The Association of Investment Companies

Making people better off

How investment companies can help

September 2024

www.theaic.co.uk

About the AIC

The Association of Investment Companies (AIC) represents closed-ended investment companies whose shares trade on public stock markets.

The AIC's members comprise 328 investment companies, with assets under management of over £250 billion.

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Contents

Making people better off

We are all the same

We all want well-funded local schools and hospitals providing top-quality services. We all want to see opportunity and employment flourish in our communities. We all want our friends and family to have financial security so they can deal with life's difficulties and have a secure retirement.

Few of us get out of bed thinking about how financial services can help deliver these outcomes. Even fewer think investment companies should be central to this agenda.

I am asking you to think again.

Why should you care?

Financial services help people manage their budgets, buy a house, save for a wedding, start and grow a business and prepare for retirement. Investment companies can be part of these processes.

Investment companies are a UK success story. They are one of the world's oldest types of collective investment fund. They pool the savings of hundreds of thousands of people across the UK to invest in a portfolio of assets supporting businesses and earning a financial return for investors.

Building prosperity

Investment companies can help deliver economic growth. They help create jobs and wealth, which is the foundation for raising taxes to support public services. Investment companies can invest to upgrade our public transport infrastructure, ensure our waterways are clean and build networks to enhance digital access across the UK.

Investment companies can invest directly in private businesses and infrastructure projects. This makes them an engine for growth. They have recently focused on net zero and infrastructure investments. Parts of the sector channel money into small and medium-sized enterprises (SMEs). This was particularly significant during the pandemic when their investment protected jobs. It allowed businesses to operate until life returned to normal after lockdown.

Sharing prosperity

We should all have access to the best options to save for retirement. We should all be able to offer financial help to our children (and grandchildren) when they need it. Investment companies can help anyone achieve their financial goals.

The structure of investment companies means they can take a long-term view. They are a great way for people to build their financial reserves. Three investment companies are over 150 years old. Twenty-five others have operated for over a century.

Investment companies can hold assets that cannot be held in other retail investments. The sector democratises access to private assets. This diversification helps consumers lower the risk of investment and potentially secure higher returns. Each company has a board of directors, which can help protect investors' interests and ensure they get value for money.

Younger investors often buy speculative crypto assets. Investment companies can offer them an interesting alternative by allowing them access to assets they cannot easily buy elsewhere, such as venture capital, renewable energy or infrastructure. This may encourage younger people into investment habits more likely to provide financial security.

Investment companies can help the government to deliver its policy ambitions.

A partnership for prosperity

Investment companies can help the government to deliver its policy ambitions. The government should take an active role in launching investment companies with mandates that support its mission to increase growth and the transition to net zero.

Let me know what you think

This report explains investment companies and their benefits. It also sets out policy ideas to support the sector's future success.

I would be pleased to hear from you if you want to learn more.

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Key points

Investment companies can help build the UK's prosperity.

Some are actively helping entrepreneurs build their companies, create new products and enter new markets. Others invest in infrastructure, which helps the UK become more productive and achieve higher economic growth. The sector has recently focused on renewable investments which support the UK's net zero transition.

Ninety-five of the largest 350 listed companies in the UK are investment companies. The sector adds to the vibrancy of the stock market and attracts domestic and international investors. This supports these markets as a resource for UK businesses to raise capital for future growth.

Policymakers should want to help the investment company sector do more.

F&C

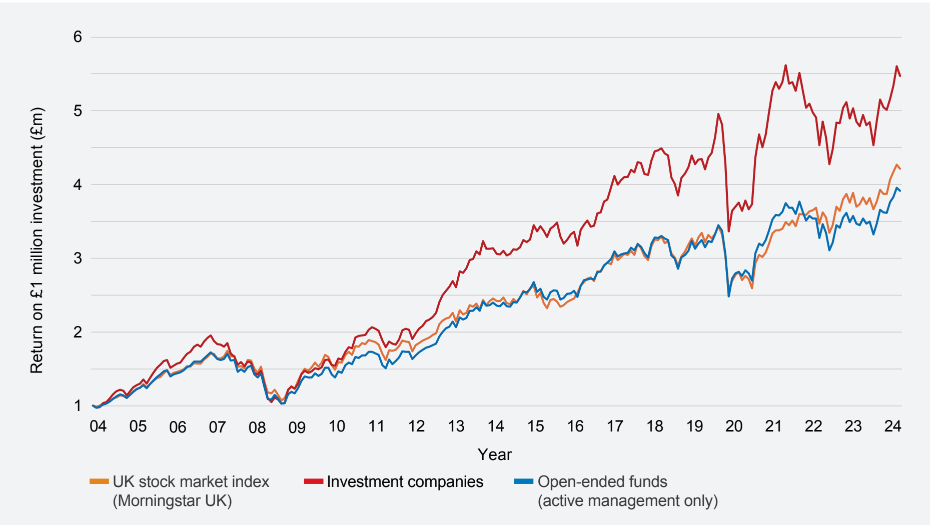
F&C was established in 1868 as the world's first investment trust. It aimed to make investing accessible to those with moderate means. Today, the Company has assets exceeding £6bn, holding a diversified portfolio of public equities and a small portion in private equity to mitigate risk and boost returns. F&C invests in over 350 companies across over 30 countries. Retail investors comprise more than 85% of its shareholders. Over the past decade up to July 2024, F&C has more than tripled investors' funds and has raised its annual dividend payments for 53 consecutive years. Columbia Threadneedle Investments manages F&C.

Investment companies can build people's financial security. Shares can be held directly, in their pension or Individual Savings Account (ISA).

