UK Finance

UK capital markets: a missed opportunity for retail investors?

On current trends, many UK savers will be unable to meet their desired standard of living in retirement. UK capital markets are part of the solution to this growing societal challenge.

In providing new opportunities for UK savers to take a greater stake in the future growth of the UK, UK Finance supports:

- A greater focus on financial education and lifetime financial planning for workforce entrants, alongside targeted measures in the FCA Advice Guidance Boundary Review to improve access to basic investment advice for retail savers.
- Innovative technological approaches to ensure that retail investors can have access to the same key forms of market information and data as professional investors.
- Active consideration of ways to make a UK digital gilt part of a strategy to encourage greater retail participation through targeted issuance for retail investors.

Global Counsel Research Partner

July 2024

By owning shares in UK companies, or lending money to the UK government, a saver is earning a return and helping fund the future of their economy.

Many UK citizens are likely to fall short of the required finances in retirement, leaving a gap between expectations and actual living standards. While many hold equity in their homes, contribute to pensions or save in other ways, too many UK citizens are not building sufficient future provision for later life and retirement. There are a number of factors driving these trends, ranging from wealth inequality, large pools of cash being stored for housing deposits and a declining public interest in equity and debt markets as a form of wealth generation. Policy makers will need to address two areas – (a) increasing the total savings of UK adults over their lifetimes and (b) allocating those savings to assets that are generally aligned to long term returns.

UK capital markets are central to these policy solutions because they enable savers to make the financing of UK companies and the UK government part of their lifetime saving strategy. By owning shares in UK companies, or lending money to the UK government, a saver is earning a return and helping fund the future of their economy. They are also channelling the benefits of that future back into their long-term income. Both offer different return potential compared to holding cash in a bank account over the same period.

Saving via capital markets

Incorporating capital market participation into the long-term savings profile of the UK can happen in two basic ways. The first is indirectly, through pensions or other institutional investments made by UK savers. The second is through direct ownership of equity and debt by individuals. In the 1960s, around half of the UK stock market was owned directly by individual UK investors in this way. Today they make up around 12% of its ownership.

Many savers will be familiar with participating in capital markets via their pension, as part of their long-term savings plan. Alongside this, an increase in widespread retail investor participation would be positive for UK citizens and the UK economy for three reasons:

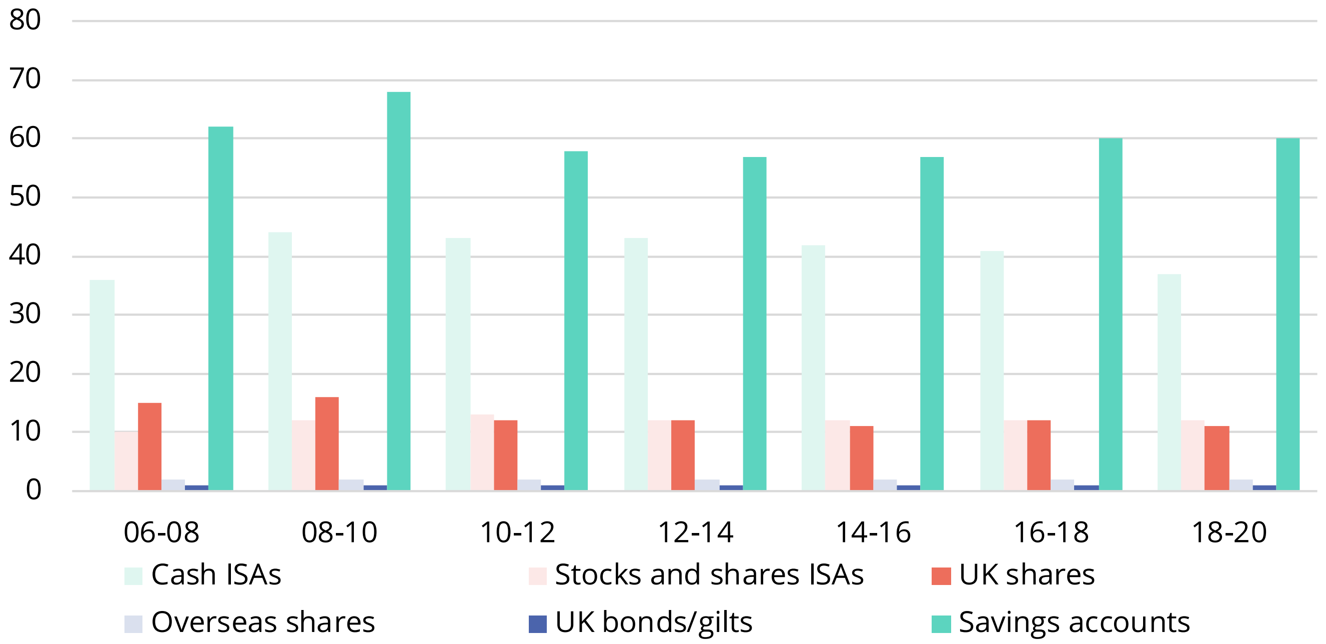
- First, it would provide an important diversification for cash savings outside a pension. Cash holdings are an important part of the UK savings mix and make up the vital deposit base of UK banks, which is used for lending to businesses and individuals. But cash holdings are impacted by inflation and returns from cash savings are generally lower than returns from equities or debt. UK savers will benefit from a strategy over the long term that embraces diversification.
- Second, some UK savers are potentially

