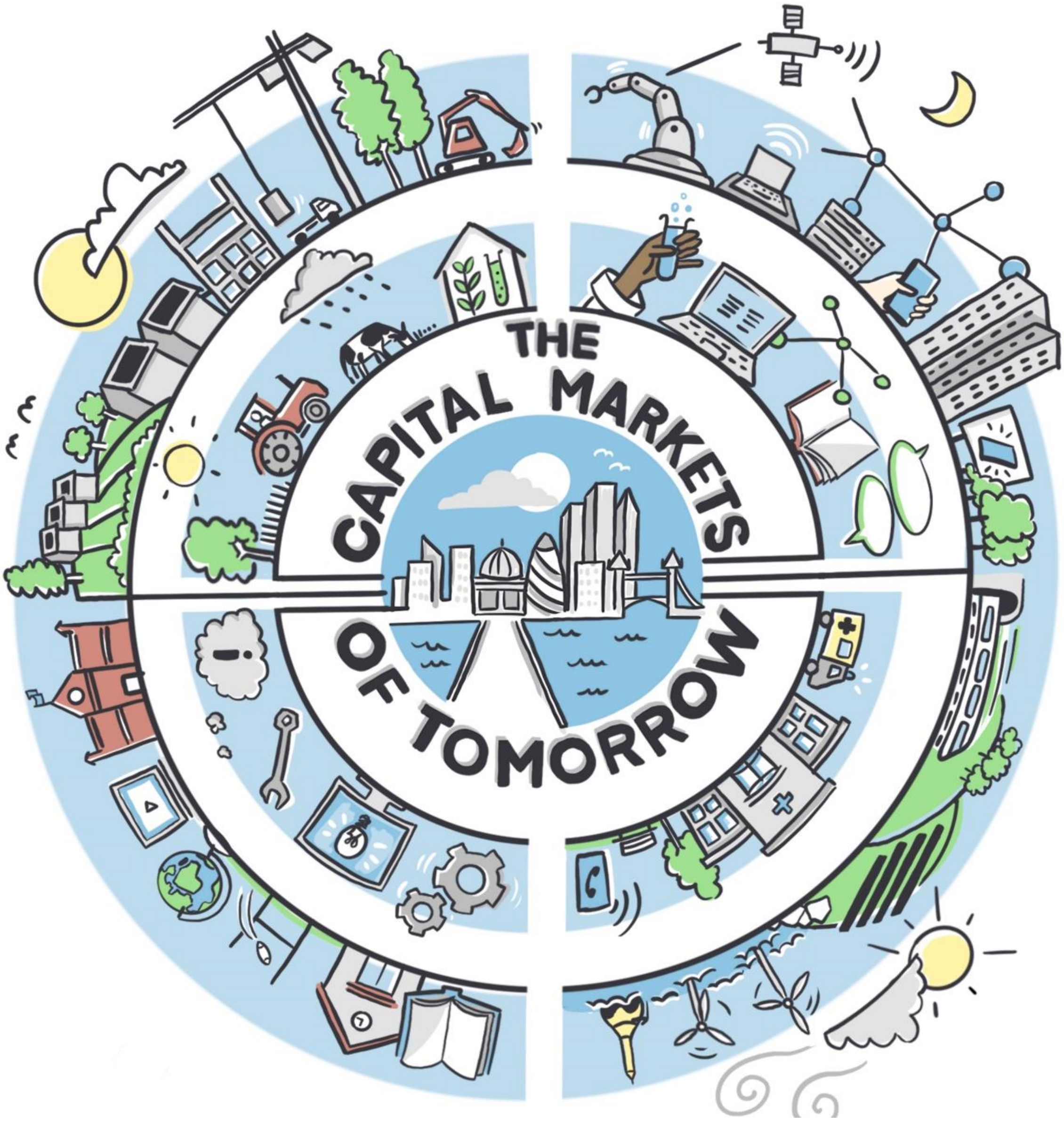

Delivering Over £100bn of New Capital into the UK Economy Every Year

Building World-Class Capital Markets Of Tomorrow

6 September 2024

PRODUCED BY TENEO

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ILLUSTRATIONS BY LAURA MILES-BOARDMAN

The Capital Markets Industry Taskforce

The Capital Markets Industry Taskforce ('CMIT') was established in August 2022, in consultation with His Majesty's Government, and welcomed by the then Chancellor of the Exchequer, to help drive the reform of UK capital markets. By bringing together industry leaders from across the UK's ecosystem, from the users of capital to the deployers of capital, its aim is to both make recommendations to Government regarding regulatory change but also importantly to be a vehicle to drive cultural change within the industry where needed.

As part of its work, in May 2023 CMIT commissioned the production of an independent report setting out the structure and model required for the UK's capital markets to ensure it remains a leading global financial centre through the 21st Century and supports the development of high-growth and globally consequential UK and international companies.

The Capital Markets Of Tomorrow team

This report has been led by Sir Nigel Wilson, former Group CEO of Legal & General, and supported by Mark Austin CBE, Partner at Latham & Watkins, John Godfrey, interim Managing Director, Public Affairs, Policy & Research at TheCityUK, Alex Hickman, Senior Managing Director at Teneo and former Special Adviser on Business to the Prime Minister, Penny James, Senior Independent Director at Hargreaves Lansdown and former CEO of Direct Line Group and Conor Lawlor, Managing Director, Capital Markets & Wholesale Policy, UK Finance.

Foreword

I was honoured to be asked by CMIT to chair the Capital Markets Of Tomorrow report to “create a model which will help long term growth for the UK economy". This goal we collectively set ourselves closely aligned with the previous government's capital market reforms, and also with the new Labour Government's growth plans as they evolved in Opposition and are now being put in practice.

And I was delighted to be one of the eleven signatories of the Mansion House Compact on behalf of Legal & General. This was the outcome of great collaboration between the financial services industry, led by the former Lord Mayor Sir Nicholas Lyons, and the previous Government, led by the Chancellor Jeremy Hunt. The goal was again for growth to be delivered by Defined Contribution pension funds investing 5% of their assets in unlisted equity by 2030. As a fast-growing pool of investable funds - it will be £1 trillion by 2030 – this has potential to be game-changing, and encouragingly, a recent ABI report highlighted that progress has been made by ten of the eleven signatories. This Compact built on the successful collaboration on DC soft compulsion auto enrolment between the Government, well led by the Coalition Government's Pensions Minister Steve Webb, and the financial services industry. I also worked closely with the Government and the Regulators during the LDI crisis in October 2022 caused by the Truss/Kwarteng budget. Sam Woods (CEO of the PRA) was outstanding in getting the Treasury, BOE, PRA, and the financial services industry to work collaboratively to halt the gilts and mortgage crisis, but the episode illustrated the systemic risks when different components of the system do not work together.

Separately, huge progress has already been made on the UK capital markets reform agenda in particular by the previous Conservative Government, the FCA and the FRC. On 29 July, four years of work in relation to the UK markets came to a head when the FCA published its radically reformed listing regime. It has moved back to a disclosure-based approach and has amended its rules for the benefit of both issuers and investors, making the UK markets match fit again. Those changes have already had a material impact on sentiment towards the UK markets and much credit should go to Ashley Alder, Nikhil Rathi, Sarah Pritchard, Clare Cole, Helen Boyd and their teams at the FCA in particular.

Significant progress has also already been made by the FRC, both in relation to its pragmatic response to its Corporate Governance Code consultation last year and in its ongoing Stewardship Code review. The zeitgeist around governance, stewardship and remuneration has become much more progressive in the last year or so and we expect that to continue to move forward constructively – for which much credit must go to Jan du Plessis and Richard Moriarty at the FRC. The changes in both the listing and governance areas have gone a long way already to creating a level playing field for the UK markets with other listing jurisdictions again.

Against this background, and with a supportive Government, BOE and PRA, it is critically important that we have honest and well-understood situational analysis as the basis from which to develop ambitious solutions that finally deliver long term growth for the UK economy. We are still very much "searching for the truth for the common good". As we developed this report, it became clear that the UK economy and its capital markets have fallen behind the US since the Global Financial Crisis. However, there are many potential positives for the UK, and far from subscribing to “doom loop” thinking, we are optimists. Our optimism, however, is conditional on continuing with existing reforms and pushing them further. This is a time for action by all parties with an interest in UK capital markets.

First, the historic data, and the challenge. Between the mid 1950’s and the Global Financial Crisis (2008/9), UK and US growth metrics across real wages, productivity and real GDP per capital were similar. Further, as highlighted by the Barclays Equity/Gilt report, in the fifty years between 1955 and 2005 the UK real equity annual average return was 6.6%, which slightly outperformed the US’s 6.2%. Unfortunately, since the Global Financial Crash (GFC), between

2010-23, the USA has delivered 8.4% and the UK only 2.2%, a significant and possibly "embedded" outperformance.

A key question is whether this is an aberration, and the UK will deliver "mean reversion" in equity returns and growth metrics over the next decade, or whether the gap is here to stay. We are optimistic, and believe that the UK can return to its pre-existing parity.

ONS data demonstrates how poorly the U.K. economy has performed since the GFC.[1] There has been no growth in real wages or real GDP per capita and small growth in productivity. As the TUC and several academics have commented, average wages in the UK would have been £10,000 per annum higher if they had matched their performance prior to the GFC. ONS data also shows that real GDP per capita was £27,218 in 2007 and £27,819 sixteen years later in 2023, so no annual growth. In Q1 2024 it was £6,903 compared to £6,850 in Q1 of 2007, again no growth. Productivity is only around 5% higher in 2023/4 than it was in 2007, much lower than the pre GFC trend growth of around 1.5% per annum. This poor performance was against the background of Government debt increasing from £1 trillion in 2010 to £2.7 trillion in 2023/4, i.e. 100% of GDP, which is also £2.7 trillion.