Investment companies can deliver better long-term returns for investors.

Investment companies can deliver better long-term returns for investors. As the chart shows, investing in UK shares using an investment company would have earned a higher return than using a tracker (a type of fund which invests in all companies on a particular stock market). The investment company option would have also beaten actively managed open-ended funds (which select investments). See page 14 for an explanation of how investment companies differ from open-ended funds.

Fig 1: How funds compare when investing in UK shares



Source: AIC / Morningstar

Even so, trackers and actively managed open-ended funds are more often held by pension schemes and wealth managers. Financial advisers also more often recommended trackers and other actively managed open-ended funds. These intermediaries, and asset managers, should consider using investment companies to get the best outcome for their clients.

The government should consider using investment companies to build new partnerships providing public investment and private capital.

The government wants to attract private investment to help achieve growth. Pension funds could be a source of growth capital if they can find the right investment vehicle: one that offers the right investment objectives, asset allocation and can meet their operational needs. Investment companies can meet all these conditions.

The government should act as a cornerstone investor in new investment companies as part of the proposed National Wealth Fund. These would invest in businesses and projects to increase the UK's prosperity. Government-backed investment companies would aim to attract a wide range of private investors, including pension funds and retail consumers, as partner investors.

Pension funds could be a source of growth capital if they can find the right investment vehicle.

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Policy in focus: Making people better off

To ensure that investment companies can deliver growth and share wealth, the government should:

- Support the provision of scale-up capital (see page 16)
- Create an effective regulatory environment (see page 18)
- Stop taxing investors who buy British (see page 23)
- Introduce a UK ISA (see page 25)
- Develop partnership funds (see page 31)

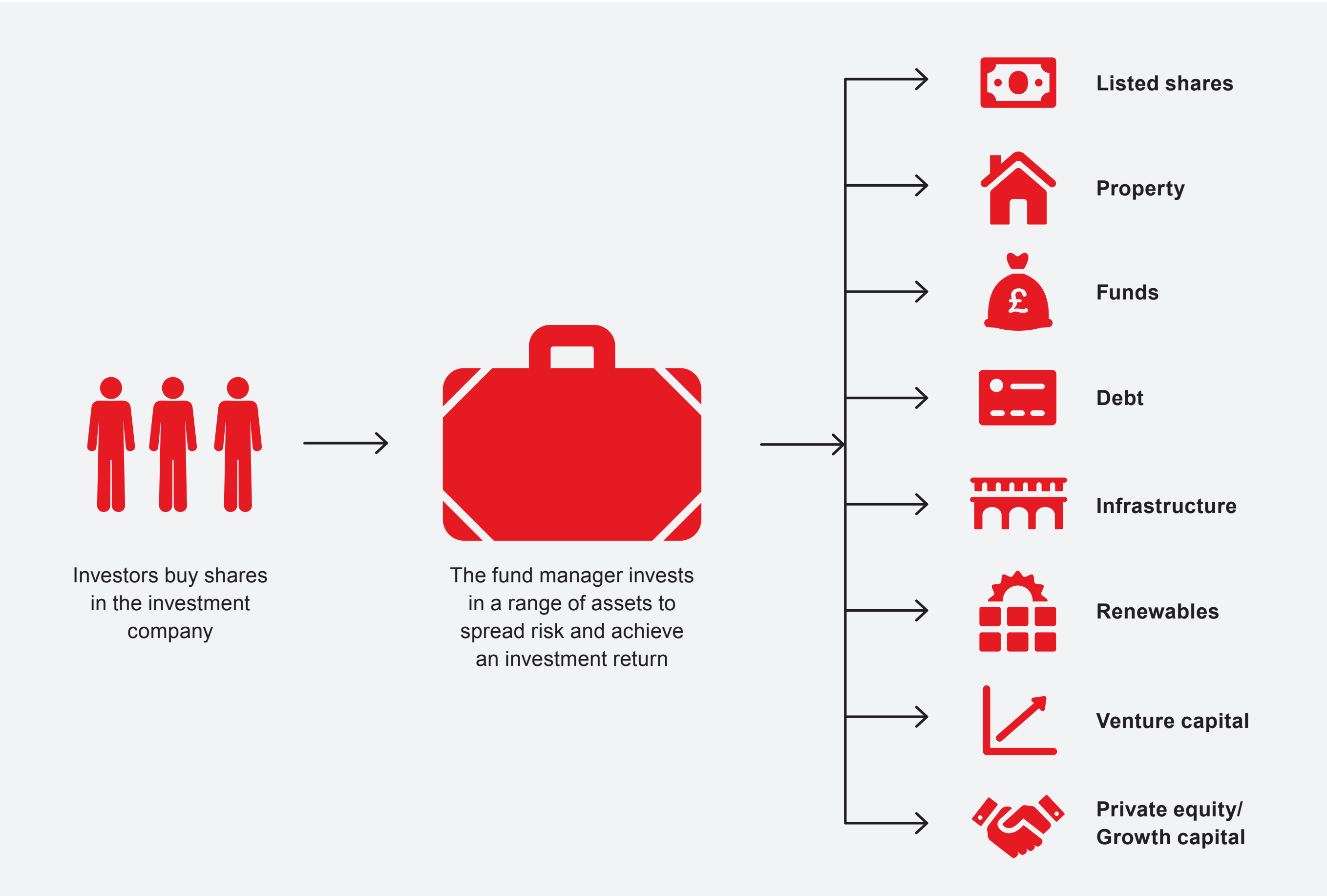
The government should act as a cornerstone investor in new investment companies.

What are investment companies?

