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13 December 2024

Financial Services Strategy

HM Treasury

1 Horse Guards Road

London, SW1A 2HQ

Submitted via email: FSGrowthStrategy@hmtreasury.gov.uk

State Street comments: UK financial services growth and competitiveness strategy

Dear Sir/Madam:

State Street welcomes the opportunity to comment on the Call for Evidence issued by HM Treasury on the Financial Services Growth and Competitiveness Strategy (the "Strategy").[1] Overall, we are supportive of government's initiative, and, in particular, its recognition of the unique and critical role that wholesale services and asset management play in pooling and deploying capital to growth sectors and critical infrastructure.

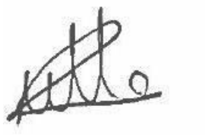
This Strategy will be complementary to the various important reforms this government has already initiated—notably, the ongoing review of the pensions and retirement landscape. We thoroughly support the outcome of the initial phase of that review. Consolidating pools of state-backed and private capital will help provide scale and capability, and new scope for UK savers and firms to participate in those markets, because it allows for better decision-making and portfolio risk diversification, amongst other things. This is an area in which State Street has specific expertise and interest given our core businesses, as a custody bank and asset manager. We, therefore, stand ready to contribute to further work by government and the UK regulators on pension reforms.

We agree with the stated objectives and policy priorities set out in the Call for Evidence. High-quality regulation, international competitiveness, and economic growth are essential for the prosperity of UK financial markets. From State Street's perspective, there are pertinent opportunities that can be driven by innovation and technology in the financial services sector—especially, fund tokenization and responsible artificial intelligence. And while there are some regulatory adjustments to affect the Strategy, some of which we have highlighted in this letter, we believe there has been positive work in recent years to recalibrate the regulatory environment in a way that is conducive to wider economic growth that should be continued.

This Call for Evidence is a fundamental first step and we look forward to further opportunities to engage with government on the role that financial services can play in supporting wider economic growth.

Yours sincerely,

[1] Financial Services Growth and Competitiveness Strategy - GOV.UK (www.gov.uk)



Michael R. Eldridge

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Alex Castle

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State Street comments

Question 1: Which of the following statements best describes you as an individual or as an organisation:

Financial Services Organisation

Question 2: Which of the following best describes your business:

Established Player

Question 3: Which of the following UK regions do you:

- **a) operate out of:** London, Scotland
- **b) have headquarters:** Not applicable

If you/your organisation is not headquartered in the UK, please provide the country and city of your organisation's headquarters.

United States, MA, Boston

Question 4: Which part of the financial services sector does your organisation operate in? Please check all the markets in which your organisation operates. Separately please indicate which of these subsectors or market you consider your firm to primarily operate in.

- a) Asset Management
- c) Financial Market Infrastructure
- h) Payment Services
- i) Pension Fund

l) **Other – please specify.** Custody bank

Question 5: How many employees are in your organisation:

a) in the UK? Large (250+)

b) in an overseas branch, subsidiary or headquarters? Large (250+)

Question 6: Do you intend to take on additional staff in the next 12 months? Yes

Question 7: Are you planning to:

a. Invest more in your UK business in 2025 than in 2024? Yes

What are the reasons behind the answers you gave to the above questions? What opportunities/growth areas are you investing in?

State Street employs ca. 2000 people in the UK and all of our major business lines are represented. Whilst most of our headcount is based in London, we have a sizable footprint in Edinburgh which is integral to our overall UK presence. Our growth in the UK will largely be driven by (a) expanding our asset management and asset servicing business, (b) investing in digital technologies, (c) navigating post-Brexit regulatory changes, and (d) leveraging strategic partnerships. With the UK being a major financial centre, our strategy will help State Street meet the evolving needs of institutional clients in the UK.

Chapter 3 – Objectives and Approach

Question 3.1: Do you agree with the proposed objectives set out in paragraph 3.6?

We welcome the 'Invest 2035 Modern Industrial Strategy' announced by the government and the identification of financial services as one of eight "growth-driving sectors". This recognises the sector's importance for the funding and supporting of the economy, as well as its roles an employer and tax contributor.

