The Framework for Growth and UK Financial Services

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What does PwC's framework for growth mean for financial services?

Securing economic growth will inevitably be a priority focus for the new Government, and we welcome its renewed focus on industrial strategy. On 14 October 2024, the Government published its Industrial Strategy Green Paper, setting out their ambition to tackle barriers to growth in the UK's highest potential growth-driving sectors and places. The Financial Services sector was identified as one of the eight sectors which offer the highest growth opportunity for the economy and business. As acknowledged in the Government's Green Paper, a renewed industrial strategy for the UK will need to be informed by an understanding of which interventions could have the biggest positive impact. To help contribute to this discussion, earlier this year PwC launched our Framework for Growth research, which groups the various levers for driving economic growth and productivity into ten core components.

As the Government acknowledges, the financial services plays a unique role in channelling investment into other sectors through lending, capital markets activity and investment in UK assets. As such any successful industrial strategy will need to put financial services at its heart, to support one of the UK's most dynamic and productive sectors, and its role in providing the vital financing needed to grow the rest of the economy. There is an opportunity for policy makers at all levels of government, and within the regulators, to look for opportunities to help support the efficiency of the sector's role in financial intermediation. This could involve a renewed effort in assessing and removing impediments whether they be regulatory, informational challenges for investors and firms or those related to skills and technology.

Financial services is one of the UK's most economically important sectors contributing £171bn (8.2% of the total) to UK real Gross Value Added in 2022[1]. Analysis prepared by PwC for the City of London Corporation in 2024 shows that financial services contributed £110.2bn[2] to the public purse in 2023. This is 12.3% of total UK tax receipts.

Positively the importance of the sector is recognised by the Government, with HMT confirming that Rachel Reeves' first Mansion House speech as Chancellor of the Exchequer will set out how she will **'work in partnership with FS industry and regulators to deliver growth. This will include delivering the stability the sector needs to grow, the support it needs to invest across the UK and reforms it needs to remain at the cutting-edge of new innovations and technologies[3].'**

£171bn was contributed by financial services to the UK's real Gross Value Added in 2022, making up 8.2% of the total. This highlights the sector's significant importance in the UK economy.

1 https://www.thecityuk.com/media/sapbwnqv/enabling-growth-across-the-uk-2024-uk-based-financial-and-related-professional-services.pdf
2 https://www.theglobalcity.uk/total-tax
3 https://www.gov.uk/government/news/chancellor-reeves-pension-funds-can-fire-up-the-uk-economy

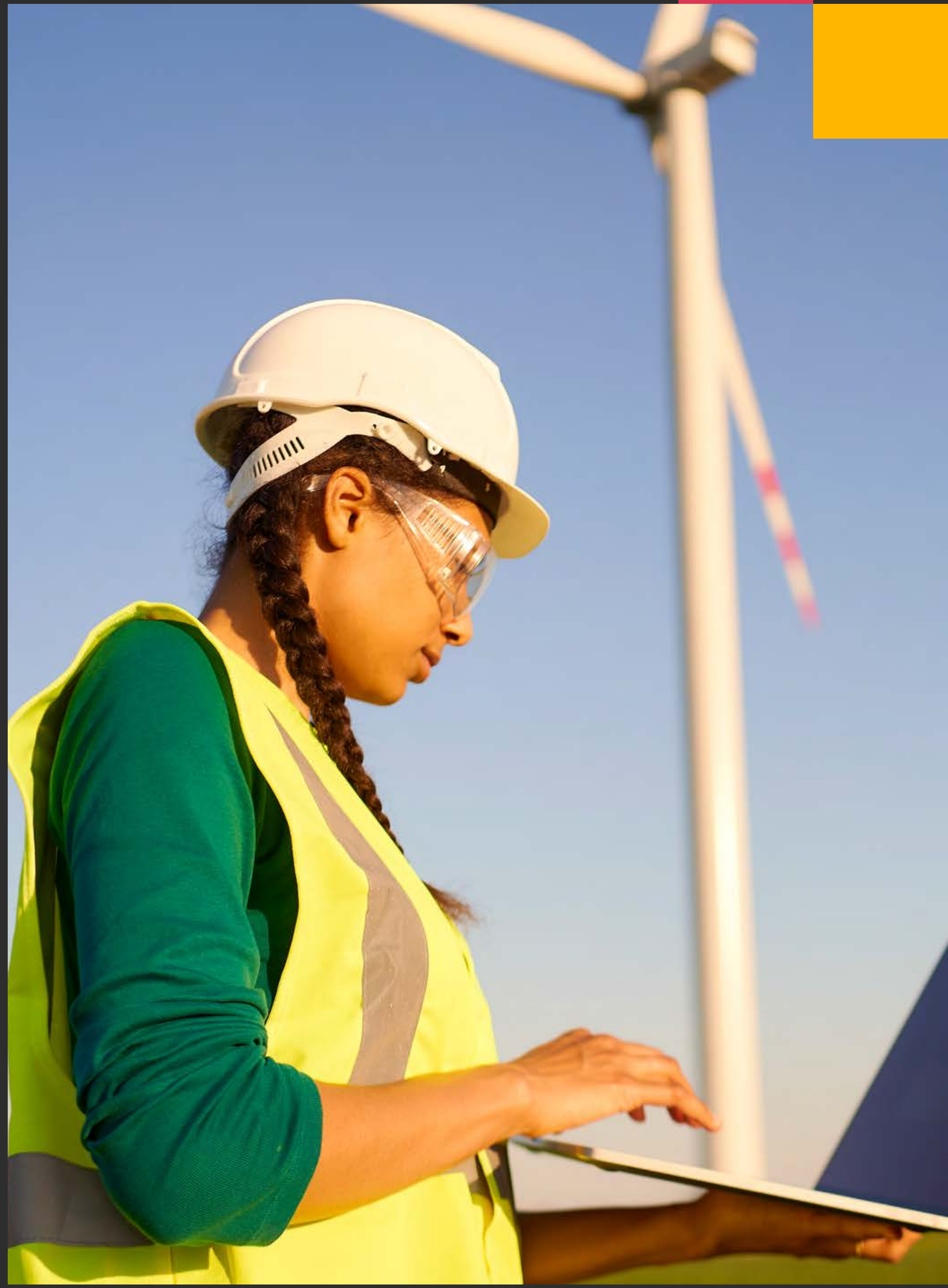
So what impact do the different components of PwC's Framework for Growth have...