Investment companies are funds listed on UK stock markets. Sometimes they are known as investment trusts. The sector also includes UK Real Estate Investment Trusts (REITs) and Venture Capital Trusts (VCTs). Regardless of their name, investment companies perform two basic functions:

- **Pooling funds:** They accumulate capital by issuing shares on a stock market. Individuals, pension funds, or other institutions buy these shares. Like a commercial trading company, shareholders receive returns based on the company's performance over time.
- **Investment management:** Their core business is investing in a diversified portfolio. Professional managers appointed by the company buy and sell assets to generate profits for the company and its shareholders. They use capital raised from share issuance, arising from gains when assets are sold, or accumulated income earned by the portfolio.

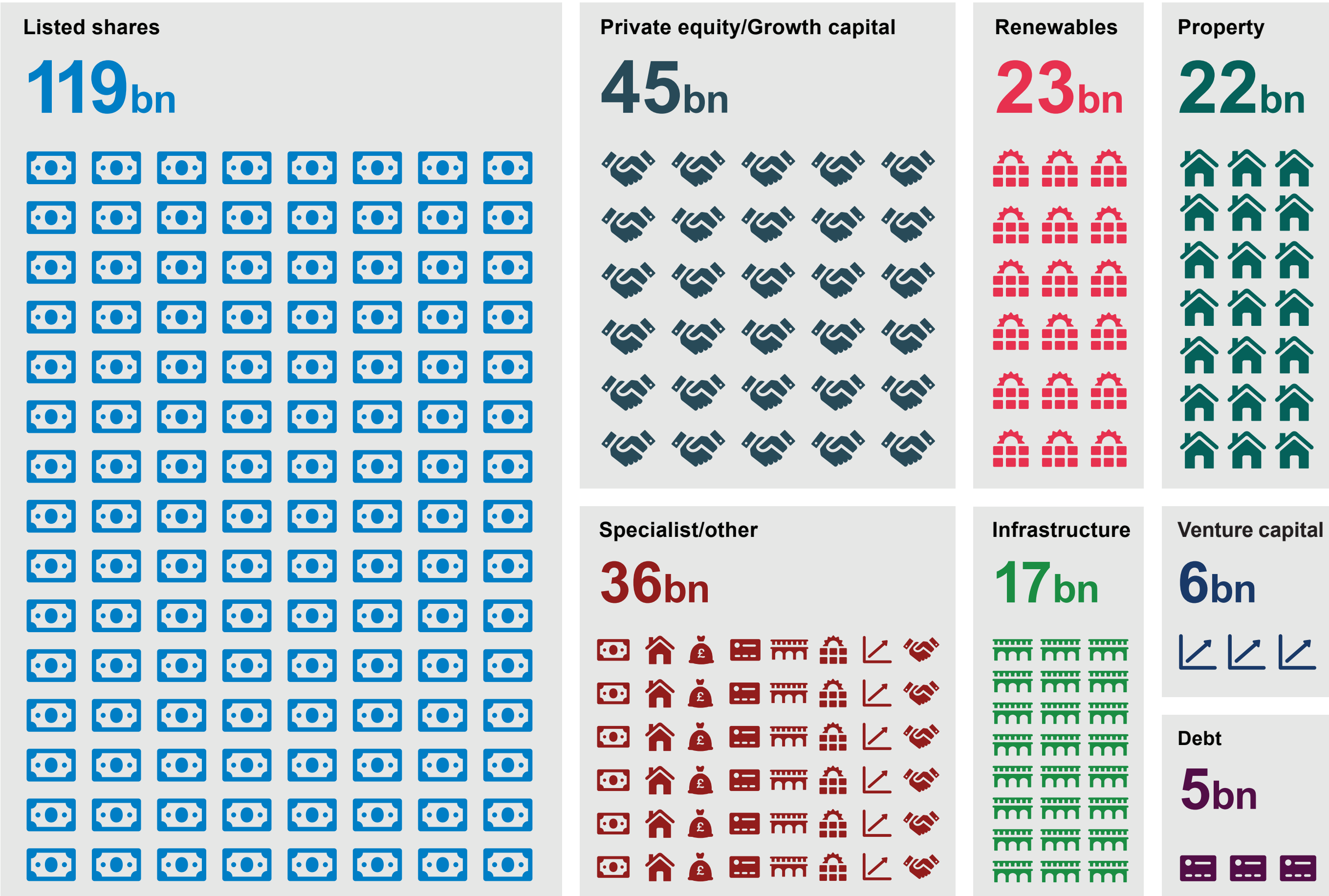
Fig 2: What an investment company does



Diversifying the portfolio helps manage risk. Holding several investments aims to offset any losses on one against gains made on others. The intention is to deliver long-term returns despite fluctuations in the value of individual assets or economic conditions.

Diversifying the portfolio helps manage risk.

Fig 3: What investment companies buy (asset class – £billion)



Source: AIC / Morningstar, data as at 30/06/24

All investment companies share these two functions. Even where the assets are similar, each company will pursue different investment objectives, such as seeking capital gains, generating income, or a blend of both. They employ different investment styles, portfolio concentration levels, geographic exposures, and risk appetites.

These asset classes break down into sub-sectors. For instance, within the category of "property," investments may include shops, warehouses, offices, houses and flats. Each sub-sector within an asset class may have its own unique characteristics, risks and return dynamics.

Currently, there are 353 investment companies traded on UK stock markets, managing a total of £273 billion in assets.