Against that background, we agree and support the objectives set out in paragraph 3.6. It would be important to consider how other already ongoing government work, in particular the work to unlock pension capital to boost economic growth and improve outcomes for savers as part of the pensions review, will interact with the objectives of this strategy.

Question 3.2: [For Financial Services Organisations] For firms operating in more than one jurisdiction, what are the main drivers affecting your decisions on where to invest?

There are several drivers that affect strategic business decisions on where to invest. These range from health of a jurisdiction's overall (financial services) ecosystem, the proximity to clients, access to talent and to other markets and locations to open and deep financial markets, supported by a stable regulatory environment. For firms with global operating business models, such as State Street, a regulatory framework that seeks to align with international standards is a prerequisite, as this allows firms to manage their international operations efficiently and effectively while maintaining appropriate levels of investor protection and market integrity.

Question 3.3: What do you consider to be the most important trends or changes likely to affect the financial services industry over the next 10 years?

The most important trends to affect financial services industry over the next 10 years, in our view, will be seen in the technology and innovation space. There is already extensive exploratory work between public and private sectors with respect to evolving best practices in the offering of digital assets and tokenization (i.e., traditional assets such as bonds or money market funds), underlying technology (e.g., distributed ledger technology) in addition to advancements in the use of artificial intelligence (e.g., generative AI, quantum computing)—see comments on 'Innovation & Technology' below.

Chapter 4 – Policy Pillars

Question 4.1: Do you agree with the list of policy pillars that the government intends to focus on? Are there other areas that should be included?

Yes, we agree with the proposed list of policy pillars.

Question 4.2: Please rank the list of pillars in order of importance to your business or organisation for i) day-to-day operations and ii) longer-term plans for investing in the UK

Day-to-day operations:

1. Regulatory Environment
2. Skills & Access to Talent
3. Innovation & Technology
4. International Partnerships & Trade
5. Regional Growth

Longer-term plans for investing in the UK:

1. Innovation & Technology
2. Regulatory Environment
3. International Partnerships & Trade
4. Skills & Access to Talent
5. Regional Growth

Question 4.3: How well is competition currently working in the financial services sector, and how can it be improved?

The UK's vibrant and dynamic capital markets remain some of the strongest and deepest globally, with a wide range of actors contributing to the overall ecosystem. This is a strong foundation on which to build a financial services growth and competitiveness strategy, and we welcome the commitment by government, and the execution of our regulators, to ensure the UK regulatory environment supports competitive financial markets.

There has been a significant amount of work in recent years to reform UK capital markets and the wider regulatory framework, with a view to enhancing competition and growth, which we discuss further in Section 5.

In addition, the introduction of the FCA and PRA's secondary competitiveness and growth objective, once fully embedded, should support competitiveness in the financial services sector. The UK financial services regulators have a strong reputation for having rich technical policy expertise, and this is underpinned by their principles-based and outcomes-orientated approach, which is proving more effective by comparison to rules-based approaches. Given the secondary objective is intended to be applied in the day-to-day activities of our regulators (including, strategy, policy development, supervision), we appreciate the time it takes to embed into the culture of any organisation.

However, a narrow focus on the regulatory framework is insufficient for delivering competitiveness should action not be taken in other areas as well. For instance, the UK continues to be viewed internationally as a less tax efficient fund location compared to its international peers and finding a solution should remain a priority in the context of the UK Funds Regime review. After all, competitiveness is determined by a range of factors, which are defined by government, the regulators and the financial sector—and so engagement between all is essential.

Innovation & Technology

Question 4.4: What is your assessment of how effectively the UK supports innovation and the adoption of new technology? What could be improved in the financial services sector?

The UK has been effective in supporting innovation and adoption of new technology. This has been premised on effective partnership between the regulators and leading innovators via the regulatory sandboxes, which provide a safe place for market innovators to explore the benefits of new technologies. This approach has yielded a pragmatic regulatory approach and has influenced approaches taken by regulators in other jurisdictions too.

More prescriptive regulatory approaches adopted by other jurisdictions have also affected our approach to innovation. For instance, the new EU rules on artificial intelligence (AI) has shaped our strategy, though we also actively participate in the Lord Mayor's "Investor Consensus on Responsible AI" Initiative.

With strong international regulatory competition in this area, there is no room for complacency and so we welcome and support a focus on innovation and technology.