In contrast the USA was able to deliver its 8.4% growth because it has become: the premier global tech superpower; the controller and dominant player in financial architecture markets and businesses; and a global energy superpower even more so if it seizes its potential in renewables and LNG. Apple alone has a market cap of $3,400 billion ($4 billion in 2004) more than the combined FTSE 100. Productivity is 25% higher than the UK, PPP wages are over 30% higher. US Government debt is also around 100% of its GDP, and while the US Dollar is a global reserve currency, both countries may face challenges in achieving lower long-term interest rates on their Government debt with negative consequential impact on the real economy. During QE, the UK delivered gilt rates that were both *stable* and *lower for longer.* The UK missed a huge opportunity to boost investment during this period. The UK, with £2.7 trillion of Government debt, budget deficits and the BOE selling gilts, means a huge supply of gilts, possibly £1.25 trillion in the next five years. The UK needs to avoid crowding out private capital and interest rates being too high, therefore discouraging investment. This represents a significant challenge for the Debt Management Office.

This report quantifies the average £100 billion annual scale of additional investment required by the UK economy over the next decade – the UK's demand for capital. We very deliberately took a broad view of Capital Markets and hence their capacity to supply that demand. Listed equity is vital and it sits at the apex, but just to focus on this felt too narrow. As the CMIT agenda has reflected, the VC and scale-up aspects are crucial to the flow of home-grown companies for future listings, while debt capital markets, including a well-functioning gilt market are vital, not least for funding infrastructure and public services. We also have to solve legacy problems of perpetual outflows from UK active equity funds, 0.5% stamp duty, £300 billion invested in cash ISA's and the decline of AIM.

The other side of the coin however shows us that the UK has significant strengths with which to offset these disadvantages. Our historic track record of under-investment has left us with both large pools of capital and a range of opportunities for productive investment. The doom loop can become a virtuous circle if we seize these opportunities.

There has never been such a large amount of money globally available and seeking investment opportunities. Capital pools include domestic and international capital sources such as sovereign

[1] The GFC was a "Minsky Moment"[1] with the BNP suspension of redemptions in August 2007 the leading indicator. Given the end of QE, spectacular growth in Government and non-banking debt alongside several asset markets being potentially overvalued we must remain focussed on avoiding another "Minsky Moment". (A Minsky moment is the onset of a market collapse brought on by speculative activity that defines an unsustainable bullish period.)

wealth funds, retail investment, private equity “dry powder”, and the UK is fortunate in that we have £6 trillion of long-term capital within our pension and insurance industries. So, the supply of capital for growth is available. Mathematically we need to invest around an additional £100 billion of productive capital per annum for ten years, so £1 trillion in total, to deliver 3% annual growth in real wages and real GDP per capita.[2] We know that since the GFC the UK has underinvested both in absolute terms and compared to our G7 peers with our Investment/GDP ratio around 17 to 18% compared to our peers of 20 to 25%. This underinvestment gap is also around £100 billion. This underinvestment has been in many areas including housing, energy, water, and transport and has been recognised by both the current Labour Government and its Conservative predecessor. The demand for additional new investment per year is around £30 billion for housing, £50 billion for energy and £8 billion for water.

Furthermore, both Governments recognised we have world class universities and the potential to create large technology driven growth businesses in areas such as renewables, financial services, AI, Quantum Computing and Life Sciences. The additional annual demand for VC capital is £20 to £30 billion. This is crucially important as it provides the flow of growth companies maturing through start-up, to scale-up, to grown-up. It is the way to deliver a healthy home-grown listed sector, with economic activity in the UK, and the complement to the "Wimbledonisation"[3] phenomenon where the UK is a listing venue for overseas companies attracted by regulatory advantages.

There is therefore clearly enough supply of and demand for capital to deliver the UK’s 3% growth objective. The challenge is to make the UK a competitive market into which to invest, by having the best regulation and the best-functioning markets. The Capital Markets Of Tomorrow have to deliver that capital and allocate that capital efficiently. We therefore support incentivising investors where the global pitch needs to be levelled, whilst investors remain in charge and responsible for making the right fiduciary decisions. In the past we have failed on delivery, for example, where the Government has crowded out rather than crowded in capital with projects such as the £100 billion on HS2. Governments have regularly set an annual target to deliver 300,000 new houses but we have not delivered 300,000 houses since 1969/70. Only 0.3% of our SME’s are classified as growth companies and few of our most successful new businesses have become successfully UK listed. There are probably twenty to thirty large UK growth companies that have yet to IPO including Matillion, Revolut, Quantexa, Octopus, Monzo and True Potential. In addition, there are dozens of previously UK listed companies owned by private equity which could relist in the UK. Furthermore, listing on NYSE or NASDAQ is not a panacea for UK or international companies, as has now increasingly been understood, and as we saw with the 20 largest UK companies that chose to do so over the last 10 years. Those companies have either already delisted or are on average trading down by over -80%.[4]

We welcome the ambition that Angela Rayner and Mathew Pennycook have demonstrated in respect of housing. We are supporters of devolution as capable and ambitious Mayors like Andy Burnham, Andy Street and his successor Richard Parker increasingly seize growth opportunities and work effectively with Capital Markets to deliver economically and socially useful outcomes. We are confident that Emma Reynolds will continue to modernise our pensions system in her role as Pensions Minister. We urge Ed Miliband, Wes Streeting and Jonathan Reynolds to continue to be intellectually honest about the challenging supply-side issues they need to address such as declining productivity in the NHS, lack of electricity grid capacity and the fact that too many UK households spend a disproportionate amount of their income on housing compared to peers.

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[2] An average investment over the period of c.3% of GDP. UK GDP is currently c.£2.7 trillion so year one investment would be c.£70 billion, rising with underlying GDP growth which itself benefits from investment multiplier effects. An ambitious stretch target but achievable.

[3] The term `Wimbledonisation' is often used by researchers to describe London's role as a meeting place for the world's top businesses and financial institutions, typically the big banks, despite the UK boasting few star players of its own.

[4] Dealogic data, July 2024.

Finally, to whom do capital markets matter, and why? The short answer is that they matter to everyone: savers, investors, those looking for a secure retirement or who rely on a successful growing economy for their job or income. Capital markets reach into every region of the UK and every part of the UK economy; we are all invested in their success.

We hope this report gives an honest appraisal of both the challenges and the opportunities, demonstrating that we are at a turning point – away from a cycle of negativity and towards a future where our capital markets can once again deliver their true potential.

Nigel D. Wilson

Sir Nigel Wilson

The UK Elevator Pitch: Creating Capital Markets Of Tomorrow

Our political, financial, economic and regulatory institutions have been collaborating at pace to create the Capital Markets Of Tomorrow through purposeful and relevant reforms including a comprehensive series of publications, regulatory reforms and legislation addressing several of the friction points in UK capital markets.

This programme of work began with a clear diagnosis of the UK's problems by market practitioners with daily experience of our capital markets, and resulted in recommendations that are supported by the Labour and Conservative parties. These interventions have served to:

1. **Raise the political and public profile of the UK's capital markets and their importance to the future success of the British economy, businesses and communities.**
2. **Demonstrate that, outside the EU, the UK can continue to provide competitive and innovative leadership in financial services.**
3. **Strengthen the connectivity between our capital markets and key national missions such as boosting economic growth, creating globally consequential British tech and life sciences companies and decarbonising our economy.**

A range of reforms and behavioural changes have already resulted from these interventions, plus a new culture of continuous improvement. Both will help ensure the UK remains the home to a globally competitive capital market for the rest of the 21st century and the engine of the UK's GDP growth.

It's now time to literally put our money where our mouth is: utilising our public and private markets to invest our capital in productive assets up and down the UK, enable British businesses to grow faster and deliver good competitive returns for pensioners.

Why Do Capital Markets Matter?

Everyone should care about the strength of the UK's capital markets. It matters to our ambition to become a science and technology superpower, it matters to our ability to fund critical services in the UK – from hospitals to social services, to the defence of our nation – and it matters to anyone who wants to ensure we are providing the best chances of success and handing over a meaningful legacy to future generations in the UK. From improving productivity, per capita income and real wages – all of which have remained below the UK's potential since the Global Financial Crisis (GFC).[5]

The myth that capital markets are irrelevant outside the City of London is pervasive but inaccurate (see more myth-busting in the Appendix). Of the more than 2.4 million people working in financial and related professional services in the UK, TheCityUK has estimated that two thirds work outside London,[6] and the "big 4" professional services firms in the UK (PwC, EY, KPMG and Deloitte) are moving to reverse a model which previously split jobs 80/20 in favour of London versus regional cities.The good news is that the UK already has a globally significant financial

"The good news is that the UK has all the raw ingredients required to achieve success"

centre and all the raw ingredients required for success and to become an even more competitive alternative to other financial centres around the world, and address the UK's demand for capital.

The UK's capital markets are a major tax contributor, providing the UK Government with more than £100 billion annually[7] – equivalent to over half the annual funding requirements of the NHS; and together with related professional services, they directly provide 2.5 million jobs,[8] two thirds of them outside London — and this is before we consider the vital role the sector plays in funding the government's gilts and debt issuance programme.

However, the value of the UK capital markets extends far beyond serving as a tax-generating platform where global capital market transactions take place.

The financial ecosystem that supports our capital markets plays an important role in the domestic economy. New Financial's study in May 2020[9] demonstrated that more than 90% of large UK companies regularly use capital markets to raise capital, invest or manage risk, and that, alongside the activities of the major players, capital markets supported 14,000 smaller (i.e., with revenues of less than £200 million) UK companies. This activity supported 5.5 million jobs. When COVID hit the UK, our markets raised more money for UK-listed companies than the next 5 European venues combined – keeping companies afloat, and people employed up and down the country. In May 2024 multinational electricity and gas provider National Grid used a £7 bilion rights issue to finance investments in its UK and US networks until 2030. Our broader industries, emerging technologies and indeed crucial public services all benefit from successful capital markets.