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abrdn

Since 1993, abrdn UK Smaller Companies Growth Trust has held a portfolio of around 50 small and mid-sized companies listed on the London Stock Exchange and AIM. It seeks long-term capital growth. The trust is managed by abrdn Investments. Its portfolio is valued at nearly £440m. The management fee is on a sliding scale: 0.75% per annum for the first £175m, 0.65% per annum for assets between £175m and £550m, and 0.55% per annum beyond that. This cost-effective, transparent model benefits retail investors, who own over 60% of its shares. Since June 2004, the market value has increased by 946%, compared to the FTSE All-Share's 100% rise.

POLAR CAPITAL

Polar Capital Technology Trust is a global technology investment trust. It is dedicated to identifying the best and fastest growing technology companies in the world. After launching in 1996 and changing its asset manager to Polar Capital in 2001, the trust has enjoyed stellar growth and is now a FTSE 250 constituent. Performance has been exceptional – the trust has provided investors with total share price returns totalling 596% in the ten years to June 2024. It now has c.£4bn in assets under management. Its shareholder base includes both professional and individual retail investors, with almost 25% of its shares held by retail investors.

What makes them different?

Investment companies are different from most retail investment funds. These differences have a big impact on how they can help secure economic growth and deliver better investor outcomes.

Structure

Investment companies issue a fixed number of shares. This makes them “closed-ended” funds. These shares trade on the stock market, allowing investors to buy and sell their shares as they wish.

Most retail investors, pension schemes, wealth managers and other institutions tend to use “open-ended” funds (OEFs). This means that the asset manager creates new shares when investors buy into the fund and cancels shares when investors leave. Thus, the size of the fund grows or shrinks based on investor demand. This requirement to redeem (pay back) investors means that OEFs may have to sell assets if more investors wish to leave the fund than invest.

This is more than a technical difference. The investment company structure allows longer-term, patient investment. This can mean better returns for investors. Their structure allows investment companies to hold a wider range of assets than OEFs. Investment companies can hold hard-to-sell assets which may offer a better long-term return. Investment companies can support economic growth, job creation, and infrastructure development in ways that OEFs cannot.

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Governance

An independent board of directors governs each investment company. The board oversees the asset manager. The asset manager performs the day-to-day tasks needed to run the company.

In investment companies, the shareholders are both the “customer” and the “owner”. This allows boards to make decisions without potential conflicts of interest between customers and owners. Investment company fee arrangements illustrate how this model can get a better outcome for shareholders.

Since the start of 2018, from an industry currently numbering 353 companies, there have been 225 fee changes that have enhanced shareholder value. These changes often involve reducing fees or removing a performance fee. Another approach has been to introduce tiered fees.

Tiered fee arrangements set a percentage fee rate on assets up to a certain level. Lower rates are set on subsequent tiers. Tiered fees mean that investors pay less as a percentage of the total assets under management. This is justified because it costs proportionately less to manage a larger portfolio. Currently, 147 investment companies use tiered fees to capture these economies of scale. By way of comparison, tiered fees are virtually unknown in OEFs. Our research identified only seven tiered free arrangements among 4,800 OEFs. This shows the power of the independent board in securing better terms for shareholders within the investment company structure.

Boards also assess if an investment strategy is being delivered in the best way. They can even replace an underperforming manager. All their decisions have investors’ interests in mind.

This level of independent oversight is not a feature of OEFs.

An independent board of directors governs each investment company.

Building prosperity: enabling economic growth

A growing economy creates employment. Jobs are central to improving the fortunes of people and their families. Growth allows the government to raise more revenue to support public services. Investment companies can help deliver economic growth. With a supportive political and regulatory environment, they could do even more.

Investment companies can provide permanent long-term capital.

Providing permanent capital

Investment companies can invest in private assets, such as unquoted shares, debt, real estate, renewable energy generation and infrastructure projects. Private assets take time to sell, making them unsuitable for OEFs, which may need to raise cash quickly to pay investors who want to leave the fund.

OEFs holding private assets have a history of failing to meet their promises to pay back investors wanting to leave the fund. OEFs holding property, for example, have had to suspend their redemptions, or have failed entirely. This is because investors wanted their money back faster than the manager could sell the buildings held in the portfolio. This structural problem has led to high-profile fund failures. The most well-known example was the collapse of the Woodford Equity Income Fund. Its holdings in unquoted shares, combined with persistent redemption requests, were central to its demise.

Investment companies do not have to sell assets when shareholders want to trade out of the fund. Instead, investors buy and sell their shares on the stock market. The manager's decision to sell an asset can be based on the investment merits, rather than being determined by redemption requirements. This mechanism allows investment companies to provide permanent long-term capital.

SCOTTISH MORTGAGE INVESTMENT TRUST

Scottish Mortgage Investment Trust is one of the largest investment trusts, with £14bn of assets. Launched in 1909, the trust now offers low-cost exposure to public and private companies in one highly-liquid fund. It democratises access to private companies including Space X, Bytedance (owners of TikTok) and Stripe. It is a widely held retail investment – more than 80% of its shareholders are retail investors. It more than quadrupled investors' money over the ten years to July 2024. Scottish Mortgage is managed by Baillie Gifford, an asset manager based in Edinburgh.

Providing ‘scale up’ capital

VCTs are an important way to help create jobs and growth.

VCTs are a type of investment company. They invest in SMEs, which often struggle to raise capital due to being too small or too risky for traditional financial institutions. To encourage investment in VCT shares, retail investors receive tax incentives. This helps offset the higher risk of investing in small growth businesses.

VCTs can only invest in SMEs that meet criteria set by the government. These ensure that taxpayers get value for money and targets government resources on companies with the potential for transformative growth. VCTs are an important way to help create jobs and growth.

