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Restoring vibrancy to the listed funds sector of the LSE is vital to its success

Overzealous market rules are starving the economy of cash needed to fix our decaying infrastructure

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The British economy is bewitched by the curse of safety first. Nowhere is this hex more apparent than the listed funds sector, a £255bn bedrock of the London Stock Exchange.

For more than 150 years, closed-end funds have collectively directed capital into infrastructure projects, such as Marconi's first communications cable across the Atlantic. Yet even as the nation's infrastructure finance requirements soar, regulations that have worsened since Brexit are hindering the sector's ability to help the UK decarbonise and digitise.

To accelerate the energy transition and build the data centres and fibre for the new digital economy, UK infrastructure needs will rise to an estimated £70bn a year by the end of the decade. Given the cornucopia of necessary projects – nearly all of which provide stable, long-term cash flows – investors should be euphoric.

Instead, as Bim Afolami, the economic secretary to the Treasury, has warned, regulators risk turning the sector into the "safest graveyard" where even modest and societally useful risk-taking goes to die. Not only does this starve the British economy of much-needed investment, but it needlessly suppresses returns for the growing number of Britons dependent on defined contribution pension plans.

Given the lack of progress on both these challenges, the mood at last month's LSE Annual Investment Funds Conference was macabre. Restoring vibrancy while giving the wider economy a welcome boost is entirely within the UK's own gift, depending as it does on a few simple, inter-related regulatory changes. More ominously, it also depends on the nexus of politicians and regulators, who together hold power over the City rulebook, acting with determination and urgency.

A first necessary change is to the Financial Conduct Authority's destructively overzealous interpretation of EU rules on fee disclosures. Uniquely, the FCA demands that investment company fees – which are already reflected in the share price of a fund – be double-counted by forcing firms to disclose them to investors. This falsely inflates investment company fees in the reports of the wealth managers and multi-asset funds that buy them. Notwithstanding the energetic efforts of Baronesses Altmann and Bowles to remedy this anomaly, bureaucratic sluggishness and a strangely somnolent attitude from industry lobby group AIC has reduced progress to a crawl. Regardless of one's views on leaving the EU, this is a Brexit bonus waiting to be grasped.

A second culprit are the rules governing investments by defined contribution pension plans, which are rapidly becoming the norm. Current rules insist that these pensions invest in liquid, low-cost assets. Fair enough, you might say. But this prevents access to higher-cost, but also higher-returning, private venture and infrastructure funds. To quote Parliament's works and pensions committee, "two decades of regulatory policy caution have almost entirely destroyed the UK's [defined benefit pension] system" by forcing funds into conservative bonds. The weak current state of the LSE is one consequence of this approach.

By contrast, Australia, Canada and other countries' large pension pools have generated excellent long-term returns by prudently investing in diversified portfolios encompassing "riskier" assets such as shares, infrastructure and private equity, as well as safer investments such as highly rated bonds.

The severity of the FCA's guidance on customer disclosure has led several fund platforms to block access to some investor companies – including those with £1bn or more of stable, cash-flowing, real economy assets – on the grounds of risk and complexity. Yet the same rules say practically nothing about retail investors buying as much as they like of the most speculative and esoteric company on Aim or, worse, crypto. A bizarre outcome.

Finally, the LSE and other index providers could also play a role in reviving the market by adapting index rules to bring the larger infrastructure funds into the appropriate infrastructure indices, thereby ending an unnatural disadvantage. This would improve liquidity and price discovery, encouraging people to invest and trade. Faced with the need to attract tens of billions of pounds in investment over the coming years, politicians and the City now seem to agree that "something must be done". Unless something is – something that allows UK pensioners to easily invest in productive, long-term infrastructure assets – then HM Treasury, the FCA and the Pensions Regulator will hasten the decay of the UK's financial sector, along with its roads and bridges.

Brexiteers criticised the EU for suffocating the UK in red tape. But the dysfunction in the listed fund sector is largely a result of self-asphyxiation. If Britain is serious about upgrading its decaying infrastructure – and giving a welcome boost to a financial sector crucial to economic dynamism – the government and regulators need to loosen their "safety first" stranglehold.

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