...on UK financial services, and the Government's aspirations for the sector?

The Framework for Growth research identifies ten components which will influence growth and productivity in the UK. These are summarised in the table below.

In the section below we have grouped the ten components and prepared some initial thinking on what they mean for financial services and what steps the industry, regulators and Government could consider to support the success of the sector.

	Component	Description
1	Skills, education and talent	The infrastructure for developing and enhancing the skills and knowledge of the UK's population, encompassing: formal education, vocational training, apprenticeships and lifelong learning.
2	Innovation ecosystem	The network and environment that fosters and supports the development of new ideas, technologies and processes. Includes: research, entrepreneurship, collaboration and funding.
3	Sustainability and environmental considerations	Practices and policies that promote the resources, minimise environmental impact, and address climate change. Includes initiatives to: reduce carbon emissions, conserve energy, promote renewable energy sources and protect ecosystems.
4	Regional development and social inclusivity	Initiatives that promote balanced growth and equal opportunities across regions and communities, addressing regional disparities and ensuring evenly distributed access to resources and opportunities.
5	Infrastructure and planning	The development and management of physical structures, services and systems to support the needs of businesses and communities. Includes: transportation networks, utilities, buildings and public spaces.
6	Trade policy and promotion	The strategies and activities aimed at aiding international trade and encouraging growth.Includes the formulation of policies and agreements to support exports, attract investment and enhance market access.
7	Cyber security and resilience	Protection against and responses to cyber threats and ensure the continuity of digital systems. Includes approaches to safeguard information, networks and infrastructure from unauthorised access, data breaches and disruptions.
8	Digital transformation	The process of adopting and integrating technologies and strategies to enhance business operations, improve efficiency and deliver better services.
9	Private sector investment	The allocation of funds into various business ventures. It includes investments in startups, established businesses and infrastructure. The aim is to generate financial returns, stimulate growth and/or productivity, and create employment opportunities.
10	Tax and regulation competitiveness	Policies and measures implemented by governments to create favourable conditions that attract private sector investment and encourage economic growth.



Regional development, financial inclusion and skills

The financial services sector is an engine of economic growth and opportunities throughout the UK, and has the potential to further drive regional growth. Over half of financial and related professional services gross value added is generated in regions and nations outside London, and two thirds of the sector's 2.4 million jobs are based outside the capital.[4] The sector provides highly productive, well paid jobs; in absolute terms, financial services output per job was £189,350 in 2023, while whole-economy output per job was £70,819[5]. Additional steps to drive economic growth outside the capital (such as supporting investment in growth industries, developing workforce skills and a focus on building regional financial centres) would enhance the sector's ability to build on this and deliver further growth across the UK. Devolved and local government (including combined authorities and regional Mayors) have a central role to play in supporting the development of regional financial centres (and further consideration could be given to the need for regional financial services strategies and devolved powers) but also in working with the financial services sector to access capital and identify local investment opportunities.