Policy in focus: Support the provision of scale-up capital

In opposition, the government committed to maintaining VCT tax reliefs. To achieve this, it must secure State aid approval from the European Commission. This requirement arises from the terms of the Brexit agreement. Failure to obtain approval will result in key VCT tax reliefs automatically lapsing on 5 April 2025.

The government must complete its State aid negotiations to ensure VCTs can continue to raise capital to support SME growth.

Also, we expect HM Treasury to review how the tax system can best support enterprise. This should include considering options to embed, enhance and extend the role of VCTs.

GoodLifeSorted

Good Life Sorted (GLS) is helping elderly and vulnerable people live independently in their own homes. It introduces elderly people and their families to fully vetted, hand-picked local ‘Helpers’. These Helpers provide paid home help services such as cleaning, laundry, meal preparation, shopping and companionship. Since its launch in 2019, GLS has delivered over 200,000 hours of help across the south of England. The service provides a cost-effective alternative to traditional home care agencies, helping to alleviate loneliness, improve wellbeing, and increase social interactions for individuals that need it most. GLS received funding from Blackfinch Spring VCT.

definely

Founded in 2020, Definely helps legal professionals create, draft and review legal documents. The system was created by a visually impaired lawyer. Headquartered in London, it has over 60 employees located globally. Funding from Octopus VCTs is allowing the company to add to its existing base of 40,000 active users from the largest companies and law firms in the UK, US, Canada and Australia. In 2023, the company was named as one of the in the UK’s fastest-growing tech companies. Clients include A&O Shearman, Slaughter & May and Dentons.

Infrastructure investment

The UK's economy will be able to grow faster if its public infrastructure is modernised. Investment companies can provide the funds to achieve this.

Thirty-two specialist investment companies hold £40 billion in infrastructure assets.

Since 2018, investment companies have raised £12 billion for investment in infrastructure. Economic uncertainty, misleading consumer disclosures and higher interest rates have led to a pause in fundraising. Once these headwinds subside, capital raising will resume. Investment companies will be better able to exploit this opportunity if policymakers resolve regulatory issues that can make it more difficult to attract investors.

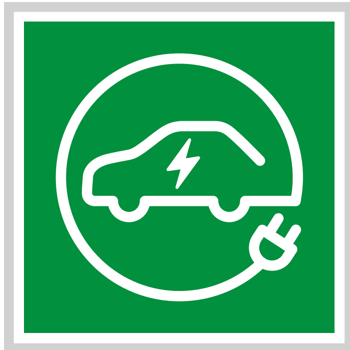
Policy in focus: Create an effective regulatory environment

Investment companies need well-targeted and effective regulation. Many of the current rules were set before Brexit. Europe does not have a thriving investment company sector. The rules, therefore, were not always made with the needs of investment companies and their investors in mind.

The Financial Conduct Authority (FCA) has the authority to change some regulations. One area for early action is prospectus reform. Revisions to the rules could lower costs of raising capital while still providing investors with the information they need to decide whether to buy newly issued shares.

The government must give the FCA more powers to go further. One priority should be reforming consumer disclosures. The current rules provide information that can distort investment decisions and make investment companies appear more expensive than they really are. They have caused some fund and wealth manager investors to sell their holdings in the sector. Reform will protect investors. It will allow investment companies to raise more money for investment in UK businesses and infrastructure as market conditions stabilise and confidence returns.

Thirty-two specialist investment companies hold nearly £40 billion in infrastructure assets.



Gore Street
Energy Storage Fund

Gore Street Energy Storage Fund, launched in 2018. It is London's first listed and internationally diversified fund focused on energy storage. It owns and operates approximately 1.25 GW of battery storage facilities across Great Britain, Ireland, mainland Europe, and the US. Energy storage is essential for integrating renewables into the grid by balancing variable outputs from wind and solar sources. This supports the UK's 'net zero by 2050' goal. As of 31 March 2024, the fund's unaudited Net Asset Value is £541m. Managed by Gore Street Capital, it is popular with retail investors, who make up over 25% of shareholders.

TRIG

TRIG was one of the first investment companies investing in renewable energy infrastructure projects listed on the London Stock Exchange. It provides institutional and retail investors with a liquid investment to support the energy transition. TRIG was launched by InfraRed Capital Partners and RES in 2013 and became a member of the FTSE 250 index in 2015. Since its launch, strategic acquisitions as well as development and construction activity have grown TRIG's portfolio to 2.8GW of generation capacity and enterprise value exceeding £5bn. This capacity can power nearly 2m homes and avoid nearly 2m tonnes of CO_2 emissions per annum.

Focus on sustainability and net zero

Investment companies can mobilise the capital needed to achieve the UK's energy transition to net zero carbon emissions.

Investment companies already hold substantial renewable energy-generating assets, including wind turbines, hydroelectric projects, and solar installations. They also invest in the infrastructure needed to modernise the energy grid. This includes battery storage. This allows renewable energy to be used even when the sun is not shining, or the wind is not blowing.

The investment company sector holds £23 billion in renewable assets. £8 billion of this was raised since the start of 2018.

Investment companies also hold other sustainable assets, such as power projects using carbon capture and reuse technology and hydrogen supply. They can act as pathfinders, pioneering investment into new net zero asset classes.

Helping businesses grow

Businesses need access to capital to grow. It is not always easy for them to get the money they need from banks and other investors. Investment companies can fill these funding gaps.

Investment companies can inject capital into a business. When they buy a company outright, the fund manager often helps it achieve its commercial goals. This can involve helping it enter new markets or purchase other companies to build scale. Sometimes it means refinancing or retargeting existing activities to strengthen the business and create value. Private investments are typically long-term. The aim is to grow the business before selling to another investor, business or listing the company on a public stock market.

