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Updating and Improving the UK Asset Management Regime: An FCA Discussion Paper

The UK's Financial Conduct Authority (FCA) released a Discussion Paper (DP23/2: Updating and improving the UK regime for asset management) in February 2023 which recognises that, as a consequence of Brexit, it is time to consider what the shape of the UK's asset management regulatory regime will take in the future.

Go-To Guide:

- The background to and details of the Financial Conduct Authority's Discussion Paper about reviewing the regulatory framework for the asset management sector
- Next steps to that review

Background

In the early 1980s, after substantial debate and consideration, the UK implemented a collective investment scheme regulatory regime which ultimately, alongside vital tax considerations, created the building blocks for the UK's regulation of funds and fund managers. Over time, that regime was modified by both:

- European regulatory initiatives such as the Alternative Investment Fund Managers Directive (AIFMD) impacting private funds, the Undertakings for Collective Investment in Transferable Securities Directive (UCITS) regime impacting retail funds, and the Packaged retail and insurance-based investment products (PRIIPs) disclosure requirements for retail financial services products; and

- substantial changes to the UK's domestic requirements for marketing private funds under the FCA's rulebook and different exemption orders.

After 40 years of gradual modifications the UK's asset management regulatory regime is not always effective or proportionate. Consequently, the FCA has identified in its Discussion Paper several areas for potential reform, including:

- the obligations and rules of conduct in relation to portfolio managers and fund managers;
- the classification of different types of AIFM and the rules specific to small and full scope AIFMs;
- the regime for retail funds; and
- technology in fund operations and improving unitholder engagement.

1. The rules of conduct in relation to portfolio managers and fund managers

The Discussion Paper highlights the current uncertainty around which rules apply to fund managers and which apply to portfolio managers. The distinction is important in cases where fund managers have delegated or contracted out portfolio management activity to third parties which act as host authorised investment fund managers (Host AIFMs).

The Discussion Paper identifies the following issues in relation to portfolio management which need reform:

(a) there are no specific rules for portfolio managers in relation to investment due diligence and liquidity management, but there are specific rules for fund managers;

(b) there is no specific obligation on portfolio managers to consider the risks they pose to financial stability, but there are such obligations for fund managers; and

(c) there is a need to tighten up the existing regulatory framework to prevent people from using technology to manage multiple individual portfolios in order to evade the specific rules that apply to fund managers.

The FCA is considering different options for resolving the issues stated above, one of which is standardizing the rules for portfolio managers and fund managers.

The Discussion paper argues that Host AIFMs have often fallen short of the relevant FCA standards in relation to portfolio management and that the FCA will endeavour to clarify the expectations of Host AIFMs. Potential considerations for reform include setting minimum contractual requirements of Host AIFMs and portfolio managers.

The Discussion Paper also indicates the need to clarify the rules around dilution adjustments and liquidity risk management rules. In respect of the latter, the FCA is considering requiring fund managers to comply with liquidity stress testing guidelines issued by the European Securities and Markets Authority. In particular, for retail funds subject to the FCA's COLL rules, the FCA is considering removing or amending rule COLL 6.12.11R(2) so that the qualification "where appropriate" does not provide a potential loophole for fund managers not to conduct stress tests.

2. The classification of AIFMs

Currently, the rules applicable to fund managers marketing or carrying out regulated activities in the UK differ depending on the firm's thresholds of assets under management. Firms which manage less than the minimum threshold (Small AIFMs) are subject to fewer reporting requirements. The FCA is considering raising the minimum threshold to reflect recent trends in inflation and the growth in markets since these thresholds were created.

Additionally, the FCA is considering clarifying the existing rules and expectations of Small AIFMs as well as the distinction between Small "registered" AIFMs (the superset of Small AIFMs who have registered with the FCA in relation to a fund) and Small "authorised" AIFMs (who have been authorised by the FCA to conduct regulated activities).

3. The regime for retail funds

The authorised retail fund regime consists of Undertaking for Collective Investment in Transferable Securities funds (UCITS funds) and Non-UCITS Retail Schemes (NURS). In connection with the FCA's new obligation on firms to demonstrate that they deliver good outcomes for retail customers (the Consumer Duty), the FCA has expressed a desire to reform the way the retail funds regime operates.

The Discussion Paper considers potential approaches to reforming this area, which include:

(a) removing the distinction between UCITS funds and NURS funds, therefore reducing the complexity of the regime by creating a single type of retail fund which draws on the benefits of both and removes unnecessary regulatory red tape;

(b) rebranding NURS funds under a "UCITs plus" to clarify the distinction between the UCITS funds regime and the more complex NURS regime; and/or

(c) creating a new type of "basic fund" aimed at investors with less experience; this would need to satisfy certain investment requirements to be considered a safe investment for consumers.

4. Technology in fund operations

To advance the FCA's Consumer Duty principle, the Discussion Paper raises a few areas of the current asset management regulatory regime which could be modernised with technology to become more consumer friendly. The key considerations highlighted in the Discussion Paper are principally geared towards improving investor engagement, including:

(a) making digital versions of prospectuses of funds more accessible to readers in terms of content and format;

(b) using technology to streamline the system of ongoing reporting to make it easier for firms to comply with their reporting obligations and for investors to meet their information needs; and

(c) reforming the rules and considering the use of technology with respect to unitholder meetings to enhance the participation of stakeholders in meetings with fund managers.

The Discussion Paper also briefly identifies other potential regulation updates relating to the use of blockchain and the tokenization of assets by asset managers to improve investor engagement and the transferability of investments whilst protecting the consumer. This Discussion Paper is open for responses until 22 May 2023 and will eventually lead to a more detailed Consultation Paper where actual changes may be proposed.

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