Losing our place as a global leader in capital markets, finance and professional services would be a retrograde step for the whole economy. Gaining global market share can however drive growth for the UK as a whole.

[5] The Conservatives and the Economy, 2010–24 | Institute for Fiscal Studies (ifs.org.uk)
[6] key-facts-about-uk-based-financial-and-related-professional-services-2024.pdf (thecityuk.com)
[7] City of London State of the Sector Report (2021)
[8] TheCityUK Key Facts (2023)
[9] The value of capital markets to the UK economy (2020)

Risk capital… and more risk capital
Deployed into UK companies
New products and services
Enhanced international and domestic revenue
Company growth and value creation
Better returns for savers and investors
Growth and prosperity
New jobs
R & D
Innovation
New plant & equipment
International expansion
Improved products
Upskilled Workforce
Productivity
Tax revenue
Increased exports
Capital for re-investment
GDP growth
International investment
Better pension returns
Dividends
Regional growth
Increased spending power
Increased quality of life

It’s Time To Act

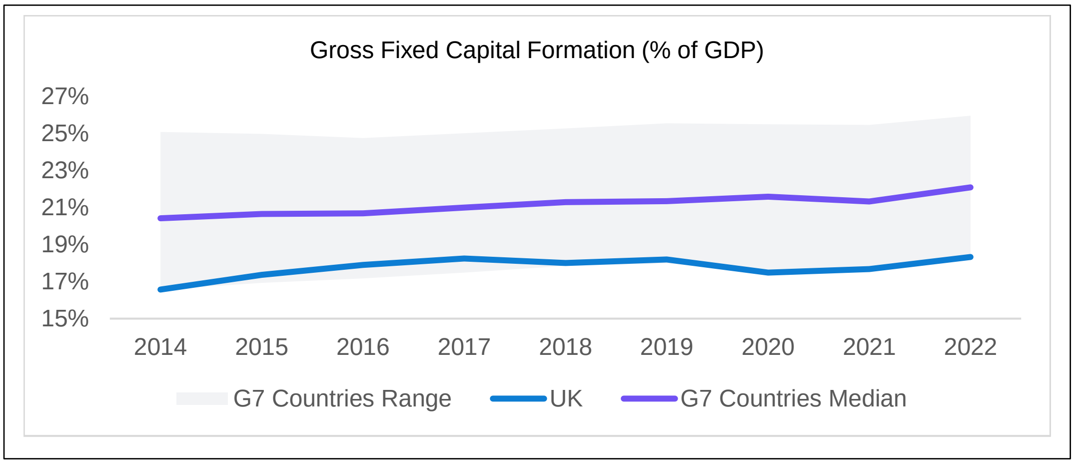
The UK is entering a period of regeneration that will require huge amounts of capital.

It is not difficult to identify where the demand for £100 billion of additional capital over the next ten years comes from. For example, it is widely agreed that to achieve the UK’s housing target of 300,000 new homes per year, we will require at least £20 to 30 billion of additional capital every year, while the UK’s energy targets of 5-7GW of new offshore wind and 3GW of new solar per annum requires at least £20 billion per annum. The water industry has announced a requirement for £8 billion of additional capital per annum, and the scale-up capital required for tech and life sciences is estimated to be at least £15 billion per annum. Meanwhile, the cost of decarbonising buildings is estimated at £4 to £8 billion per annum and the roll-out of electric vehicles will require £3 to £5 billion per annum. Transport, education and health all need billions of pounds of new investment, with a single hospital costing ~£1 billion.

The UK’s investment to GDP ratio sits at around 17 to 18%; this is well below other G7 countries that have investment rates in the 20 to 25% range.[10] Considering these figures and the existing demand for capital, the UK needs to address a funding gap of over £100 billion, or around 3% of GDP, every year for the next ten.

The competition amongst capital markets centres has never been fiercer.

Over the last two decades highly competitive regional capital markets have emerged on the world stage, often backed by high growth economies, and often using aggressive measures designed to promote national economic growth whilst protecting that growth



Source: World Bank national accounts data, and OECD National Accounts data files

from moving overseas. From China and India to Africa and the Middle East, where emerging economy companies would in the past have typically defaulted to using UK capital markets to fuel their growth ambitions, this can no longer be presumed.

At the same time, North American investors have been attracted to investing in the entrepreneurial ecosystem in the UK, with many high growth companies in the UK now counting large numbers of overseas investors on their boards. Whilst there is nothing wrong with this in principle, the UK should not underestimate the influence this has on the trajectories of these companies, including decisions to be acquired by a larger overseas company or choosing to IPO overseas.

Since Brexit, the EU has sought and continues to seek to build a European alternative to London’s capital markets. Whilst it has not been successful to date, it is deploying measures that seek to challenge the UK’s dominance in the region.

[10] World Bank national accounts data, and OECD National Accounts data files

Match-Fit UK

The UK public capital markets, which sit at the apex of our successful debt and equity capital ecosystem, are on the point of being match fit again.

On the legal and regulatory front, the listing regime has moved back to being disclosure-driven, with simpler listing segments and with materially fewer black letter requirements set around it – as wanted by both investors and issuers. And the onshored prospectus regime will be slimmed down and streamlined when it comes online in 2025.

On the market practice front, crucially in relation to governance and stewardship, the regimes are now focused on fostering international competitiveness and UK economic growth. A revised investor and issuer covenant will create a level playing field in relation to the remuneration regime in the UK when compared to other jurisdictions, including Europe and the US. And "comply or explain" now means just that – not "comply or else" – so that companies have the freedom *not* to follow a conventional application of the corporate governance code if the circumstances justify it without being penalised by investors. And a revised stewardship regime that has undergone a root and branch overhaul will soon be in place, which emphasises collaboration and trust over antagonism and mistrust.

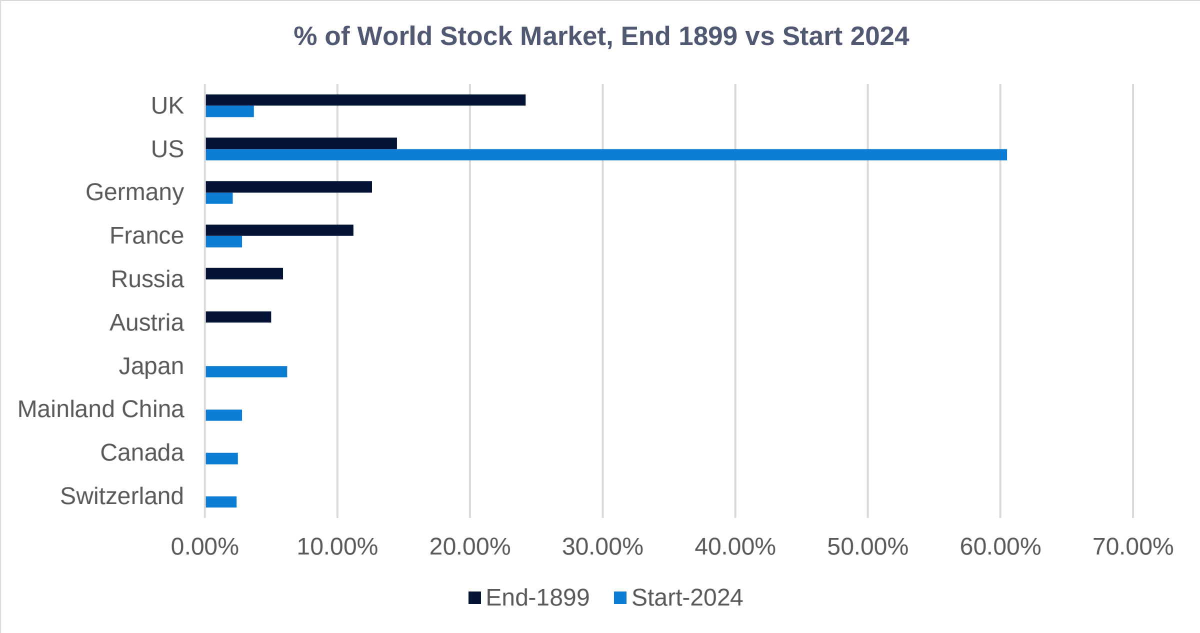
Sitting alongside these revised regimes should be UK indices that are globally minded and welcoming of both UK and international issuers.

In relation to mindset, a market that is 'risk on' rather than 'risk off' is starting to be embedded that has an insurgent, entrepreneurial mindset and celebrates everyone's success.

The role of regulation

Given the mobility of institutional capital and the economic attractions of locating a capital market hub in any given jurisdiction, it is unsurprising that the UK faces competition from other centres. This must be addressed if we, as a mid-sized country, are to retain a globally significant capital market.

One important component of the cost of doing capital markets business is the cost of regulation and the cost of compliance for both conduct and prudential regulation. While there is an advantage to having a clear, transparent and respected independent financial regulatory architecture, we need to recognise that this advantage can be eroded away. Regulators' approach to delivering their competitiveness objective is, therefore, of huge *ongoing* importance, and should be approached with a keen eye to and continuous scrutiny of what is being done in competing jurisdictions.