Cash and other assets

Cash is the primary savings vehicle for UK households. The number of UK households directly holding UK shares as part of their savings has fallen over the last two decades.

Fig 1: UK households holding asset types.

Two-year periods, 2006-2020 (%).



UK ONS National Household Wealth Survey

missing an opportunity to express individual preferences through a direct investment approach in terms of the sectors, geographies, and sustainability criteria. Direct investment also provides day to day control over, and access to, invested savings in a way that a pension does not.

- Third, when a UK investor owns UK debt or equity, they are investing in the UK and the returns from that investment are channelled back into the UK. This enables UK savers to share in the success of UK companies. It also cultivates a level of 'ownership' and 'skin in the game' for society.

Technology is enabling the development of new platforms and other market innovations that simplify and improve the experience of owning stocks and shares. This will be important for increasing retail participation in equity markets. If the UK is to establish and embed an investment and savings culture, it will require not only financial education and better advice but also efficient and user-friendly platforms that offer positive experiences and lead to the formation of investing and saving habits across the UK.

Recent regulatory reform in UK markets should also positively impact some of the push and pull factors influencing market behaviours. Current proposals from the Digitisation Taskforce, around the

Many surveys over the last decade, including those conducted as part of the UK's Financial Capability Strategy have identified serious gaps in consumer knowlege, including on key investment themes such as the time value of money, diversification and the compounding effect of interest.

digitisation of the shareholding system, should make it simpler for investors with smaller shareholdings to play a direct role in the governance of the companies they own, provided that this is accompanied by appropriate protection of shareholder rights.

Risk, education and advice

To reverse the move away from retail participation in UK capital markets, we need to understand why it is happening. Despite an increasing number of platforms offering the opportunity for UK savers to allocate savings to stocks and shares, only around 11% of UK households hold shares directly as part of their savings - a fall of around a quarter since 2006 (see Fig 1). This is around half the level of the US.[1] While UK savers have recently begun increasing their personal ownership of UK government debt, this remains small. This deprives UK savers of the benefits many other European savers enjoy from purchasing government debt.

Lower levels of direct share or debt ownership may, in part, be linked to perceived risks. While holding shares in companies, or their debt, carries a degree of risk, this depends on the type of debt or shares, and on the time frame over which an investment is made. Accounting for risk over a long investment period is also a fundamental component of modern investment theory. Conversely, the UK has witnessed a trend in cryptoasset investing, a market that carries material risk and has been historically volatile. Participants in this investment market may be overlooking the under-tapped potential of two traditional and diverse categories of assets in shares and bonds. This suggests the issue may be one of understanding and accessibility rather than risk-aversion.

Many surveys over the last decade, including those conducted as part of the UK's Financial Capability Strategy, have identified gaps in financial literacy. This includes fundamental concepts such as the time value of money, diversification and the compounding effect of interest. This places the UK below the OECD and G20 averages in many cases (see Fig 2). This is especially important for individuals between 20 and 35 years of age who may be earning discretionary savings for the first time, and have not experienced periods of high inflation until recent years. More focus is needed on this group and its preparation for its future.

1 US Federal Reserve Triennial Consumer Finance Survey 2023.

In part, this is an education challenge. The UK has made several important commitments over the last two decades to improving financial literacy, especially among UK students. An early education in the basics of budgeting, savings and investment is a vital part of an individual's development. There is more to be done to help young people in the early phases of their working life understand the basics of allocating savings appropriately over their lifetime.