Question 4.5: Which technologies do you think have the most potential to transform financial services over the next 10 years? And in which financial services sectors or functions do you see these being applied most effectively?

From our perspective, the technologies/developments that have the most potential to transform financial services are generative AI, quantum computing and digital ledger technology:

- *Generative AI* has the potential to transform the provision of financial services across sectors—capital markets, banking, asset and wealth management, insurance. For example, AI can be used in lending processes, to enhance the customer journey within retail banking and for risk, credit, and pricing optimisations through automation of credit decisions. In addition, the introduction of 'Agents' (Agentic AI) will redefine recommendation systems, fraud detection, customer behaviour, portfolio management, to name a few. AI Agents can be embedded into firms' application ecosystems and would be able to engage in complex interactions and information exchange with other systems.

- *Quantum Computing* can transform the way in which firms approach risk management, investment management, customer analytics, portfolio management, for example. Quantum Machine Learning where traditional or modified machine learning algorithms will be executed on a quantum computer. Post Quantum Cryptography, the introduction of specific algorithms that are designed to withstand a quantum-based attack, will see and lead to the replacement of incumbent cryptographic approaches used within firms.
- *Digital Ledger Technologies (DLT) and Digital Assets* continue to attract regulatory and industry attention, with potential for transformation across capital, debt markets, asset and fund administration, in addition to specific product offering tokenization of traditional assets such as Bonds, Money Market Funds etc. The introduction of shared ledgers and tokenized assets will reduce friction and inefficiencies of tradition financial systems through instant settlement and reconciliation thereby significantly increasing the speed and efficiency.
- *Tokenization*, more specifically, is likely to revolutionise the way in which investment funds will be delivered in the future. This is a specific area where greater proactive engagement from regulators would be welcomed. Regulators have an important role in determining how fund managers can investigate and put new technologies and products to use. This will translate to needing greater expertise and appetite to explore new ideas in order to foster innovative evolution in the asset management sector. Considerable work has been already done by the UK regulators to explore the potential and the feasibility of fund tokenization. This includes the work of HM Treasury's Asset Management Taskforce - in which State Street had participated – resulting in a 'blueprint' for supervised entities to follow and pilot use cases, as well as work by the FCA to address potential regulatory barriers. Government should further build on these initiatives which have created momentum in driving first uses cases in industry (tokenizing a share of a regulated money market fund for use as collateral). More specifically, with regards to the Asset Management Taskforce, we would recommend renewing its mandate including increased focus on digital innovation and development in the asset management sector.

Regulatory Environment

Question 4.6: What is your assessment of the UK's current regulatory environment?

The UK has created an overall ecosystem, underpinned by a robust, agile and principles-based regulatory environment, which has made it one of the leading global financial centres.

There has been significant work in recent years to improve and tailor the overall regulatory framework in the UK, for example, reforms to the listing regime. The UK's outcomes-orientation and principles-based approach to regulation is laudable. The principles-based regulations adopted by the financial regulators have been successful and, for the most part, has enabled firms to operationalise UK regulatory requirements in a relevant, proportionate and pragmatic way.

As a general observation, there should be clearer demarcation between wholesale and retail in the application of financial services regulation (e.g., the applicability of the Consumer Duty in the wholesale market). For some participants that already had fiduciary duties, it was not clear why The Duty was necessary, but they still had to complete a significant amount of work to digest and implement the new rules. And for others, such as wholesale banks, a lot of time and effort was expended proving that the Duty did not apply or applied only in very limited circumstances. That work incurs compliance and legal costs and can distract focus from more material risks.

Providing greater clarity on the distinction between wholesale and retail expectations for The Duty would have been helpful.

In addition, the UK's general approach to promote internationally consistent standards is welcome, and it should maintain a strong voice internationally. From a financial services perspective, the UK should seek a high level of consistency, or at least interoperability, with laws and regulations of the European Union. This would help firms continue to manage their international operations efficiently and effectively and also to maintain appropriate levels of investor protection and market integrity. In this context, the operationalisation of the overseas fund regime will be crucial to maintain the UK as a place "open for business" for global fund managers.

Question 4.7: How can regulation support responsible and informed risk-taking?