Source: UBS 2024

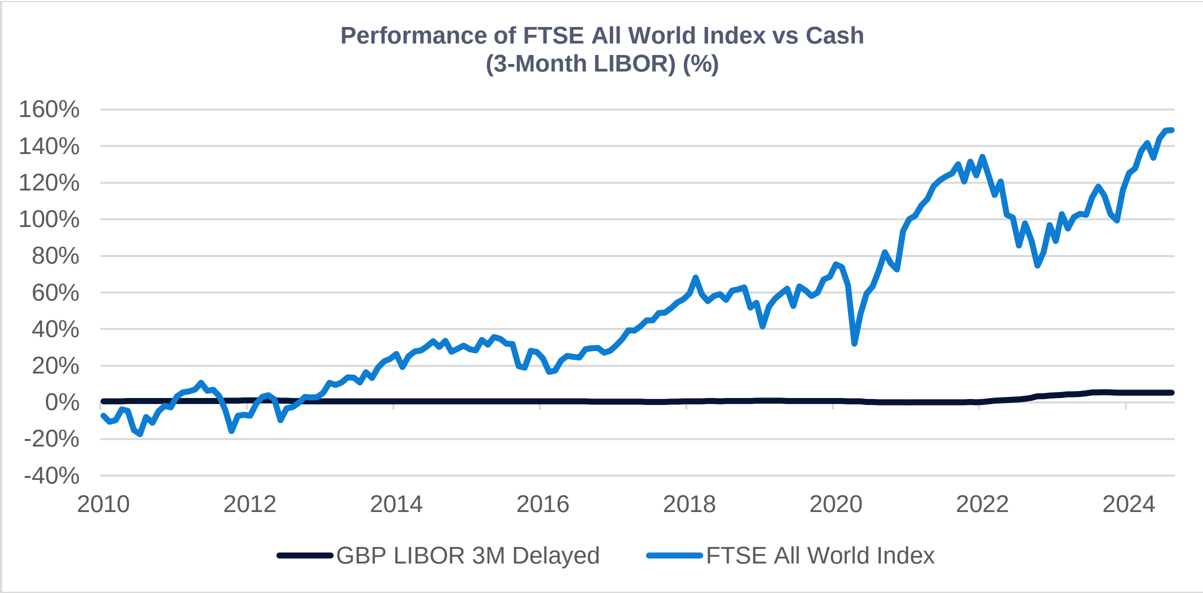
UK citizens face significant risks to their future financial wellbeing

Millions of people in the UK are still not expected to have a comfortable retirement income.[11] Lacklustre real wage growth, a low minimum automatic enrolment contribution rate, poor investment advice and financial literacy levels, and overall, relatively poor returns of UK pension investments and savings, mean many people will not have enough money to meet their future retirement income needs.

Studies show that 14 million defined contribution pension savers are not on track for the income they expect.[12] Notably, 88% of individuals aged 22 to State Pension age are projected to fall below the Pension and Lifetime Saving Association's (PLSA) "Comfortable" Retirement Living Standard (RLS)[13] – or in other words, 88% of individuals will not be able to afford the annual expenditure that is required to ensure a comfortable retirement (estimated by the PLSA at £43,100 per year).[14] A large number of citizens are poorly advised and hold more than optimal amounts in cash and low-return investments, often exposed to the eroding effects of inflation whilst missing out on the powerful effects that compounding could have on their future financial wellbeing.[15]

Effective capital markets are key to addressing these issues – and the measures that need to be taken to address them will take years to implement and bear fruit. The longer we delay taking measures to improve this situation the more difficult it will become to fix the problem.

[11] Saving in Britain | abrdn Financial Fairness Trust
[12] A call for pension adequacy review | Phoenix Group (thephoenixgroup.com)
[13] Precautionary Tales – Tackling the problem of low saving among UK households (financialfairness.org.uk)
[14] Home – PLSA – Retirement Living Standards
[15] Advice Guidance Boundary Review – proposals for closing the advice gap, Financial Conduct Authority dp23-5.pdf (fca.org.uk)



Source: LSEG Workspace

Driving Growth and Creating Wealth: Four Priorities

A hugely ambitious reform agenda and ongoing changes to market practice are already strengthening the position of our capital markets on the global stage. The UK now has the chance to build on this by seizing several opportunities that are unique.

(1) The green opportunity: The UK has a new Government with an ample majority in Parliament and which is committed to making Britain a clean energy superpower, aiming to deliver clean energy for the UK by 2030. (This objective is only second to the Government's "kickstarting economic growth" mission.)

The Government intends to seize the UK's untapped advantages – our long coastline, high winds, shallow waters, universities, and skilled offshore workforce combined with our extensive technological and engineering capabilities – to achieve this mission. To do so, the Government intends to use public investment to crowd in private funding, leveraging its Green Prosperity Plan where, in partnership with business through the National Wealth Fund, they will invest in the industries of the future.

The Government has recognised the role that our world-leading financial services industry has in mobilising trillions of pounds in private capital to address this challenge and have stated their intention to make the UK the green finance capital of the world. We would argue the UK already is in many ways *a* leading, if not *the* leading, green finance capital of the world and is superbly placed to help the Government deliver on this mission. We estimate that the UK's transition to Net Zero will require between £35 and £50 billion in capital requirements every year until 2030.[16]

This is a hugely ambitious project for the UK, but one that is backed by policy certainty for the next five years and one that our capital markets are well placed to support. The UK's financial services industry already has a range of tools it can put at the UK government's disposal. These include: a hugely experienced asset management community, a large cohort of publicly listed companies that invest in the green economy (as evidenced by the recipients of the Green Economy Mark), one of the fastest growing green bond markets, one of the world's largest Closed-End Fund Markets (that are excellently placed to make long-term infrastructure investments), and a Voluntary Carbon Market in London.

[16] E3G and WWF joint briefing – Unlocking the economic opportunity of the 21st Century through private finance

To enable the UK capital markets to best support the UK's green ambitions, we would recommend the Government focus on those interventions that can genuinely help move the dial on unlocking greater investment capital for the UK green economy from its own capital markets:

1. **Long-term Investment For Technology and Science (LIFTS) initiative:** The Government should leverage the LIFTS initiative to establish new investment vehicles to crowd-in investment from institutional investors, particularly defined contribution (DC) pension funds, to the UK's most innovative science and technology companies.

2. **Closed-End Fund Market:** The UK's Closed-Ended Fund Market has been a superb route through which capital has been raised on a public market to be invested in long-term projects and illiquid assets all around the world (from green infrastructure projects to private companies). This market has suffered in recent years, partly due to a misinterpretation of rules in the UK that has led to poor outcomes for this market, namely cost disclosure requirements that create the erroneous appearance of funds on this market being disproportionately expensive for investors. This is preventing large institutional investors from continuing to invest in these funds and thus hindering the ability of funds to raise capital to invest. The Government should prioritise returning this market to full operation by legislating as soon as possible to clarify the correct regulatory treatment. The Government should also encourage the FCA to take interim measures to mitigate the ongoing friction in this market until such time as the revised legislation is signed into law. This is a quick and easy win for the UK, given there are legislative solutions already designed (for example, a private members' bill sponsored by Baroness Bowles and others) and the market infrastructure is in place to support it once implemented.

3. **Solvency UK:** The Government should ensure that the vision for reforms to Solvency UK and the important link to the Government's ambitions for investment in the UK's green infrastructure are being delivered in practice, including progressing the Solvency UK Asset Sandbox proposals.

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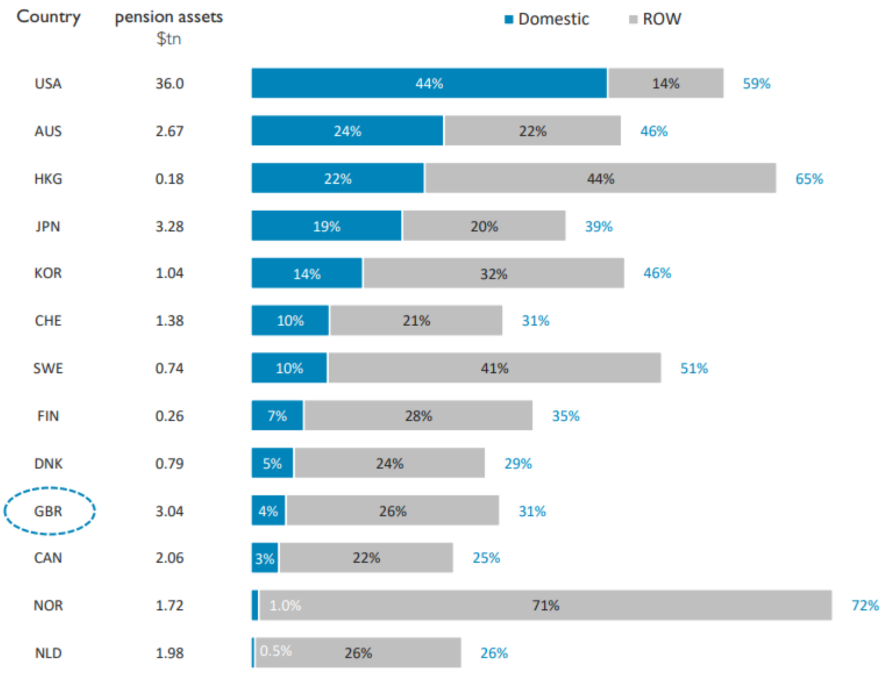
(2) Creating UK advantage: As we have already noted in this report, greater UK investment in domestic companies could generate substantial economic benefit. At present, there is limited investment into our capital markets by large UK institutions, with fast-growth UK scale-ups receiving a disproportionate share of their funding from US VCs.

In the UK there have been equity outflows from UK-focused active equity funds that have driven down UK institutional demand for UK companies across the board.[17] Whilst some of this (but not all) is offset by the inflows we are seeing into UK index funds, minimal amounts of that capital reach scale-ups.