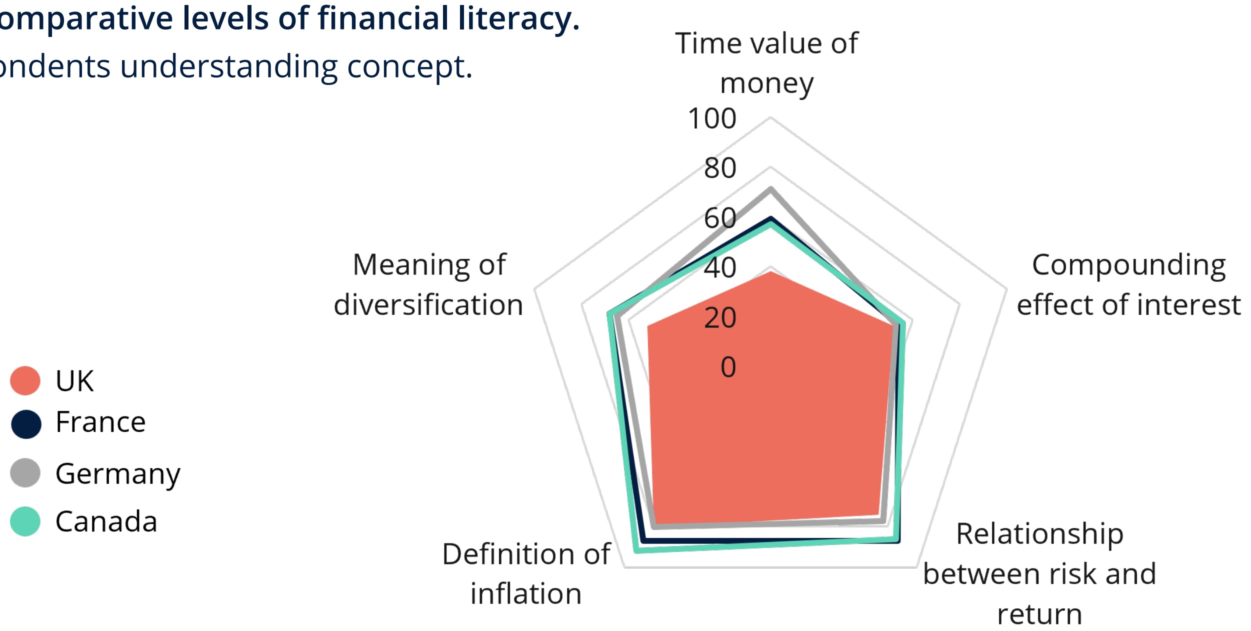
However, it is also a question of the personal and customised advice and guidance available to UK savers. The FCA's Advice Guidance Boundary Review is an opportunity to improve access to, and uptake of, financial guidance and advice. This could stimulate a larger and commercially viable new market for financial guidance of this important type. It will be important to focus on the mid-20s to mid-30s demographic as savers and potential first-time investors.

It is also important to consider the way in which retail investors access market information to make informed decisions. There are policy proposals underway to aggregate market data by way of a single feed called a consolidated tape. If a future equities tape delivers easy access to this data for free or at a nominal cost then it would help ensure that retail investors have access to accurate and timely market data to be able to make informed trading decisions.

A financial literacy challenge?

The G20-OECD-INFE Financial Literacy survey is a major global snapshot of financial literacy across markets. When the UK last particpated in 2017, it pointed to some important gaps in UK financial education and advice, especially around key investment concepts such as the time value of money, diversification and compounding. In many cases, and overall, the UK ranked below both the OECD and the G20 average.

Fig 2: Comparative levels of financial literacy.
% respondents understanding concept.



G20-OECD-INFE Global Financial Literacy Survey 2017

ISA usage patterns and what they tell us

Almost two thirds of UK ISAs are used to save cash, although more money in total is allocated to Stocks and Shares ISAs. Where it has been taken up by savers, the Stocks and Shares ISA model is used across UK income categories. With Stocks and Shares ISAs the bulk of allocations are not made directly to UK company shares.

Fig 3: Cash/Stocks and Shares ISA mix 2022.
Total mn and %.