There is a distinct lack of investment culture in the UK, meaning there is a vast sum of potential investment that remains untapped in economically unproductive deposit accounts. Revising the regulatory framework in isolation would not address the root problem, though—regulators are only one piece of the puzzle. Government can help to ensure financial literacy is a core part of school curriculum, so that people are well educated on the benefits of investment, making them better able to take advantage of investing opportunities. If the 'risk/reward trade off' inherent in investing is not well-understood, however, it is entirely understandable that regulators would be averse to adopting a more accommodating risk appetite—one that moves closer to requiring firms to disclose risks associated with investment activity, as opposed to inuring investors to market movements.

<u>Regional Growth</u>

Question 4.8: [For Financial Services Organisations] What are the three most important factors, ranked in order, that you consider when making an investment location decision within the UK?

From State Street's perspective, i) skills, expertise and ongoing talent development, in addition to ii) connectivity between all regions, and secondary issues such as iii) sufficient real estate, are important factors when considering and making investment location decisions within the UK.

Question 4.9: How can we capitalise on synergies between different regional financial services hubs to support growth?

London and Scotland are leading financial services locations, with Scotland increasingly cultivating a digital ecosystem having already grown its fund administration and similar support services sector.

There is a role for government at the local and regional level, and while they can have idiosyncratic brands, there must also be cohesiveness between regional, local and even global financial services related policies. This is essential to avoid bureaucracies between layers of government that can act as an inhibitor for capital allocation.

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

Question 4.10: What is your assessment of the UK's ability to attract global talent to the financial services sector?
Question 4.11: What is your assessment of the UK's ability to effectively upskill and reskill domestic workers for roles in the financial services sector?

We defer to the relevant work done by the Financial Services Skills Commission in this area.

International Partnerships & Trade

Question 4.12: What barriers do international financial services firms face in either establishing and operating in the UK, or using UK markets?

State Street first established its UK presence in 1972 and since then our footprint has expanded and now includes offices in London and Edinburgh employing ca. 2,000 staff. As such, the UK is an integral part of our global strategy and operating model, and we do not experience barriers to operating in the UK.

With regards to barriers when operating in the UK, we welcome the government's plans to collect feedback and to consider improvements to the current environment and framework. As set out above in our response regarding the wider regulatory environment, reducing the burden of proof for wholesale firms having to demonstrate that they are not interacting with retail clients and that respective retail requirements do not apply, would make a difference and would be considered a significant improvement.

In addition, we strongly support the UK's agile approach to regulation as demonstrated through the effective us of public-private partnerships (including the UK Asset Management Taskforce) and the effective deployment of pragmatic and innovative approaches such as sandboxes in the digital space. This agile approach helps the UK with ensuring that its regulatory regime is not too rigid, does not create unnecessary barriers and obstacles and supports innovation.

Question 4.13: What opportunities should the government seek to advance through its international financial services relationships?

As a global firm, we continue to support international consistency and strong policy collaboration between regulators across the globe and in this context, we welcome the good and active participation of the UK regulators and policymakers in the global regulatory work and discussions. The UK's clear ambition to play a "global" role on financial regulation and to be a facilitator of global regulatory discussions is of increasing importance. Similarly, it is important that the UK continues to demonstrate in international fora a positive attitude on how capital markets, far from only being a source of risk, can drive economic growth and development.

In addition, the result of such continued international cooperation and coordination is a broad international alignment of regulatory frameworks which is beneficial for the financial services sector and the UK's overall competitiveness. We appreciate the UK seeking to promote internationally consistent approaches to various regulatory topics. In some cases, the UK's initiative has influenced pragmatic approaches in other jurisdictions. For example, the UK conceived the first 'regulatory sandbox' in 2016—something that has been emulated by other jurisdictions. Such collaborative approaches to innovation are hugely beneficial and should be continued.

Moreover, advancing bilateral relations with key markets and jurisdictions is important too. As such, we would encourage the government and the regulators to continue their efforts in agreeing bilateral cooperation agreements and memoranda of understanding as this help to open up markets and support the UK's role as a hub and financial centre of choice.