A thriving financial services sector also benefits consumers' economic wellbeing and resilience – helping them save for the future, buy a home, invest, and insure against risk. Measures to further improve financial inclusion would enable financial services firms to deliver these benefits to a wider section of the population.

Inclusion is a multifaceted challenge, encompassing issues such as education, digital inclusion, access to products and services, and engagement. PwC research from 2022 shows that 20.2 million individuals in the UK are financially underserved, meaning they would have difficulty accessing credit from a mainstream lender.

Therefore it is perhaps unsurprising that prior to the election the Labour Party announced its intention to create a national financial inclusion strategy[6].

While it's not yet clear what this will focus on, consideration of measures to both widen consumers' access to basic services and products, and to reduce the advice gap, would be welcome. A number of initiatives have been introduced by the previous Government and regulators in recent years to support financial inclusion and improve the outcomes experienced by vulnerable customers. It will be important that further measures are developed in partnership with the industry and explore scope to harness the benefits of emerging technologies such as biometrics, artificial intelligence (AI) and open banking, which have the potential to support provision of services to those parts of society currently underserved.

Another key consideration for the Government and industry is levels of financial literacy, which remain low in the UK. Many financial institutions have rolled out widespread skills and employability training programs for their customers and financial education is already on the curriculum in the UK. However there may be scope to drive further collaboration between industry and education providers to realise the significant benefits from increased levels of financial literacy (estimated to be nearly £7bn per year for the UK economy by the Confederation of British Industry[7]). Improved financial literacy may also support greater retail participation in financial markets, something which could support both the depth of the UK's capital markets and the financial positions of those individuals who have savings to invest.

The skills that the FS sector itself needs have also changed dramatically in recent years. Research by the financial services skills commission (FSSC) People + Technology: How skills can unlock value for Financial Services, published in 2023 and supported by PwC, shows that financial services has the second-largest skills gap in the UK economy, and the biggest among highly-skilled sectors. FS is a globally competitive market so retaining and investing in talent, particularly by developing future-focused skills, is key to the sector's ability to continue to thrive and drive economic growth. PwC's Framework for Growth report sets out a number of recommendations to address the UK's broader skill challenges which are relevant to financial services and complement the recommendations made by the FSSC.

4 https://www.thecityuk.com/media/sapbwnqv/enabling-growth-across-the-uk-2024-uk-based-financial-and-related-professional-services.pdf
5 https://www.thecityuk.com/media/sapbwnqv/enabling-growth-across-the-uk-2024-uk-based-financial-and-related-professional-services.pdf
6 https://labour.org.uk/wp-content/uploads/2024/01/Financing-Growth.pdf
7 https://cdn.gohenry.com/site-furniture/amp-uk/pdfs/UK_CBI_Economics_Financial-Literacy-Project.pdf

44% of financial services firms ranked cyber security as one of the top three most important components of the Framework for Growth.

64% of all funding into UK growth companies came from overseas investors.

Innovation, cyber and digital transformation

Technology and innovation is driving significant change in financial services. A number of trends, including changing customer preferences and the transformative potential of Cloud enabled digitisation and AI mean FS firms are increasingly embracing technology to remain relevant and cost effective. However, progress is mixed across the sector, with many long standing FS firms struggling with legacy systems. Whilst financial services firms spend a significant portion of total revenue on technology, a relatively small fraction of this is available for spend on genuine innovation, reducing the opportunity to realise the transformational benefits of technology. The pace of technological change impacting FS is unlikely to reduce, with developments such as central bank digital currencies, tokenisation, quantum computing and the metaverse only likely to increase the pressure on legacy business models. This means that all FS firms need to prioritise digital transformation in order to protect and grow their business models. This will require firms to consider a range of factors including skills, clients and customers, markets, products and controls together.

Disruptive cyber attacks are increasingly impacting financial services firms and consumers, in a way not seen before, so it is unsurprising that 44% of financial services firms ranked cyber security as one of the top three most important components of the framework for growth. New regulations and investor expectations are driving more transparency around cyber incidents and risk management. This requires increasing visibility of cyber risk within firms from the boardroom down and through supply chains.

