Financial Services Regulatory Insights

FCA considering the future shape of asset management regulation in UK

AT A GLANCE

February 2023

What's new?

- The FCA published DP23/2: Updating and improving the UK regime for asset management on 20 February 2023 to explore how it might improve UK asset management regulation and modernise the regime.
- This comes in the context of the UK Government's proposals for the Future Regulatory Framework (FRF) and in anticipation of the FCA receiving a new secondary objective on international competitiveness. See our 'At a glance' for more details.
- The regulator wants to gather feedback to better understand industry's views on the current regulatory regime as well as the potential impacts and unintended consequences of different actions the FCA could take. Feedback will help the FCA decide what work to prioritise once the FRF is finalised.

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What does this mean?

- This discussion paper (DP) focuses on rules dictating how asset managers operate in the UK and how the FCA might change the regime. The aim is to improve outcomes for markets and consumers as well as supporting the UK's position as a global centre for asset management.
- Alongside this DP, the FCA is also asking for views around how it can design and deliver a 'good' retail investment disclosure framework. Please see our 'At a glance' on DP 22/6 for more details.
- The FCA is looking at areas of the current regulatory regime where reforms may be needed to achieve the outcomes set out above. These include the structure of the regime, how it works, and responding to technology-related developments.
- The FCA wants to make the **structure of the regulatory regime** clearer and more coherent. This could include:
  - Looking at where a common framework of rules could be created for all types of asset managers.
  - Amending the regime for professional funds, for instance by changing the size thresholds used to determine whether a firm is considered a full-scope alternative investment fund manager.
  - Changing retail fund regimes, particularly the rules for Undertakings for Collective Investment in Transferable Securities (UCITS) and non-UCITS Retail Schemes (NURS). For example, by adjusting or removing the boundary between UCITS and NURS regimes to improve the clarity for investors between the regulatory categories of funds (e.g. mainstream vs complex retail investment products).
- The FCA put forward options for how it might **improve the way the regime works** and rules for fund managers, depositaries and funds. Options include:
  - Clarifying requirements for authorised fund managers (AFMs), including host AFMs, by changing rules or adding guidance.

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- Enhancing liquidity management requirements, such as liquidity stress testing, swing pricing, and disclosures about fund liquidity.
- Clarifying regulatory expectations regarding investment due diligence, including suitability assessments and rules for depositaries.
- Modernising or improving fund rules to focus on achieving what the FCA views as appropriate outcomes, such as updating or providing further guidance around UCITS' eligible assets and modifying rules on authorised funds' prudent spread of risk.

- The FCA groups possible regulatory responses to **technology-related developments** into two main categories: (i) how to enable technological development and innovation; and (ii) how technology could be used to improve investor engagement.
- Firstly, the FCA is assessing where technology-driven change or structural changes as a result of technology could potentially drive better outcomes for consumers. For instance:
  - Technology in fund operations, including ways that units in funds are bought/sold (e.g. 'Direct2Fund').
  - Fund tokenisation and its potential future role in authorised funds.
  - Tokenisation of portfolio assets and the implications of the growing market in tokenised financial instruments.
  - Potentially allowing investments in unregulated tokens (e.g. cryptoassets) within the scope of authorised funds' eligible assets.
- Secondly, the FCA is looking at how technology can improve the ways fund managers, distributors and investors interact with each other. Areas highlighted include:
  - Post-sale information fund managers provide about their funds and their activities e.g. the fund prospectus and periodic manager's reports and accounts.
  - Ways in which retail investors can interact with fund managers to express their views e.g. rules for unitholder meetings.

What does this mean for firms?

- HMT's proposed approach for the FRF represents a considerable change in how regulatory requirements for firms are developed, as it delegates many powers previously held at the EU level to UK regulators. This approach would make firms' engagement with the regulators even more important.
- This is an opportunity for asset managers to reflect on the current regime/ where it causes operational challenges and then communicate what changes they think the FCA should prioritise.
- Some of the options being considered by the FCA may also represent an opportunity for firms to reduce compliance costs. For example, consolidating existing rules and therefore simplifying the compliance burden for firms.
- Firms should also be alert to the requirements introduced in the FCA's Consumer Duty rules, in particular the imperative on firms to understand the ongoing information needs of investors. Firms' implementation of the Duty will closely inform future policy and regulatory measures focused on improving investor engagement.

Next steps

The deadline to respond to the DP is 22 May 2023. The FCA will engage with stakeholders to rank the ideas set out in the DP by priority level and to consider next steps.