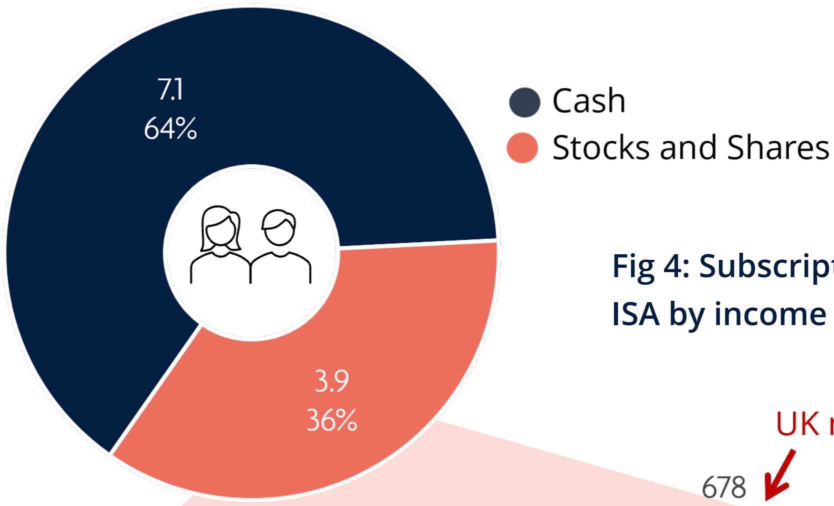


Fig 4: Subscriptions to stocks and shares ISA by income group 2022.

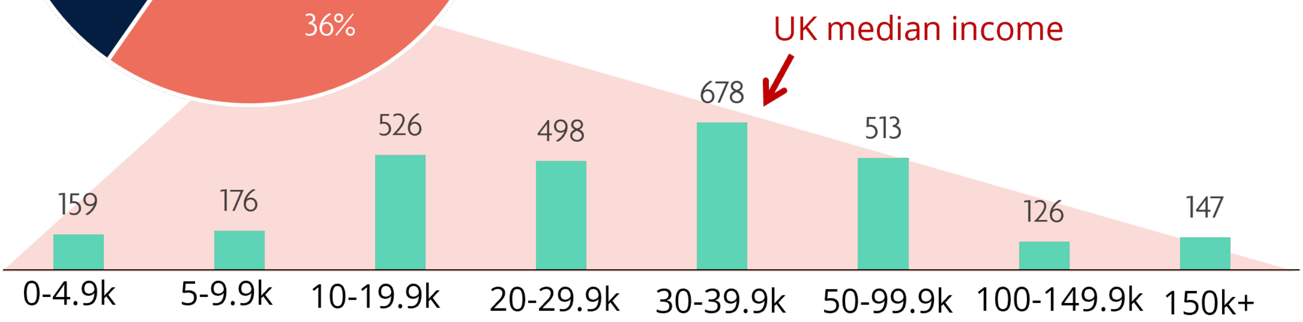
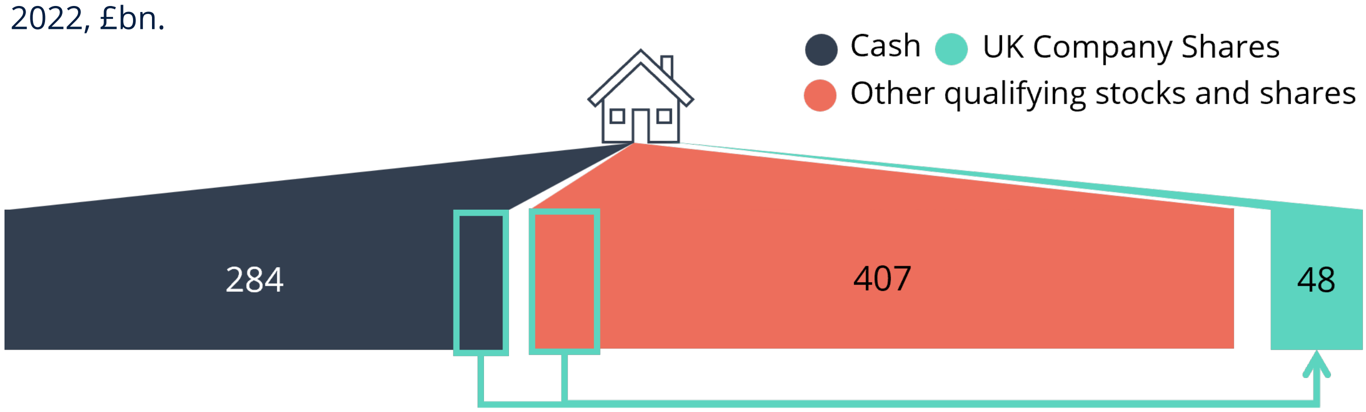


Fig 5: Composition of all ISA holdings.
2022, £bn.