The growing geopolitical uncertainty and conflict is often played out in cyberspace. Although cyber is a national risk, in many cases the levers to mitigate the risk sit in the private sector, particularly in financial services, where there is an increasing expectation on the sector to support the national interest.

The FS sector is also increasingly exposed to cyber risks, as technology transforms how businesses work, creating new digital processes that are ripe for interference. Discontinuities, such as a critical supplier outage due to a cyber event, are becoming more common.

The challenge for the FS sector is to embed cyber security into transformation and balance the trade off between pace of change and increased potential risk. In light of this it will be important that FS firms put cyber security at the centre of business model reinvention to gain trust, safeguard reputation and build resilience, but crucially to also take risks in a safe manner to create new sources of value.

Despite the potential for innovation to put pressure on specific business models, the UK is well placed to take advantage of the technology revolution. The UK was home to 3,000 fintechs in 2021, and fintechs accounted for 59% of all UK unicorns, a higher share than any other financial centre[8]. While there is much that the Government and regulators have done to encourage the development of this ecosystem, for example through the development and use of regulatory sandboxes, the UK cannot stand still while existing and emerging financial centres seek to develop and grow their own fintech sectors.

In opposition the Labour Party committed to creating a Regulatory Innovation Office (RIO) to '**help regulators update regulation, speed up approval timelines, and co-ordinate issues that span existing boundaries**[9]' showing a welcome focus on supporting innovation. While UK regulators have been among the most forward thinking when assessing the implications from technological change, it will be vital that the UK's regulatory framework keeps pace with innovations such as AI and tokenisation, to support the sector's ability to take advantage of these. The UK has largely applied a principles based approach to regulation of technology, seeking to allow firms the flexibility to innovate. Avoiding granular rules which may quickly become out of date brings benefits but needs to be balanced with the need to provide the regulatory certainty firms need to deploy these technologies. The Government and regulators should prioritise providing regulatory certainty in areas where innovation has the potential to improve the competitiveness of UK firms and markets. Policy makers should also ensure that an assessment is made of areas of regulation which have the potential to inhibit innovation and continue to focus on ease of authorisation and scale up of innovative fintechs.

8 https://labour.org.uk/wp-content/uploads/2024/01/Financing-Growth.pdf
9 https://labour.org.uk/wp-content/uploads/2024/01/Financing-Growth.pdf

Sustainability and environmental, infrastructure and private sector investment

The financial services sector plays a fundamental role in supporting investment into the UK economy. The outstanding amount of loans made by major banks to UK businesses totalled £527.6bn as of November 2023, 35% of which went to small and medium sized entities (SMEs)[10]. Insurers, asset managers and other investors in long term UK assets play a central role in providing much needed capital to support infrastructure and green investment (the Investment Delivery Forum estimates the country faces a £615bn funding shortfall to deliver on energy, transport and housing infrastructure ambitions by 2030[11]). So it is unsurprising that the new Government will be looking to the FS sector as a key source of investment and has already launched the new National Wealth Fund, which will form a key part of its approach.

The previous Government put in train a number of welcome reforms aimed at improving the attractiveness of the UK as a location to do business or to support the ability of financial institutions to invest in UK assets. These include reforms to Solvency II, overhauling the listings rules and the Mansion House Compact. It will be important that these are delivered on, but equally important is that the focus on driving investment into the UK continues. It is well publicised that the UK has some of the largest pools of capital in the world (for example, the UK is behind only the US in terms of size of pension funds) but that this has not necessarily translated into commensurate investment into UK assets.

In its Industrial Strategy Green paper the Government acknowledges that 'there is still much to do to improve access to growth capital and scale up finance in the UK.[12]' In this context an ongoing focus on measures which can support investment into the UK economy is needed. There would be merit in the Government, regulators and industry looking at the regulatory and wider policy framework at a system-wide level to ensure it supports the provision of capital at all stages of the capital raising lifecycle. Steps to encourage firms to list in the UK could, for example, be undermined if early stage growth firms are unable to access early stage capital in the UK.

For example, in the first eight months of 2022, 64% of all funding into UK growth companies came from overseas investors[13], reinforcing the need for an overarching strategy to support access to capital at all stages of a company's growth.