Lastly, with regards to the UK's relationship with the European Union, we believe that the UK should seek a high level of consistency, or at least interoperability, with EU laws and regulations, based on an outcomes-oriented approach. This would help firms continue to manage their international operations efficiently and effectively and for the UK to function as a financial services hub. In this context, we welcome the improved relationship with the European Union and the ongoing regulatory dialogue in financial services.

Chapter 5 – Priority Growth Opportunities

Question 5.1: Do you agree with the priority opportunities that have been identified?

Yes, we agree with the priority opportunities that have been identified.

Question 5.2: Which of the following business areas and activities do you see as high growth opportunities for your firm? Please rank the below from 1 to 11, where 1 is the highest growth potential.

1. Asset Management
2. Pensions
3. Financial Market Infrastructure
4. FinTech
5. Payment Services
6. Sustainable Finance
7. Retail Banking
8. Investment Banking
9. Financial Advice
10. Insurance/Reinsurance
11. Mutual/Cooperative

Sustainable Finance

Question 5.5: In the UK's sustainable finance framework, as set out in the Chancellor's Mansion House package, do you see barriers or gaps that would support the growth and competitiveness of the UK sustainable finance market?

We support the Chancellor's overall ambition set out in her mansion House speech. With respect to exploring benefits of a UK Green Taxonomy, the UK should observe lessons from similar implementations in other jurisdictions (e.g. the EU, various initiatives in the Asia-Pacific region) and, in particular, note how highly prescriptive regulatory approaches have proven highly challenging to implement in practice given limited application to the current investible universe. From the perspective of an index-based investment manager, we recognise that government intends to bring forward regulation on the provision of ESG ratings, which has, to some extent, acted as a barrier to increasing capital allocation towards sustainable investments.

Question 5.6: What do you think should be the UK's priority when engaging with the global sustainable finance agenda, both bilaterally and at a multilateral level?

The UK should promote globally interoperable standards for financial services companies, recognising the importance of tailoring according to individual business models---for State Street, as a custody bank, we do not have influence our clients' investment decisions, and so the setting of decarbonisation targets on assets under custody and administration is inappropriate.

Policy discussions at the multilateral level should focus on development of principles-based standards (e.g., for effective transition planning) to ensure global interoperability while recognising differing levels of political ambition. Meanwhile, bilateral discussions should seek to explore mutual recognition mechanisms for comparable regulatory frameworks (e.g., sustainable-themed fund labelling, disclosure/reporting, marketing & distribution) to ensure a proper global transition.

Question 5.7: What are the opportunities and barriers for the financial services sector in developing the products and/or services necessary to facilitate investment into the net zero transition? For each opportunity, please provide an indication of the type of intervention required, for example developing guidance, or supporting the development of further capabilities.

The main barriers to sustainable investing continue to be imperfect and/or nascent data sets, though enhanced TCFD-aligned climate-disclosures are intended to address this overtime. For global firms, inconsistent regulatory approaches (e.g., product labels / disclosures) is not only highly challenging from a compliance perspective but it could impose restriction on foreign domestic investment.

Capital Markets (including retail investment)

Question 5.8: Are there any barriers to growth in capital markets that are not being targeted by existing government reforms? How can private and public markets be grown so that they best support UK growth?

The UK has invested significant time and effort into modernising its capital markets regime, to bring its primary markets on par with those in other advanced markets by enhancing the competitiveness of its own regulatory regime. The government is, therefore, right to now focus on a modern industrial strategy, which fully incorporates the unique and critical role that capital markets play in pooling and deploying capital to growth sectors and critical infrastructure. This strategy presents an opportune moment for the UK to reimagine the way in which it generates and allocates growth capital in an agile manner, though there has been extensive government work (reform of the UK listing rules, development of a UK consolidated tape for all asset classes, the transition to T+1, and the review of the UK research market and creating optionality for payments for investment research) in this space already.

In addition, London is a powerhouse in both FX and fixed income trading/origination. Reforms to improve listing requirements have been helpful given overseas investors want equity markets that are deep and liquid, preferably with higher growth firms coming to market via private equity and venture capital. The UK is still viewed as a relatively expensive and difficult place to list, and to maintain that listing. Government should monitor the listing environment to assess whether any further reforms, targeting structural, regulatory, and governance dimensions, are warranted.