Specialist private equity companies are a long-standing feature of the sector. They hold assets worth just under £45 billion. Some invest directly. Others invest via several other private funds. Other investment companies also make private investments as part of a mixed asset allocation strategy.

The importance of private equity is growing. Investment companies allow retail consumers get exposure to these assets, which they would otherwise not be able to access.

GREENCOAT UK WIND

Greencoat UK Wind ("UKW") listed in 2013. It is a British investment company that is a long-term owner of UK wind farms. It provides regular dividends and capital growth through reinvestment of excess cashflows. As the first renewable infrastructure fund on the London Stock Exchange Main Market, it has attracted billions in pension and wealth capital to the renewables sector. With £6bn in gross assets, UKW powers 2.3 million homes and avoids 2.5 million tonnes of CO_2. It aims to grow with the market, supporting new builds and helping the UK achieve its net zero targets.

SERAPHIM SPACE INVESTMENT TRUST PLC

Seraphim Space Investment Trust ("SSIT") is a UK-based SpaceTech investment company with £226m in assets under management. It is the world's first listed SpaceTech growth fund. It has global investments, including across the UK, Europe and the US. It is focused on growth stage private financed SpaceTech businesses in areas such as climate, security, communications, mobility and cyber security. 40% of its investments are either headquartered in the UK or with significant operations here, SSIT has been a key driver for UK innovation and enterprise, supporting the UK's global ambitions in space.

Supporting UK stock markets

Investment companies represent 95 of the 350 largest listed companies in the UK.

Stock markets allow businesses to raise funds for further growth. A listing allows earlier stage investors to sell their stake so that they can recycle their capital into other growth-oriented companies. A vibrant stock market is a national asset.

Investment companies represent 95 of the 350 largest listed companies in the UK. They include four of the FTSE 100. They are the largest sector by number on the main market of the London Stock Exchange. Investment companies have helped sustain our stock market ecosystem while other issuers have left the market.

Since 2000, 487 investment companies have launched on the London Stock Exchange. They made up 51% of all initial public offerings. They have been responsible for 34% of all capital raised.

Investment companies are also important investors in shares listed on the London Stock Exchange. They use active management (rather than passively buying all shares in the index). This approach rewards success and tests companies that underperform. Active management helps the market set share prices. Without active management the markets would not work.

The investment company sector holds £30 billion of its assets (12%) in UK listed shares.

Reforms seeking to support UK stock markets must recognise that investment companies are a key strength of those markets.

Policy in focus:
Stop taxing investors who buy British

Each time you buy shares in a UK company traded on the stock market you will be taxed 0.5% of the purchase value. You will not pay this tax (or stamp duty) when buying the shares of foreign companies. Investors are penalised for buying British. Stamp duty makes it less attractive for UK companies to raise capital on UK stock markets.

Stamp duty is particularly harmful for investment companies because they compete with OEFs. There is no stamp duty to pay when buying an OEF. An investor using a UK investment company to buy the same portfolio of assets starts at a disadvantage. This makes investors less likely to buy investment company shares, which could deliver a far better performance over the long term (See Fig 1 and Fig 4).

Abolishing stamp duty on shares will simplify the tax system. It will support investment and growth. It is easy to achieve. Stamp duty does provide government revenue but retaining this tax is short-sighted. It ignores the benefits of a strong domestic stock market and how it can enhance economic growth.

One option would be to phase out stamp duty. A first step should be to exempt investment company shares. This reduces the initial cost to the Exchequer. It recognises that investment companies promote growth as they provide capital for growing businesses and UK infrastructure. It will also help retail consumers get the investment returns they need for a more secure retirement.

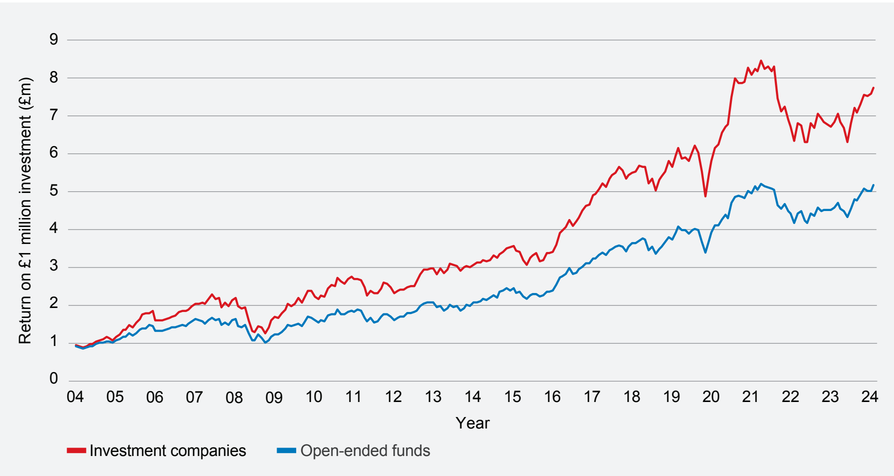
Sharing prosperity: making people richer

Anyone with a little money to invest can buy investment company shares, including through tax-efficient pensions and ISAs. Consumers who do their own research often buy investment companies because they can outperform tracker funds and active OEFs (see Fig 1). The performance of mirror funds highlights this potential.

Anyone with a little money to invest can buy investment company shares.

Mirror funds are pairs of funds. One is an investment company. The other is an OEF. Both investments share the same portfolio manager. Both give exposure to similar assets. The chart below shows the performance of pairs of mirror funds holding non-UK equities.