If UK savers opted to move 10% of current cash ISA holdings and 10% of non UK-company stocks and share holdings to UK company shareholdings this would represent a c£70bn boost for UK public company markets and potentially higher returns for those cash savers.

UK ONS

Most UK ISA holders continue to use them to hold cash rather than taking advantage of the stocks and shares ISA option... However, where Stocks and Shares ISAs have been adopted by savers, they are popular across all income categories, reflecting the fact that shareholding potentially has broad-based appeal.

The ISA model and investment in the UK

For several decades the Individual Savings Account (ISA) has been one of the most important ways in which savers have made regular tax-efficient long-term savings. Most UK ISA holders continue to use them to hold cash rather than taking advantage of the Stocks and Shares ISA option. Of all UK ISA allocations in 2021-22, only around a third by volume were in stocks and shares, although this third accounted for the greater value (see Fig 3). However, where Stocks and Shares ISAs have been adopted by savers, they are popular across all income categories, reflecting the fact that shareholding potentially has broad-based appeal (see Fig 4).

Some UK citizens may not be aware of the benefits that a Stocks and Shares ISA can bring to a diversified portfolio over the medium- long term. In addition, there are also potential structural issues with the current ISA model that could act as a constraint on maximising its benefits for individual UK investors.

One relates to the ISA treatment of fractional shares. These are conventional shares that can be made available to individual investors at a price point lower than a single share. These fractional shares function in the same way as 'full' shares. Crucially, they enable individual investors to build ownership in high value shares that might otherwise be beyond their reach.

For example, an individual share in UK-head-quartered life sciences firm AstraZeneca averaged around £11,000 over 2023. An individual saving and investing even as much as £10,000 a year would need to allocate more than an entire year's saving just for one share. Retail investors are effectively excluded.

HM Treasury should follow through on commitments to legislate on the inclusion of fractional shares in the ISA wrapper. This will need to be supported by an approach from regulators and HM Revenue and Customs that allows savers to invest in fractional shares on the same basis as full shares.

Developing a retail gilt market

UK savers directly hold very little UK government debt. Direct ownership of this debt carries exemptions from capital gains tax - intended as an incentive for UK savers to lend to their government. This benefit is overwhelmingly used by wealthier investors, who have the knowledge to directly purchase UK government debt. The UK Debt Management Office estimates that UK households directly held just over £3bn in gilts in 2023 - about 0.2% of UK government debt.[2]

UK gilts can at times be a better retail investment than other government-backed savings products, such as bonds issued through National Savings and Investment. Other European countries have developed targeted sovereign debt products for retail investors, and have seen retail participation in government debt rise.[3] Recently the UK has opened access to retail investors to buy newly issued gilts through digital brokerage platforms, but more should be done to encourage demand for, and access to, these products through awareness raising. For example, as the UK continues to test and develop the concept of a digital gilt, consideration should be given to the ways in which this technology could be used to boost access for individual savers and tap fresh sources of demand for government debt.

Conclusion

Alongside effective and adequate pension provision, enabling UK savers to directly participate in UK capital markets boosts choice and over time can help UK savers maximise the potential returns from their savings. For a UK saver, the ability to participate in UK capital markets offers individuals a greater stake in the future success of the UK and its companies and a better potential return on long-term savings. It will also help to develop savings strategies that work across a financial lifetime.

These savings would also deepen the pool of funds available for the UK government and UK companies and channel the returns from those funds back into the UK economy.

The capital markets are the engine of the UK's economic future. The benefits of participation in the building and running of that engine should be as accessible and wide-spread as possible. Taking action now to renew the link between UK savers and UK capital markets is key to that.

How can I support this agenda?

- Support a greater focus on education and support for young earners on how to manage savings and investment over a lifetime, and the advantages of equity ownership in this mix.
- Support changes to the advice and guidance framework in the UK that enables savers to seek basic investment advice at a proportionate cost and level of regulatory oversight.
- Support the launch of a digital gilt in the UK, with a particular focus on how this might help support wider direct public participation in UK debt issuance.

2 UK DMO statistics.
3 See, for example, the Italian BTP Italia programme.