There is also an urgent need to assess the financing landscape for SMEs in the UK. A recent Bank of England survey[14] shows that half of SMEs surveyed reported that they used only internal funds to finance investment and that around 70% of businesses preferred slower growth to having debt. Of those that did seek to access external financing, well over 80% stated they have never used equity finance or market-based debt finance. The most common source of external finance for SMEs surveyed was a credit card. There are likely to be multifaceted reasons for the scenario described by the survey. These are likely to include increased borrowing costs, challenges for SMEs in accessing the UK's capital markets, risk aversion (from lenders, investors and borrowers) and a lack of understanding from SMEs on financing options available. However, limited access to external finance is likely to have a negative effect on SME growth. There are a number of steps industry and government could explore to address this. These include steps to improve the visibility of financing options for SMEs and investment opportunities within the SME sector, building on developments such as the Private Intermittent Securities and Capital Exchange System to support further innovations which will broaden the number of firms able to access capital markets and ensuring the regulatory framework does not discourage investment in the SME sector.

The Government has also set out strong ambitions to reinforce the UK's global leadership in sustainable finance. Regulation is also likely to have a key role to play. Labour's financial services strategy from January 2024 signalled a clear focus on rolling out sustainability disclosure requirements and a UK green taxonomy. Enhanced transition planning requirements for FS firms also figure as a priority in the financial services strategy. It will be important that this initiative is taken forward in a manner which ensures the approach firms take to transition planning supports both their own decarbonisation, and more widely across the economy, in a proportionate way. The Labour Party's financial services strategy also stressed the importance of greening the UK's housing stock and committed to working with the sector to expand the offering of green mortgages available to homeowners who, for example, complete retrofitting work. It will be important that industry, regulators and government do not treat sustainable finance as a siloed part of the financial eco-system, as it will require an overarching approach to truly support the transition to net zero.

A clear and proportionate regulatory framework can help facilitate the FS sector's role in supporting the transition to net zero. The sector is likely to welcome greater certainty on the trajectory of the regulatory framework in the UK, something which will support business strategy and development. The current level of complexity in the global regulatory landscape for sustainable finance also means that regulatory implementation and compliance takes up significant resources and bandwidth in firms, which could be allocated to other activities supporting the transition if the regulatory landscape was more harmonised and streamlined. Equally important though will be a focus on creating the right broader policy framework to incentivise the development of the sustainable finance market in the UK, including through fiscal as well as regulatory measures.

£615bn is the estimated funding shortfall, according to the Investment Delivery Forum, needed to achieve the country's energy, transport, and housing infrastructure ambitions by 2030.

10 Bank of England, 'Monetary financial institutions' loan to UK non-financial business, by size of business (November 2023)', (2024)
11 hhttps://idforum.org.uk/wp-content/uploads/2023/11/Investment-Delivery-Forum-REL-Infrastructure-Investment-Challange-Press-Release-06.11.23.pdf
12 https://www.gov.uk/government/consultations/invest-2035-the-uks-modern-industrial-strategy
13 https://capitalmarketsindustrytaskforce.com/wp-content/uploads/2023/02/ToR-Workstream-1-Sources-of-capital.pdf
14 https://www.bankofengland.co.uk/quarterly-bulletin/2024/2024/identifying-barriers-to-productive-investment-and-external-finance-a-survey-of-uk-smes

Regulation, tax and trade policy

The financial services sector is one of the most intensively regulated and taxed sectors in the economy (for example, HMRC data shows that the financial services sector, inclusive of the bank levy and bank surcharge, contributed £18.4bn to corporation tax receipts in the year to March 2023, the largest contributor of any sector in the UK). The sector has also experienced a period of significant regulatory change, and therefore a period of regulatory stability would help to build certainty and confidence, and enable businesses to plan effectively. That said, there are a number of things the new Government and regulators could consider to support the sector and deliver economic benefits.

Ensuring the PRA and FCA's secondary objective for growth and competitiveness is fully embedded in all aspects of the regulatory approach in the UK will be of fundamental importance. Delivering this will require the regulators to consider how the importance of the secondary objective can be instilled in their own organisational cultures and the way they interact with firms. It will also require Parliament and other channels of public scrutiny, to hold the regulators to account for delivery of growth and competitiveness objective.

The regulatory agenda in the UK is currently extremely broad and there may be an argument for greater prioritisation of regulatory initiatives which will support economic growth. Allowing other issues to be deprioritised would also create more capacity in the regulatory system, potentially speeding up progress in priority areas.

The strength of the UK's financial services industry is – in part – due to the open and interconnected nature of the UK as a hub for international financial services activity. The Government's trade policy has an important role to play in both maintaining and promoting the UK's position as an international financial services hub.