Fig 4: Mirror funds compared (global equities)



Source: AIC / Morningstar

The investment company option outperforms. Investors should think about using investment companies to achieve their financial goals.

Policy in focus: Introduce a UK ISA

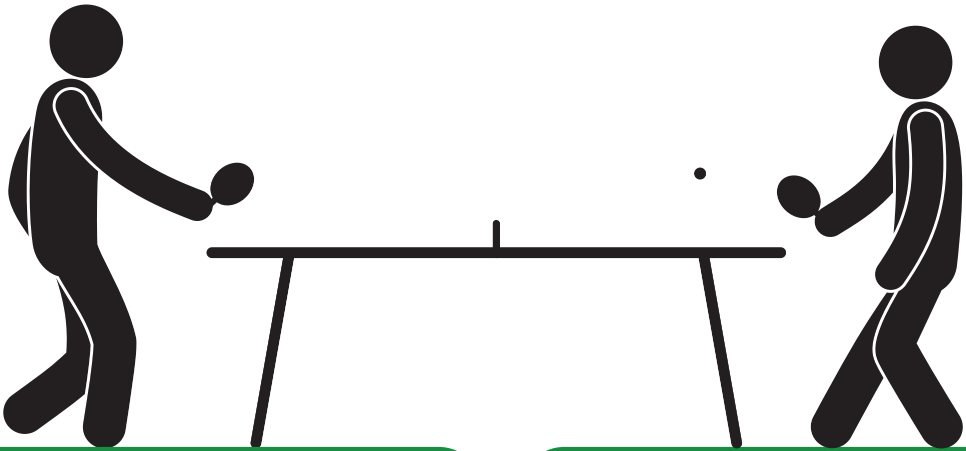
A UK ISA should be created to encourage retail investors to buy UK listed shares. All investment companies should be eligible holdings for a UK ISA. They provide an excellent introduction to buying shares. They can spread risk and offer the possibility of superior performance. They support UK markets, and the ecosystem of professional services that support them, and can provide retail investors with exposure to private assets that they cannot get through other routes.

Excluding investment companies would restrict investment choice, make providing a UK ISA less attractive, and undermine efforts to support UK equity markets.

How do investment companies get better returns?

- **Investing for the long term:** The asset manager can invest for the long term. They do not have to buy or sell assets according to whether investors are leaving or joining the fund.
- **A wider range of investment options:** Investment companies can invest in a wider range of asset classes than OEFs. Asset classes include unlisted shares and debt, renewables, infrastructure, and property. Many of these are not available using OEFs.
- **Full exposure:** Investment companies can fully invest in the target assets. This is not always true of OEFs. For example, OEFs holding real estate often hold 20% or more of their portfolios in cash as a way to try to make sure they can pay investors wanting to leave the fund. Even small increases in exposure to cash can substantially reduce returns over time.
- **Governance:** They have independent boards of directors. The directors ensure that shareholders are not overpaying for services. They can challenge the portfolio manager's approach to get the best result.
- **Controlled borrowing:** Investment companies can borrow to invest in assets. This is known as 'gearing'. The aim is to generate a long-term return greater than the cost of debt. Borrowing for investment increases risks, so investment companies tend to use this option modestly. Half of investment companies do not use gearing at all. Of the 178 companies that do, about half of them (93 companies) have gearing of less than 10%. Even used sparingly, this approach can earn superior returns over the longer term.
- **Providers of income:** Investment income is very important for some investors, such as pensioners. Investment companies pay dividends. This provides an investment income. Dividends are not guaranteed, but many investment companies seek to provide regular income by holding back some revenues when their income is strong. They then pay out this reserve to provide a 'smooth' dividend over time. Twenty-one investment companies have increased dividends year-on-year for over 20 years. The number is growing. Ten of these have raised dividends in each of the last 50 years.

During the pandemic, many investment companies maintained their dividends while other companies suspended them. Eighty-five per cent of income-paying investment companies increased or maintained dividends in 2020. The record of similar OEFs is not as good. For example, 100% of investment companies in the global equity income sector increased or held dividends in 2020, compared with 24% of equivalent OEFs.



WWH

Worldwide Healthcare Trust is a FTSE 250 company investing in the global healthcare sector. Established in 1995, it has a diversified portfolio of shares in around 50 pharmaceutical and biotechnology companies. These range from early-stage biotech firms researching innovative new products to global pharmaceutical companies. It has £2.2bn of assets under management. It is popular with private wealth managers and retail investors, who hold over 79% of its shares.

LITERACY CAPITAL

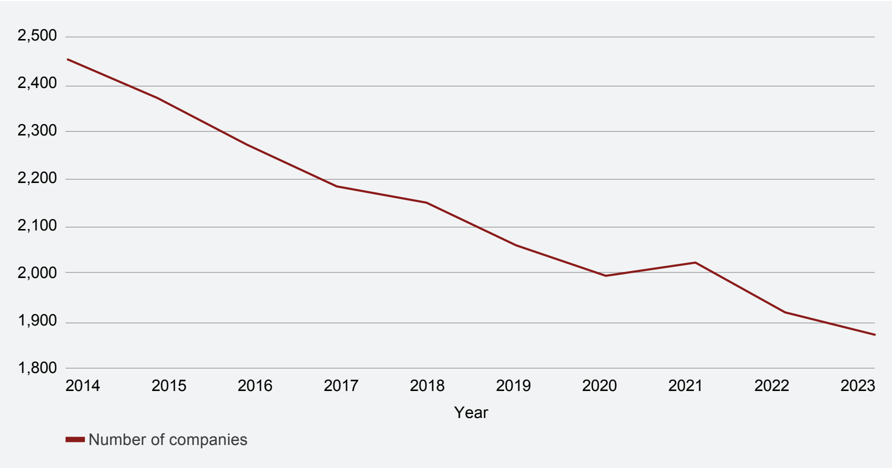
Founded in 2017 by members of the Pindar family, Literacy Capital has grown its assets under management organically from £54m to £306m. The fund is a long-term investor in smaller, private businesses and aims to help them expand and accelerate their growth. Despite the strong investment performance, which ranks the trust #1 of all listed investment companies over the last three years, Literacy Capital also has a charitable objective and has made substantial annual donations to charities focused on improving child literacy in the UK. Over £9.2m has been donated since the trust's creation in 2017.