Most scale-ups have market capitalisations that are too small to qualify for any of the important UK focused indices that those index funds track. Accessing scale-up funding is not a new challenge: the 1930s saw the coining of the term "McMillan Gap"[18] to cover this funding lacuna at the growth stage. More recently, the "valley of death" has become an accepted term for the polarisation of funding in the UK to seed stage and late-stage, with a gap at series B and beyond. As noted earlier in this report, the Scale Up Institute has estimated this gap at £15 billion.[19]

[17] UK equity markets are vital, but need to be revitalised – Articles – News & Insights – Peel Hunt
[18] MacMillan Committee, 1931
[19] The Future of Growth Capital – ScaleUp Institute

The allocation to domestic and international equities in different pension systems around the world



Source: New Financial analysis
Note: excludes UK and Canadian personal pension assets because of lack of data; Norway only includes data on the global and national public reserve funds

Whereas other countries can count on their domestic retail investors to broadly invest in their own country's companies, the number of households who directly own shares in the UK has more than halved in the last 20 years from 23% to around 11%.[20]

The flow of funds into the UK's most successful "scale-ups" is increasingly international, with a significant amount from the US. Early investment in UK companies grants these investors a high degree of influence over the decisions on the future direction of travel for those companies. The UK has a choice between mimicking the "home bias" used in some other jurisdictions or accepting that, in many cases, international capital (most of it from the US) will determine the success of the UK's best businesses. The UK has excellent companies to invest in, evidenced in large measure by the large amounts of foreign investment. But we are limiting our country's growth potential by not leveraging home advantage in the way other countries with successful capital markets do (e.g. France, Germany, Japan, Sweden, Australia or the United States).[21]

There is ample room for UK investors to invest more domestically while still retaining sufficient investments in other markets, and suggesting the idea that increased investment in UK companies results in a heightened geographical concentration risk is simplistic. Many British companies, particularly listed companies, derive their revenues from several markets outside the UK.

On the demand side, there are several levers the UK can pull:

1. **Creating incentives for institutional investment in UK companies:** by ensuring that more of the £60 – £70 billion per year of taxpayer money that is used on annual pension tax benefits is applied in a way that encourages investing in UK companies.

[20] [Widening Retail Participation in Equity Markets - NewFinancial]
[21] [Letter-to-the-CHX-Pensions.pdf (capitalmarketsindustrytaskforce.com)]

2. **Removing barriers to institutional investment in UK companies:** Reversing the dividend tax impact on pensions funds introduced in 1997 by re-introducing tax credits on dividends received from UK companies.
3. **Creating incentives for retail investment in UK companies:** introduce a streamlined ISA product that builds on the idea of an increased tax-free allowance for investments including in UK companies (i.e. the “UK ISA”).
4. **Removing barriers to retail investment in UK companies:** this includes exploring ways to lower or remove Stamp Duty Reserve Tax (SDRT) on shares. The UK currently taxes its retail investors with SDRT when buying a UK-listed Aston Martin share but not when buying a German-listed Porsche share or US-listed Tesla share.
5. **Encouraging individuals in the UK with the capacity to invest in risk assets to do so:** the UK could allow institutions to nudge those holding high amounts of cash savings towards investments. Greater financial education and better advice can also play a key role here, and the Government should work with industry on a national public campaign on why investing in UK markets and supporting UK companies matters.

On the supply side, the UK needs to ensure it is creating the environment for high margin, high growth companies to flourish and remain in the UK:

This is important, especially given the rise of global indices and passive investment. The most important global Index is the MSCI where US companies now represent around 70% of the index (largely driven by some of the hugely successful US tech companies). We know that what largely differentiates the performance of the US versus the UK is the performance of their Big Tech 7. Apple ($3.4 trillion) and Microsoft ($3 trillion): each has a market capitalisation more than all the FTSE 100 combined. There’s also Alphabet ($1.9 trillion), Amazon ($1.8 trillion) and Nvidia ($2.6 trillion), along with Meta ($1.3 trillion) and Tesla ($0.7 trillion). We have nothing remotely like these businesses. This is why the rest of the world represent only 30% of the MSCI with the UK at 4% (below Microsoft and Apple).

As equity index funds grow and active equity funds shrink, there is a risk that our markets represent an ever-diminishing share of the MSCI and other global indices. This is because whilst the FTSE 100 is a global index, it does not yet represent all of the global industries, particularly the new large “tech” businesses that attract the highest valuations. As more funds flow into US markets at the expense of investment in UK markets, this trend risks becoming self-perpetuating.

Whilst the UK missed the opportunity to create large scale tech businesses in the 2003-2023 period, peer comparisons in new emerging industries would suggest that many of the UK businesses in FinTech, enterprise tech, consumer and retail, life sciences, healthcare, entertainment, quantum computing, AI, renewable energy and nuclear fusion are the equivalent of their US counterparts, or better in certain cases. The UK has the talent and home-grown innovation to build the next series of globally consequential businesses. All parts of the regulatory and policy universe need to work together to help support this ambition. This includes, for example: improving access to the NHS for therapeutics and technologies for UK companies, support in provision of appropriate infrastructure for scale-ups within regeneration zones, greater skilled labour mobility including for entrepreneurs seeking to establish in the UK, and the implementation of the Kalifa reform package to grow the UK tech sector. These changes need to be made with recognition that our international competitors are prioritising similar reforms in their own markets.

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(3) Restoring the UK’s Risk Appetite: Since the financial crisis, UK markets have become known for their focus on managing downside risks – often for good reason. But taking an appropriate amount of informed and rewarded risk is an inherent part of well-functioning and liquid capital markets. To help achieve the UK's growth ambitions, we need a market that is 'risk on' rather than 'risk off' – a return of an insurgent and celebrated entrepreneurial mindset.

The events leading to the GFC saw light-touch regulation, reckless innovation and a "risk-on" culture that culminated in governments (i.e. taxpayers) picking up the bill. It is understandable that the pain that followed from that crisis resulted in regulatory intervention and subsequent risk aversion being introduced into the system. However, the pendulum may have swung back too far in the other direction, at least in the UK.

Whilst it is important to have a market that operates to the highest standards of conduct (bad behaviours are damaging to the whole ecosystem), the drive should never be to remove the risk of failure entirely from capital markets. Problems are generally caused by taking risks that are not understood, as opposed to taking on risks where both the risk and reward are well-recognised and managed. This is a change of emphasis that should be encouraged by regulators.

We cannot expect to achieve meaningful growth while we micromanage business through regulators, second-guessing decisions that rightly belong to company boards and not trusting investors to be able to make their own investment decisions without feeling the need to look over their shoulders.

A move in this direction has been seen in recent reforms, including changes to fee caps in DC pensions and the focus on more outcome-based investment for LGPS funds – all of which are designed to encourage considered risk-taking. However, this change must happen not only at the level of regulatory policy, but also at the level of implementation and supervision of firms. The competitiveness objective for regulators is a key component of this and it now must be reflected in the day-to-day activities of regulators.

Counterintuitively, to properly calibrate our market's risk levels, we should not focus on measuring risk levels per se. Measuring risk should be seen as secondary to measuring the output of our risk taking. Metrics focused on net company formation and company growth attributable to capital market activity, and the broader economic multiplier effects of that growth, will give us a better sense of whether our approach to risk is moving in the right direction. Several failed companies and bad investments (even where investors lose money) are more palatable in a market where many highly successful companies and lucrative investment opportunities are being created.

A system of regulation and disclosure, guided by the premise that "nothing should ever go wrong", will limit our ability to take the calculated risks our country needs to grow the economy – and will place us at a competitive disadvantage to our international competitors. By championing calculated risk taking, we are not questioning the importance of high-quality regulation. Effective rulemaking has been central to London's success – and many regulatory initiatives, including those following the GFC, have been highly valuable. The role that the FCA's sandbox played in encouraging the innovation that seeded the emergence of our globally leading fintech industry is a case in point. UK capital markets will re-establish and sustain a risk-on culture more quickly and with greater confidence if the UK is regarded as one of, if not the best, regulated advanced economy in the world.

Those of us working in the markets need to challenge our own assumptions and behaviours. Are we truly taking calculated risks? Are we striving to ensure that the service we provide is unmatched by anyone anywhere in the world, drawing upon the extraordinary expertise and capability available in London? Are investment opportunities across the UK receiving the attention they deserve?

Every part of the capital markets ecosystem needs to understand and live the risk-reward dynamic: investment advisers and the currently unregulated consultants, for example, who act on behalf of asset owning clients, should look beyond pure cost and focus on overall returns in their advice on achieving genuine value.

(4) Unleashing the Power of UK Retail Investors: Historically, UK has had a strong tradition of pensions savings and direct retail investment in shares. The privatisations and de-mutualisations of the 1980s and 1990s – including the 'Tell Sid' Campaign – followed by the dotcom boom of the early 2000s generated significant retail share ownership. However, retail share ownership levels have fallen back in recent years.

The statistics for retail UK share ownership declining in recent years were highlighted in two reports published in the second half of 2023, namely "Retail Therapy — Making the case for wider share ownership" by Nick King of the Centre for Policy Studies and "Widening Retail Participation in Equity Markets" by Maximilian Bierbaum and Sheenam Singhal of New Financial LLP, both of which make the case for the strong socio-economic benefits that retail investment in public markets can unlock.

The statistics in those reports demonstrate that UK retail share ownership levels are significantly behind those in countries such as the US and Australia, and some European countries such as Sweden, despite the UK having the largest capital market in Europe. The reports also highlight how most ISAs are held in cash rather than shares,[22] and how much the UK population holds in cash deposits, the current cost of living crisis notwithstanding. "Pension Freedoms" encouraged this tendency to "cash out" of long-term investment.[23] The FCA itself has recognised that in 2022 there were at least 4.5 million UK consumers with investible assets of £10,000 or more held mostly or entirely in cash, despite having no plans to withdraw from their savings in the next 5 years.[24]

Moreover, where UK retail investors have invested in equities, they have increased their equity allocations outside the UK, seeing other markets, notably the US, as more attractive. This all points to a significant amount of "dry powder" that could be deployed into the UK stock market if a shift in the UK equity culture can be achieved.

The reasons for the decline in levels of retail ownership are varied. The main factors usually cited include: the regulatory burden of advising retail investors on share investments; the ISA regime not being directed enough at shares rather than cash; the UK consumer preference to invest in real estate rather than financial assets; and the investment research regulatory regime, which has reduced the investment research covering small and mid-cap companies, in particular.

