 1", many considered there was a need to better market UK growth companies to pension managers and trustees – fostering greater investment through engagement over mandation.
- Many noted that the profile of a typical UK investor is one that is too risk averse and scared to lose money. This constrains the ability of UK entrepreneurs, in receipt of UK investor money, to grow as they must focus their energy on protecting investors capital over focusing on growing the company. Founders need to have the freedom to take risks in order to grow, and investors need to understand that not tolerating those risks will ultimately stifle growth.
- Some suggested there would be value in setting up a UK superfund to lead late-stage investment rounds in UK companies – potentially leveraging DC money – to help plug the existing gap in that later stage growth investment.

Human capital and talent

- There was consensus in recognising the excessive friction to attracting talent that currently exists in the UK, particularly that associated with immigration restrictions, bureaucracy, and attitudes towards immigration.
- There was an urgent need to remove barriers to attracting the necessary skills required by the UK and to help portray the UK as an open and business friendly destination. The UK needs to see its position through the lens of being on a global market, where we need to attract global talent and global investors to grow.
- Some pointed out to the restrictions on university students coming to the UK to study but then not being able to remain to work in UK companies or found and grow companies in the UK (e.g. students arriving from EU countries). We are missing out on great talent that is already here and has an affinity for the UK.
- Levelling the playing field globally for remuneration matters because there is a global war for talent and we need to stop thinking about ourselves just in the UK context.

Development of the Intermittent Trading Venue to provide secondary liquidity to private company shares

Focus: Support the development of a new class of venue, which would operate on an intermittent trading basis and act as a bridge between public and private markets, boosting the UK as a destination for all companies to gain access to the investment they need to create jobs and grow.

Context

Following HM Treasury's Wholesale Markets Review and as confirmed by the Chancellor of the Exchequer as part of the 2022 Edinburgh reforms and 2023 Mansion House speech, Government, regulators and market participants have been exploring an entirely new concept in markets to help bridge the gap between public and private markets, and which would operate on an intermittent basis, reflecting the periodic nature of its liquidity and disclosure events. We refer to this new market as an Intermittent Trading Venue (ITV).

The aim is for this venue to provide private companies with an additional mechanism to access liquidity for existing shareholders (including employees) and access new investors, including international investors, when they are not ready to trade on public markets. In turn, it will allow a wider range of investors to gain exposure to these companies at an earlier stage of their growth. Early investors and staff rewarded with shares in those companies will be able to sell shares through a structured and regulated price transparency mechanism, without the need for the company to be publicly listed.

Overall

- There was overwhelming support for the venue. In particular, participants felt it would help prevent companies from being sold too early to release capital for early investors or from coming to market too early.
- It would help recycle seed and early growth capital back into the UK growth ecosystem (by allowing angel and other early-stage investors to trade places with later stage investors).
- It would also help companies build their governance structures and prepare for a potential future IPO or future funding rounds. As companies build an investor network within the UK, supported by a UK venue and UK network of professional advisers, it can help support the domestic IPO pipeline.
- Many stressed the importance of standardised documentation (such as shareholder agreements and key article clauses) as well as providing tools to help manage the auction process.
- Some noted that arranging secondaries in the existing market can be difficult and ITV had the potential to resolve this through a mechanism that was both time- and cost-efficient. Attendees stressed that in order to attain broad market adoption, ITV has the opportunity to be cost-effective for its users.
- There was general consensus on ensuring ITV is global in nature – an offering for international companies and investors – to help the UK capital markets differentiate themselves.

Reasons why a company would use ITV

- Currently, arranging secondaries can be difficult for companies in the UK and ITV could help reduce the cost and effort involved, including through the standardization of the process in the UK.
- As diversity of shareholder register increases, the liquidity needs can vary. ITV could facilitate efficient partial exits that allow interests to be better aligned and also allow founding teams / management to de-risk personal lives and focus on pursuing growth and building their business.
- Similarly, ITV will support making UK companies more attractive to talent, as it will provide a mechanism for them to capitalise on company shares earnt as part of their remuneration packages without having to wait for a far-dated liquidity event like a potential IPO. Share options are a great tool to align employee incentives with the success of the company, and a mechanism that enables employees to realise some gains from their shares in a shorter time horizon will only strengthen this.
- The auction process would also create an opportunity for raising the profile of the company and help it become a known quantity ahead of large private fundraising rounds or an IPO.
- The mechanism would contribute to better price discovery, improving the understanding of private businesses' valuations (which is currently very opaque) and improve the understanding of the fair value of portfolios invested in private companies.

Information/disclosure

- There was support for a centralised portal being the vehicle through which companies refresh their investor information rather than relying on public statements via a public Primary Information Provider. This would allow greater control over information access, given the importance of privacy in particular for growing companies, where competitors having access to proprietary information could be a major concern to potential users of the venue.
- Currently, most investors in private transactions have different approaches to what they want to see. Anything that simplifies the process for founders / companies, would be very well received.
- Forward looking information was described as one of the key pieces of disclosure. Further market engagement and consideration of the liability regime will need to be undertaken.
- Comprehensive guidance will need to be developed for intermediaries (banks and lawyers) to help them manage liability.

  Some suggested that disclosures should be structured to allow for natural language data interrogation to allow better cross-company evaluation.