Improving secondary liquidity should be a focus, including the impact of stamp duty. Companies have benefited from greater liquidity (and valuations) from listing elsewhere, which is evident from the number of companies that switched listings from UK to the US, for example. The FCA's own data shows, from March 2023 to March 2024, UK listings declined 5.8% (1,124 to 1,059)—a fall of 40% from its peak in 2008. Boosting secondary liquidity will support more primary issuance.

Question 5.9: Are there any barriers to retail participation in UK capital markets? What more can be done to encourage consumers to invest in capital markets to a longer-term time horizon?

The UK's vibrant and dynamic capital markets remain some of the strongest and deepest globally and we welcome the government's commitment to build upon this strong foundation.

Asset Management & Wholesale Services

Question 5.12: What are the barriers to setting up and conducting business as a UK asset manager or conducting wholesale services in the UK?

Based upon our experience in establishing a presence in the UK, we do not see any barriers to setting up and conducting asset management activities in the UK.

However, as set out above, we do believe that there is benefit in reducing the regulatory burden for wholesale firms from having to prove that certain retail client related requirements do not apply.

Question 5.13: In what ways could the regulatory landscape for asset management or wholesale services adapt to the needs of organisations over the next 10 years

Over the last decades, the UK has been very successful in becoming a location of choice for asset management by creating an ecosystem that co-locates financial service firms, related professional services and service providers, regulators and policymakers. It is key that this ecosystem is preserved while at the same time allowed to evolve and grow.

As part of this, we recognise the reforms in the asset management space that have been completed over the last years. These reforms were necessary and ensure that the UK remains on a level playing field with other jurisdictions. But it is now the time to focus on areas where the UK can lead and by doing so increase its competitiveness and attractiveness in the asset management space.

One way of achieving this is to maintain an active and two-way dialogue with the industry of which this call for evidence is one part. To further strengthen that dialogue and to ensure that the discussion is sufficiently strategic and forward-looking, we would strongly recommend making use of public-private partnerships and in particular to consider providing the Asset Management Taskforce with a renewed mandate (incl. increased focus on digital innovation and development in the asset management sector). In the past, this has been a very helpful and successful forum as it provides a direct channel of communication but also paved the way for important changes and innovation in the UK's asset management framework, for example through the creation of the UK's long-term asset fund scheme (LTAF).

The LTAF's creation was an important step towards opening up access to private markets to a broader range of investments which we consider to be important, given the growth in that segment, the needs for additional sources of funding and the growing investor demand for exposure to private markets. In our view, this agenda could be progressed further with reform of the asset registration requirements for UK authorised funds investing in certain types of "Other Assets". The FCA Handbook requires scheme property to be held in the name of the depositary or its delegate, rather than in the name of the fund or the Authorised Fund Manager of the fund (or its nominee). This increases transactional costs, as well as operational and legal complexity and, we believe, impacts the competitiveness of such UK fund structures in comparison to international peers. We refer to the UK Depositary Association's response to this Call for Evidence, which explores this subject in further detail.

With regards to the asset management industry more broadly and its evolution over the next 5-10 years, we believe that similar to the broader financial services sector, digitisation and the introduction of AI will have the most significant impact both on how the industry interacts with its clients and how it operates. Technological innovation and progress will make access to and choice of services and products easier while at the same time significantly enhancing the efficiency and speed of the underlying infrastructure and processes. In order to facilitate and to allow for this innovation to take place, the UK needs to remain agile and innovative in its regulatory approach. Ongoing dialogue with the industry, approaches such as the use of sandboxes, etc. will be key in allowing the UK to lead in innovation in this area while at the same time ensuring the soundness and stability of its financial (eco)system.

In addition to these broader considerations, we would re-emphasise that the regulatory landscape for asset management would benefit from a clearer demarcation between retail and wholesale activities and the applicable requirements for asset managers and financial institutions. Stable and reliable cross border market access is another critical factor if the UK is to remain a location of choice for international asset managers.

Lastly, we strongly encourage the government to continue its work to consider measures to be taken to make the UK more attractive from a tax perspective as a place to incorporate funds in order to improve the competitiveness of the UK fund industry while seeking to continue to encourage open access for UK investors to non-UK funds.