The success of ISAs is a given in any debate about retail investment. However, they do not provide a sufficient incentive to choose equity investment above cash. The Personal Equity Plan (PEP), which operated from 1986 to 1999, when it was rolled into the ISA regime, represented a more effective form of tax-privileged investment account that was restricted to investments, permitting investment into collectives (e.g. Unit Trusts) without liability for

[22] Of the 11.8 million ISAs actively subscribed to in 2022, only a third (36%) were Stocks and Shares ISAs. Source: UK Office for National Statistics
[23] UK Capital Markets: Risk and Reward, UK Finance, July 2024
[24] Taking the leap on the Consumer Duty – FCA (www.fca.org.uk)

Capital Gains Tax. Reintroducing this model for the UK domestic market (i.e. UK investors investing in UK public equity) would send a powerful signal to the market. A variant of this approach would be to allow ISA-style tax treatment above the ISA limits where those investments are by UK resident retail investors in UK-listed companies, as is currently proposed in the UK ISA consultation.

Most of the reforms implemented or announced in the UK to date relate to "access to products", with only the FCA review of the advice guidance boundary focussing on access to advice. The provision of financial advice is often out of reach for all but the already wealthy – which leads to the 'advice gap' in the middle that the FCA has recently published proposals to try to address.[25] The FCA wants to see a continuum of help, guidance and advice being offered to support consumers, without the cliff edge inherent in the current regulatory framework, and we would suggest the FCA pursue this work without delay.

Low levels of financial literacy in the UK were highlighted as a key issue in both the Centre for Policy Studies and the New Financial reports referred to above, although there have not been any initiatives proposed yet to improve this.

In summary, a combination of improving access, better advice, financial education and incentivisation is needed to drive greater retail investment in the UK market.

We would recommend:

- **As noted in the previous section, implementation of measures to encourage more retail investment including in UK companies:** Creating incentives for retail investment in UK companies through a streamlined ISA product, removing barriers to retail investment in UK companies such as exploring ways to lower or remove SDRT on shares and soft measures to encourage individuals in the UK with the capacity to invest in risk assets to do so.
- **The FCA should continue to work on the upcoming reshaping of the UK's prospectus regime** with a particular focus on broadening retail access in a meaningful way and **progressing the recommendations in the Advice Guidance Boundary Review**.

These efforts should be combined with progressing the work of the Digitisation Taskforce to support simplifying capital market participation in the UK.

[25] Greater support for people's financial decisions, under regulator and government proposals – FCA (www.fca.org.uk)

Delivering Better Outcomes for the British People

While much of what we need to do is complex and granular, we must remain focused on the larger purpose of delivering greater prosperity and growth for the UK, its businesses and citizens. The arguments for this are compelling. Moreover, we must do this in a highly competitive global marketplace where technology and new industries are advancing at a pace never seen before.

Everything is connected. Good policy and best in class regulation create private and public capital markets that enable start-ups to scale into FTSE100 members, deliver strong returns for pensioners, channel billions of pounds in infrastructure projects and generate well paid jobs in fintech clusters and city centres across the UK. When the ecosystem is working effectively – encouraging calculated risk-taking to make investments, solve problems and generate significant profits and tax revenues – a virtuous circle is created which benefits all of society.

The momentum is already there, and the oil tanker is already turning. To maintain this momentum, we all need to switch to and maintain a risk-on mindset, year-to-year, and through governmental cycles. We will need to use powerful metrics to measure our performance as we do so.

A final word. Developing the right policies and regulations is relatively straightforward. It is delivery and implementation, as well as creating and maintaining the change in mindset and market practice, that is difficult. The institutions that participate in our market must genuinely engage with the reforms and adjust their practices accordingly.

Having missed out on the last tech boom, many industries have an opportunity to be at the forefront of the next wave of innovation in science and technology and capture the value from it. This time, we need to think and act differently: evolving our market model to provide a steady flow of growth equity to the market (including thinking beyond short-term results and dividend opportunities); changing our attitude to one of optimism; embracing long-term viewpoints over short-term results (including via dividends for example); holding ourselves to account for delivering long-term outcomes that really matter; and celebrating success.

As in everything, the state of our politics is also a key factor in our ability to succeed. If we can align capital, regulation and policy then there is a much higher probability of success in our businesses of tomorrow. Crucially, there is now a consensus across the main political parties on the importance of our capital markets as a driver of economic growth; Rachel Reeves refers to the UK's capital markets as the "jewel in the crown" of the British economy. The continued support of Government, as well as political stability, a predictable business environment, and good, sensible regulation that balances the twin objectives of high standards and global competitiveness, are all required if our capital markets are to flourish.

Appendix

(1) Summary of Reforms

What Do We Need	What Is Being Done
1. If we want great UK companies to stay in the UK as they grow, and ensure the UK continues to reap the benefits of attracting the best companies and investors globally, we must ensure our public markets are the best they can be. We therefore need primary market rules that are match fit, open to new ways in which companies do business and that, crucially, create a level the playing field with other jurisdictions.	
	Actioned: The FCA now has an international competitiveness and growth objective which applies to its remit as the financial market regulator in the UK.[26] **Actioned:** Material changes to our Listing Rules have been enacted. The listing regime has moved back to being disclosure-driven, with simpler listing segments and with materially fewer prescriptive requirements.[27] **In Progress:** More changes are due in the UK's review of the Prospectus Regime, where it will be streamlined and improvements are expected to unlock forward-looking information in prospectuses (dialling back the existing liability regime), making transactional activity faster (removing prospectus requirements in certain circumstances) and improving access to our markets for retail investors.[28]

[26] Secondary international competitiveness and growth objective statement (fca.org.uk)
[27] FCA overhauls listing rules to boost growth and innovation on UK stock markets | FCA
[28] CP24-12: Consultation on the new Public Trading Offers and Admissions to the Trading Regulations regime (POATRs) (fca.org.uk)

2. **Ample high-quality sell-side corporate research must be available to investors ensuring they have access to the information they need on the formidable companies that exist on our markets or could one day come to our markets.**

Actioned: The UK published its Investment Research Review in 2023, containing a series of recommendations to improve the research ecosystem in the UK.[29]

Actioned: The FCA has begun putting into action those recommendations, with the first rule changes published in July 2024 to give asset managers greater freedom in how they pay for investment research, by allowing the 'bundling' of payments for research and trade execution. These rules aim to improve competition in the market for the benefit of investors. The new payment option is also compatible with rules in other jurisdictions, making it easier for asset managers to buy research across borders.[30]

In Progress: Industry groups like CMIT are engaging with Government on the path to introducing the remaining measures of the review, including measures to create and fund a UK research platform to enable companies to procure research coverage on themselves, and increasing research accessibility for retail investors.

3. **As we have explained at the outset of this report, it is important that UK markets, companies and infrastructure are supported by greater availability of domestic risk capital from UK pension and insurance funds to retail investors. This must include reversing 25 years of de-equitisation of our economy and support for our regulators as they adapt to their new growth and competitiveness objectives.**

Actioned: Measures introduced to increase consolidation in DC pension schemes in the Edinburgh reforms with guidance for LGPS asset pooling and DC consolidation, ultimately facilitating more sophisticated investment strategies (e.g. private companies, infrastructure, growth markets like AIM and AQSE). Further measures are being considering in the 2024 UK pensions review.[31]

Actioned: Changes to 'Value for Money' rules to ensure the focus in the UK is moving to long-term value creation over cost management. The Edinburgh reforms laid regulations to remove performance fees from the regulatory charge cap. The Spring statement resulted in a request to TPR and FCA to ensure DC schemes focus on net returns, not costs – supporting a move to invest in a wider range of assets with more expensive cost structures such as private companies and actively managed funds, and less reliance on fixed income. This is particularly helpful for private companies and small / mid-cap companies (which make up over 60% of the London listed companies) which do not benefit from significant passive investments. **The FCA has since published its consultation on an updated Value for Money Framework for savers who invest in default arrangements of workplace DC schemes. The FCA expects the framework will see the market shift away from competition based purely on price and move towards real consumer value for money.**[32]

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[29] Investment Research Review – GOV.UK (www.gov.uk)
[30] FCA sets out rules and proposals to build up UK wholesale markets | FCA
[31] Chancellor vows 'big bang on growth' to boost investment and savings – GOV.UK (www.gov.uk)
[32] The Value for Money Framework - FCA

Actioned: The FCA introduced Long Term Asset Funds in 2021, a new type of open-ended authorised fund, designed to invest efficiently in long-term, illiquid assets, such as venture capital, private equity and private debt, real estate and infrastructure. The FCA announced their reclassification in June 2023 to allow retail investment.[33]

In Progress: The previous Government announced a requirement for UK pension funds to disclose UK equity holdings, supporting the next phase of interventions and acting as a soft incentive for funds to invest in the UK (revealing those UK funds with only small amounts invested in the UK). The FCA has proposed certain asset allocation disclosures in their Value For Money Consultation[34] including different bond types, types of listed and private equities, as well as the split between listed / unlisted assets and UK / non-UK assets for firm-designed arrangements. There is an opportunity for the FCA, and Government through the Pensions Review, to work with industry on seeking a prompt implementation of these requirements.[35]

In Progress: The Government has appointed the first ever joint Treasury and Department for Work & Pensions Minister[36] who is conducting a pensions review that will consider steps to improve pension outcomes and increase investment in UK markets, including assessing retirement adequacy.

In Progress: The Mansion House Compact to encourage major UK DC schemes to invest in UK unlisted companies (including in growth markets like AQSE and AIM) was announced[37] in 2023. Industry and policymakers are working on its implementation and capital deployment vehicles. Progress is being made as seen in the partnerships between Phoenix Group and Schroders to launch a new private markets investment manager with a £1 billion initial commitment (£2.5 billion over three years).[38] Legal & General Group plc have also announced the launch of a new Private Markets Access Fund to unlock private markets access for 5.2 million DC members.

It is estimated that if 5% of DC pension funds, and, similarly, 5% of Local Government Pension Scheme Assets, were invested in unlisted companies, including start-ups and scale-ups, we could see a £50 billion expansion of total sector investment, with a further £25 billion by 2030 as the DC sector continues to grow.