Democratising private investments

Private assets are becoming an increasingly important source of investment returns.

The number of companies deciding to list in the UK is at historic lows. Similar trends are evident in international markets.

Fig 5: Number of companies on the London Stock Exchange



Source: LSEG

Retail consumers and pension funds have fewer options to buy listed trading company shares to get an investment return. They find it more difficult to diversify their portfolios and harder to manage their exposure to risk.

Private assets are becoming an increasingly important source of investment returns. These assets cannot be held in traditional OEFs. Investment companies provide a bridge from the public market to private assets. They provide exposure to private assets alongside a reliable way to buy and sell when the investor wants.

Investment companies democratise private markets. They allow anyone to buy into these assets to help build their wealth and financial resilience.

Target Healthcare REIT

Target Healthcare is the UK's first Real Estate Investment Trust (REIT) focused on care homes. Part of the FTSE 250 Index, it invests in modern, purpose-built care homes where every bedroom includes a wet room, addressing the rising demand from the UK's ageing population. Since its 2013 launch, it has acquired a portfolio of 94 care homes valued at approximately £900m. The managers aim to create additional beds with wet rooms, leased at sustainable long-term rents to mitigate the shortage of suitable care homes nationwide. Target Healthcare is managed by Target Fund Managers.

Allianz Global Investors | Allianz Technology Trust PLC

Allianz Technology Trust is a UK-based fund that invests in leading global technology firms. Leveraging an experienced investment team near Silicon Valley and the support of Allianz Global Investors in London, the trust's managers excel at identifying future top companies with strong, sustainable business models and growing earnings. Over the decade leading up to July 2024, it has delivered outstanding performance, with total returns nearing 700%. Retail investors, who own over 85% of the shares directly or through advisers and wealth managers, benefit from these gains. The trust currently manages £1.7bn in assets and is overseen by Allianz Global Investors.

Partnership for prosperity

The National Wealth Fund will invest public and private money into the UK to deliver the government's strategic priorities. Government-sponsored investment companies could be launched as part of this project. The combination of being able to make long-term, permanent capital investments, independent governance and the liquidity provided by the shares being traded on a stock market could be attractive to pension funds, other institutions and retail investors. Investment companies can be set up quickly. They are a long-standing structure with an established ecosystem of providers.

The pensions industry has made commitments to invest in unquoted shares of UK businesses. Delivering these promises remains a challenge. Pension schemes may be cautious about using OEFs whose redemption promises can be unreliable where they hold hard-to-sell assets. Pension fund trustees may worry that they will be unable to sell their stake when needed. After all, it was a pension scheme wanting to take its money out of Woodford Equity Income Fund that led to that fund's suspension and ultimate collapse. The problem was that Woodford Equity Income Fund held hard-to-sell assets. It was unable to make this payout without treating its other investors unfairly.

OEFs offering private assets may not achieve the best return because they do not provide permanent capital. Investment companies can overcome the practical challenges of mobilising pension fund investment and secure better outcomes for pensioners.

Fig 6: Options for investment company partnership funds

- **UK net zero transition**
- **UK housing**
- **UK health and social care**
- **UK education**
- **UK regional growth**
- **UK infrastructure**
- **UK productive assets**
- **UK technology and innovation**

Policy in focus: Develop partnership funds

The government should support the launch of new investment companies targeting UK assets. These would be delivered by the National Wealth Fund.

Investment companies could raise additional capital swiftly. They would use the expertise which underpins the existing industry, alongside the British Business Bank and Infrastructure Bank.

Several investment companies could mobilise private capital from investors with different asset allocation requirements and risk appetites. The government would act as a cornerstone investor in each investment company. This would create a unique partnership of public and private capital.

The launch process would establish an investment objective and strategy for each investment company. Public money could fund the launch, including the preparation of the prospectus and the appointment of the board of directors.

The independent board would ensure the company operates in the interest of all shareholders. The directors would appoint expert asset managers, most likely more than one for each fund. Having multiple managers would allow for specialisation and increase the capacity of the National Wealth Fund to develop new asset classes.

The investment company's investment goals would be embedded in its articles of association. These would sit alongside an investment policy, as required by the Listing Rules. These mechanisms would align the company with the government's strategic objectives without compromising operational independence.

Each investment company could undertake further share issuance after the money raised at launch has been invested.

The National Wealth Fund could sell down its holding in each company once it has become established. It could recycle these funds into new launches as required.

Listing these investment companies on the London Stock Exchange will allow retail participation and be a vote of confidence in UK stock markets.

Abbreviations

AIC Association of Investment Companies

FCA Financial Conduct Authority

ISA Individual Savings Account

OEF Open-Ended Fund

REITs Real Estate Investment Trusts

SMEs Small and medium sized enterprises

VCTs Venture Capital Trusts

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