Regulatory divergence presents challenges for firms operating across multiple jurisdictions, and therefore an increased focus on the UK's international presence and connectivity will be important. The Government could continue to ensure that provisions that support the UK financial services sector are included as part of its Free Trade Agreement (FTA) negotiations and seek out further opportunities to advocate for global openness and alignment, where appropriate. The Berne Financial Services Agreement is a unique agreement that delivers mutual recognition of specific UK and Swiss regulation, removing a suite of market access barriers and streamlining the cross-border provision of certain wholesale financial services. This Agreement provides a valuable model for the UK to build upon with other advanced economies as it advances its vision for international competitiveness and growth. The Government plays a key role in representing the UK's financial services sector abroad, but there may be scope to devote more resources to doing so, examining the approach other countries apply.

The Memorandum of Understanding on financial services cooperation between the UK and EU – and subsequent bilateral regulatory dialogues – represent an important step building the relationship between UK and EU authorities. The UK Government should continue to progress positive and constructive engagement with EU authorities on financial services, seeking opportunities to build mutually beneficial outcomes for firms, consumers and the economy more broadly.

£18.4bn

is what the financial services sector, including the bank levy and bank surcharge, contributed to corporation tax receipts in the year to March 2023, making it the largest contributor of any sector in the UK, according to HMRC data.

> “Britain’s economic success will depend on the success of our financial services sector. The sector can be a powerful engine for inclusive growth through delivering high quality jobs, services exports, tax revenues to support strong public services, a source of pride for communities across the United Kingdom, and a crucial funding source for our transition to net zero.”
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> **Rachel Reeves**
> Chancellor of the Exchequer

Conclusion

Financial services sits at the heart of the UK economy and the UK has one of the largest and most diverse financial services sectors in the world. As Rachel Reeves has noted ‘Britain’s economic success will depend on the success of our financial services sector. The sector can be a powerful engine for inclusive growth through delivering high quality jobs, services exports, tax revenues to support strong public services, a source of pride for communities across the United Kingdom, and a crucial funding source for our transition to net zero[15]’. It will be important that the Government builds on this recognition and places the success of the FS sector across the UK as a central part of any future industrial strategy.

Summary of recommendations

PwC Framework for Growth Component	Recommendation
Skills, education and talent, and Regional development and social inclusivity.	Industry, regulators and Government to work together to ensure financial inclusion agenda supports consumers’ access to financial services in an innovative and efficient manner, including measures to improve levels of financial literacy.
	Enhance the role of devolved and local government in supporting the development of regional financial centres, and working with the financial services sector to access investment capital and identify local investment opportunities.
	Financial services firms to place addressing the skills gap as a central part of their business strategies.
Innovation ecosystem, Cyber security and resilience, and Digital transformation.	Prioritise support to innovation throughout the UK’s regulatory framework and the growth of new market entrants through the authorisation process.
	Review regulations which may have the unintended consequences of inhibiting innovation.
	Assess ways that the UK’s regulatory framework can keep pace with developments such as AI and digital assets to provide the certainty required to innovate.
Sustainability and environmental considerations, Infrastructure and planning, and Private sector investment.	Industry, regulators and Government, work towards rapid delivery of Mansion House and Edinburgh reform commitment and consider further steps to develop UK capital markets and encourage investment in UK assets.
	Explore a range of options to broaden financing options for SMEs in the UK and encourage SMEs to access financing to support sustainable growth.
	Develop regulatory and tax frameworks which further support the sustainable finance market in the UK
Tax and regulation competitiveness, and Trade policy and promotion	Regulators continue to focus on fully embedding the secondary objective for international growth and competitiveness in organisational culture and approach.
	Parliament, Government and regulators balance focus on prioritising regulatory initiatives which support economic growth.
	Government explore further ways to support UK financial services ability to operate in major jurisdictions (including the EU) through regulatory cooperation, trade policy and advocacy for the sector.

15 https://labour.org.uk/wp-content/uploads/2024/01/Financing-Growth.pdf

Contacts

Mark Batten
Banking and Capital Markets Leader, PwC United Kingdom
Tel: +44 (0) 7740 242449
Email: mark.e.batten@pwc.com

Conor MacManus
Director, PwC United Kingdom
Tel: +44 (0)7718 979428
Email: conor.macmanus@pwc.com

Darren Ketteringham
Partner, Financial Services Leader, PwC United Kingdom
Tel: +44 (0)7841 563947
Email: darren.g.ketteringham@pwc.com

pwc.co.uk

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