In Progress: The previous Government announced the repeal and replacement of the Packaged Retail Investment Products regulation with a new framework for retail disclosures (draft legislation consulted on prior to the election).

In Progress: Proposals to reform advice for investors, ensuring retail investors have better access to research and technology to make investing easier and more accessible. The FCA's 2023 "Advice Guidance Boundary Review – proposals for closing the advice gap" sets out the extent of the advice gap in the UK and important measures to address this. The HMT and the FCA put out a joint discussion paper that proposes a new model of "targeted support" that could be provided to retail investors. Targeted support would be an

[33] PS23/7: Broadening retail and pensions access to the long-term asset fund (fca.org.uk)
[34] CP24/16: Value for Money Framework (fca.org.uk)
[35] Chancellor backs British business with pension fund reforms – GOV.UK (www.gov.uk)
[36] Emma Reynolds MP – GOV.UK (www.gov.uk)
[37] Insights – case studies, factsheets & reports (theglobalcity.uk)
[38] Phoenix Group and Schroders to launch new private markets investment manager with £1 billion initial commitment; up to £2.5 billion over three years

innovative type of support, sitting between both information or guidance and simplified or holistic advice.

In Progress: Consultation launched to develop a UK ISA to encourage greater retail investment in UK markets by providing a new tax-free savings opportunity for people to invest in the UK, while supporting UK companies.[39]

In Progress: The Government is working with the PRA to ensure that the vision for reforms to Solvency UK are delivered in practice, which will unlock DB scheme capital in particular for investment in productive assets in the UK.

4. Our companies must operate in a corporate governance and stewardship environment that results in better outcomes for all – with a mindset that drives companies to succeed and compete on a global stage. Well intended reporting requirements on UK listed companies have become a material consideration for companies deciding whether to list or remain listed. We must address requirements that impose unjustified administrative burdens on users of our public markets, especially where these unintentionally discourage the use of our markets and where they create an unlevel playing field with other major capital markets.

Actioned: The Financial Reporting Council's (FRC) mandate now includes an objective to support the UK's economic growth and international competitiveness.[40]

Actioned: The FRC issued a streamlined update to the Corporate Governance Code in 2024 which amongst other things included a clear direction to ensure market participants use "the comply or explain" regime as the flexible regime it was intended to be (i.e. not to be treated as a "comply or else" regime).[41]

Actioned: The FRC have announced five material changes to reduce the reporting burden of Stewardship Code signatories, including removing requirements for certain annual disclosures.[42]

In Progress: The FRC is conducting a fundamental review of the Stewardship Code focused on reviewing its purpose, principles, the role of proxy advisors, streamlining processes to comply with the Code and how it is positioned with other UK regulators and their remits.[43]

In Progress: The FRC announced an ongoing review of all their guidance and reporting requirements to ensure any that are unnecessary or disproportionate are removed or streamlined.[44]

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[39] UK ISA consultation – GOV.UK (www.gov.uk)
[40] FRC welcomes new remit letter
[41] FRC Revises UK Corporate Governance Code
[42] FRC announces significant update to the UK Stewardship Code
[43] FRC announces significant update to the UK Stewardship Code
[44] FRC welcomes Government's plans to legislate following Non-Financial Reporting Review

In Progress: The FRC is revamping its Stakeholder Insight Group to ensure it is hearing a broader range of voices across the corporate and investment ecosystem (beyond specialists in governance and stewardship).[45]

In Progress: CMIT and the Investor Forum are driving the establishment of a new Investor and Issuer Forum (IIF) to create a venue in the UK where decision makers from investors (including both asset managers and asset owners) and listed companies can constructively engage with each other.[46] The IIF emphasises collaboration and trust over antagonism and mistrust between these two core stakeholders of UK capital markets. The work of the IIF will include seeking a consensus on how boards hold themselves accountable to shareholders whilst retaining the freedom to exercise their powers and judgements as appropriate. On the investor side, discussions will include practical measures to encourage alignment between asset owners and asset managers; ensure that the views of the fund management and governance functions within institutions are aligned; and encouraging investors to interact with individual issuers on material issues as necessary.

These efforts will be coordinated with the work of the Confederation of British Industry's (CBI) to convene a group of CEOs and Chairs from across the FTSE 100 and FTSE 250 ecosystem to help ensure their voices are heard on the important work to ensure UK equity markets remain attractive for companies to raise capital.[47]

In Progress: The Investment Association (IA) is updating its remuneration guidance to reflect the market's drive to ensure practices in the UK do not disadvantage UK companies on a global stage.[48] This reflects the start and progression of balanced and constructive dialogue in the past year in the UK in relation to remuneration policy. In today's global market for talent, the attraction, retention and reward of talent is a key component of competitiveness. This does not mean an endless rise to global reward levels, but boards need the freedom to be able to make – and justify – decisions on reward as they do on other strategic matters. Discussions are continuing to reach agreement between investors and issuers that there should simply be a level playing field regarding the structure and approach to remuneration frameworks for listed and private market peers in Europe, including in the UK, and the US.

A huge amount of progress has been achieved to streamline the corporate governance and stewardship regimes in the UK. Whilst there is more work to do, particularly on reforming the Stewardship Code, much of the further progress will be largely in the hands of the market to take advantage of these new regimes through changes in market practice. We anticipate that bodies like the Investor and Issuer Forum will become instrumental at catalysing these changes.

[45] Statement: FRC policy update
[46] IF-Press-Release-CMIT-Open-Letter.pdf (investorforum.org.uk)
[47] Ensuring the UK is a competitive place for large companies to be listed | CBI
[48] Investors review pay guidelines in light of UK competitiveness debate | Press Releases | The Investment Association (theia.org)

5. Strong public markets require both a stock of investable assets and a flow of new opportunities. We need companies to grow; from start-ups to scale-ups, to "grown-ups".

This Report supports the continuation of the Research & Development Tax Credits, Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and VCT (Venture Capital Trust) arrangements that offer tax reliefs to early-stage investors – a tax regime for start-ups as good as anywhere in the world. In the 2021-22 tax year, 4,480 companies raised £2.3 billion under the EIS scheme, while £205 million was raised within SEIS schemes.[49] We are the best in Europe in starting new businesses.

Scale-up companies however and the next tier of SMEs do require a significant increase in capital in the UK. This is fundamental to support the scaling of early-stage companies. There have been several initiatives to try to address the shortage of UK scale-ups becoming "grown-ups". These include the provision of direct government support through the British Business Bank (BBB) and the formation of the Business Growth Fund (BGF) in the aftermath of the Great Financial Crisis.

While investment has been substantial (more than £4 billion in each of the four quarters of 2021 for the BBB, and a total of £2.2 billion by BGF since inception), the BBB and BGF need to be around three times larger than at present to deliver on the UK's ambitions. The ScaleUp Institute has estimated that an extra £15 billion of investment is required in the UK.[50]

Simplifying the institutional landscape by combining the several government-sponsored investment vehicles, coupled with additional Government support, will go some way to plug this gap. This report welcomes the Government's decision to support the UK Infrastructure Bank with an additional £7.3 billion in funding and aligning it alongside the BBB under a new National Wealth Fund.[51] The UK could go further by lifting restrictions on the private investment vehicle BGF so that it can invest in FinTech, a critical industry for the UK, and to expand its shareholders beyond the existing "club" of founding high-street banks.

Private equity also plays an important role in the UK (as at September 2023, there were 1,950 private equity firms in the UK)[52] – it is a global hub for the industry outside the US. There needs to be a closer relationship between public and private markets and a recognition that both are part of the same economic ecosystem. Ensuring that both ends of the UK's funding continuum are better connected, can help companies transition from growth to scale-up to "scaled" more efficiently and without the traditional friction points that exist when a company goes from having private equity investors to listing on a public market.

In Progress: The Government has instructed officials to immediately begin work to align the UK Infrastructure Bank and the British Business Bank under a new National Wealth Fund that will invest in the new industries of the future.[53]

In Progress: The UK is creating the world's first regulated cross-over market between the private and public markets with the regulation known as PISCES expected to be in the

[49] FT Advisor, May 19, 2023
[50] The Future of Growth Capital Report – ScaleUp Institute
[51] Boost for new National Wealth Fund to unlock private investment – GOV.UK (www.gov.uk)
[52] BVCA
[53] Boost for new National Wealth Fund to unlock private investment – GOV.UK (www.gov.uk)

Financial Market Infrastructure (FMI) Sandbox in 2025. This market will help support private companies to access public market liquidity whilst remaining private.[54]

In Progress: The Mansion House Compact will help drive more UK capital into VC / PE to support our homegrown companies.

[54] Private Intermittent Securities and Capital Exchange System (PISCES): Consultation – GOV.UK (www.gov.uk)

6. A national culture that supports and celebrates entrepreneurship, risk taking and one where individual component pieces of the ecosystem make use of their agency to drive the change they want to see in our markets, which includes being ready to burst the pernicious myths that seek to corrode confidence in UK markets.

Ongoing: CMIT and a vast array of industry initiatives, including those led by UK Finance[55] and TheCityUK amongst others, are encouraging UK markets to shift in this direction, and a shift in the public narrative and media coverage is already materialising.

Market participants need to actively champion the UK and its many advantages. Being self-effacing is an attractive British trait, but self-denigration can become self-harming in a globally competitive sector.

The social nature of capital markets, with talent attracted from around the world, shapes our culture and should be fundamental to our narrative. The mood and behaviours of the thousands of men and women employed in capital markets, and those who comment on them, helps determine the actual performance of UK markets in a highly competitive global industry, how they are perceived and talked about by those currently or potentially using them, in the UK and globally, as well as influencing decisions to locate businesses in the UK.

The complexity and scale of our transactions, the global nature of markets and even the language we speak can lead to a sense of separation between the capital markets and broader society. We can lose sight of the fact that the value our markets create extends beyond GDP or tax revenue. Its products and services are fundamental to the smooth running of the global economy, they make possible new infrastructure to transform the life of a town or city and enable people we will never meet get a mortgage, rent a car or save for a holiday.

There is a clear public good in what our markets do, when they do it well, and we need to make a greater effort to communicate our purpose to the rest of society and ensure that we are better understood.

A political culture that celebrates the capital markets' successes – a major IPO, investment in an important infrastructure project, new jobs created through financial services – can help explain the markets' value to the rest of society, and project a positive narrative around the world.

Government can also help by continuing to set out a more explicit and widely understood economic strategy for the UK, which recognises the importance of capital markets for the high innovation, high growth scale-ups which are essential to future economic success. The easy availability of talent visas, grant support for R&D investment and a smart approach to procurement that enables government departments to support early-stage UK firms would all combine to create a pro-growth, risk-on culture across the UK economy.

[55] UK Capital Markets Building on Strong Foundations.pdf (ukfinance.org.uk)

(2) Myth Busting

We should not allow the UK's hugely ambitious reform agenda to be in vain by failing to grapple with some of the myths that have built up around our markets in recent times. Positive narrative matters. Narrative becomes perception and perception becomes reality. The whole system, including market stakeholders, regulators and the Government, must pull together if we are to maximise the contribution from capital markets to UK growth, performance and economic modernisation.

The UK does not start from a bad place, far from it. It has for many years had the ingredients required for success: strong institutions; a world-renowned common-law legal framework; and historic advantages, including the English language and a favourable location and time-zone. The UK has a high level of regulatory certainty and quality and, more recently, a settled political system with substantial economic consensus about the importance of economic growth. This assumes greater importance in a year when voters representing over of half global GDP are going to the polls and the geopolitical background is volatile.

Below we set out some of the myths that we must continue to challenge to help ensure the success of tomorrow's capital markets:

Myth 1: US IPOs Are More Successful Than UK IPOs

Busted: Data shows that this is untrue. The medium-term performance post-IPO in London is on par with New York. Moreover, in the last 10 years, over 200 UK companies have IPO'd on the London Stock Exchange (raising at least $100 million). Only 20 UK companies have IPO'd in the US (and 6 have come the other way, raising at least $100 million). Of the 20 British companies that listed in the US, 8 have already delisted, only 4 are trading above their IPO price and the rest are on average trading down by more than -80%.[56]

Foreign issuers tend to underperform in the US compared to the UK. Over the last five years, the average aftermarket US IPO price performance shows US companies down by 2% at time when non-US companies are down 31%. There are many cases where companies – particularly if they are classed as 'foreign private issuers' – are listed in the US, but are "orphaned" (i.e., not followed by any securities analysts in that market) and therefore attracting less investment in their shares which impacts future share value growth and the ability to return to market for further capital. Coupled with higher IPO costs and higher litigation risks, US IPOs are not without risk.

When looking at some of the UK's top strategic industries, most of the UK's recent life sciences IPO's have occurred on NASDAQ. Nine of the eleven UK companies that have listed on NASDAQ, and are still currently listed, have seen their valuations decrease (Bicycle Therapeutics and Immunocore being the only exceptions). In aggregate, the valuations of those companies are today worth £1.4 billion less than their IPO valuations. NASDAQ has not been a good solution for UK life sciences companies.

We should also ensure we are making fair performance comparisons across markets. When one strips out the Magnificent 7 companies from the US S&P 500 index, the rest of the companies in the index perform very much in line with those companies in the FTSE100[57] (which has had a record-breaking run this year reaching 8,000 points for the first time in its history and outperforming major US market indices). This is important context when understanding individual company valuations, where studies by several

[56] Dealogic (12 August 2024)
[57] The Magnificent 7 and the Other 493 | Issuer Services | LSEG (lsegissuerservices.com)

investment banks show that there is no proof the UK systemically undervalues equity when looking at real peer-to-peer comparisons between the UK and US.

Myth 2: The UK Lacks Liquidity Compared to the US

Busted: There is no disputing that the overall size and depth of the US market is larger than the UK's. The US is the largest economy in the world and consequently is backed by a large domestic market. However, whilst this is advantageous in many cases and for many companies, it is not true that it is the case for all companies.

When we analyse the liquidity that actually matters to individual companies (i.e. their share turnover), the data shows that it is untrue that the UK lacks liquidity when compared to the US.[58] When considering total liquidity in the UK market, not solely the liquidity traded on the London Stock Exchange, and adjusting for available free float, liquidity in London is in fact comparable to that in the US.

The size of the US market can in fact be a hindrance for those relatively small companies (valued below $10 billion) looking for liquidity in their shares, which can become “orphaned” on US markets, as noted above. The misconception of a liquidity differential between the UK and US can sometimes be driven by simplistic comparisons across different market structures and incomplete analysis when comparing trading volumes, despite easily available data.

Myth 3: The UK is Not a Good Place to Start a Business

Busted: The UK is already a leading nation in terms of the number of startups founded and UK early-stage VC markets are an absolute and comparative success story. The UK has the second-largest VC industry in the world, behind only the US, and attracts more VC investment than France and Germany combined.

In 2021 £28 billion was invested in UK venture capital, compared with £10 billion in France and £14 billion in Germany. The UK accounted for 31% of European VC investment by number of investments and 34% by value. The British Venture Capital Association (BVCA) similarly reported[59] that after record-breaking fund-raising in 2020, 2021 saw £34.8 billion invested by its members in more than 1,850 businesses across the world. Half of this total was invested in more than 1,300 UK businesses, two-thirds of which were outside London. This is supported by a best-in-class tax regime for early-stage investment.

The UK is also home to a globally leading growth market. Over the last 5 years, 54% of all European growth market capital raised was raised on London's AIM, where this year alone we have seen highly successful IPOs including by US companies MicroSalt and AOTI.

[58] London vs New York: What liquidity differential? | Issuer Services | LSEG (lsegissuerservices.com)
[59] BVCA, Report on Investment Activity 2021

Myth 4: Our Economy is Today Smaller Than It Was, So “Rebalancing” is Needed to reflect This in Investment Portfolios (and the recent performance of our equity markets support this)

Busted: Whilst some market participants and economists may regard this behaviour as comprehensible and rational, observed from the streets of Wandsworth, Birmingham or Belfast, it just looks self-destructive. Similar behaviour would be unthinkable in the US or France. The decision of UK pension funds to disinvest in our capital markets is defeatist and self-harming. It is the opposite of the aggressive plans for capital markets growth we see in other competitor countries. The current assumption on the need to rebalance ignores the mechanistic effects at play here: as investment in UK equities falls, so they lose their prominence in global indices, driving further outflows.

One characteristic of a large global capital market located in a mid-sized domestic economy is the “UK neutral” mindset that some elements of our capital markets apply to transactions and investments made in London. By “UK neutral” we mean that little or no consideration is given to the consequences of these decisions on the UK’s wider economy, and competitiveness. The prolonged withdrawal of UK pension funds from investing in UK equities is an eye-catching example, but another is the relative lack of investment by UK institutional investors (compared with, say, their Australian and Canadian peers) in the UK’s transport and energy infrastructure.

Whilst we may be the 6th largest economy in the world, we rank as the 3rd largest country globally for equity capital raised. UK markets have raised more equity capital than the next 3 European exchanges combined, and the London Stock Exchange is the only European exchange in the top 10 exchanges globally (and has been for the last decade). 2024 opened with two of the largest 5 ECM deals globally.[60] Our markets may serve a role that is disproportionate to the size of our economy – but then again, our markets are enabling growth beyond our economy, which incidentally, supports the growth of our own economy.

London’s financial pre-eminence historically has been built on global access, and today the City still leads the world in product areas, including global banking,[61] OTC derivatives[62] and global (re) insurance,[63] as exemplified by the Lloyds market. These global businesses are significant contributors to economic growth and to tax contributions to fund UK government activities. Professional and Financial Services make up a larger share of the UK economy than in comparable countries. While some protagonists argue this creates “imbalance”, we would suggest that any question of balancing the UK economy requires other sectors to grow, rather than seeing the financial and professional sector shrink – especially given that this sector can play an instrumental role in growing other sectors.

[60] Dealogic (August 2024)
[61] City of London Annual Review of UK Financial Services (2023)
[62] City of London Annual Review of UK Financial Services (2023)
[63] City of London Annual Review of UK Financial Services (2023)

Myth 5: Our Capital Markets Are Not Generating “Public Goods” So Why Should We Prioritise Them

Busted: The role of capital markets extends far beyond participants’ contribution to tax. The provision of government services (or “public goods”) funded by borrowing also relies on successful capital markets. But this is insufficiently understood by the public. Unfortunately, too many people associate capital market activity with “casino banking”, driven by self-interest and greed and riven by intermittent scandal. It is a narrative that does not reflect reality and needs to be debunked, and the true value of our capital markets to the wider UK economy carefully and constantly explained. A good example of UK capital markets generating a public good is the role they play in enabling the Government to borrow.

The UK’s total government debt (“gilts”) amounts to some £2.7 trillion, and it is growing — digesting this stock requires an effective UK capital market. The UK government’s Debt Management Office (DMO) performs its function with great professionalism. It is one of the “unsung heroes” of the City, helped during Quantitative Easing by active purchases from the Bank of England, which owns around £730 billion of gilts.[64]

Quantitative tightening now reverses this position so that willing buyers will now need to be found to absorb a “deluge of gilts” — probably around £250 billion a year. This will entail attracting overseas purchasers and working closely with UK pension funds, which are the natural purchasers of gilts, including index-linked gilts of which they are the only purchasers.

These investors fund not just the pension incomes of our retired citizens, but they also fund essential services including the NHS. It is hard to imagine a more crucial role for capital markets in an economy where we borrow the equivalent of our total GDP.

[64] Bank of England Report on the Bank’s official market operations 2023-24

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