

## **Discussion Paper**

### **DP23/2**

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Updating and improving the UK  
regime for asset management

**February 2023**

## How to respond

We are asking for comments on this Discussion Paper (DP) by **22 May 2023**.

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Or in writing to:

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# Chapter 1

## Overview

### Introduction

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- 1.1** The UK asset management industry consists of around 2,600 firms. They manage around £11 trillion of assets for UK and global clients, ranging from large institutions to small retail investors.
- 1.2** The asset management industry operates globally. The UK is recognised as a world-leading centre for asset management. Many UK firms are parts of wider asset management groups serving clients worldwide. The global nature of the industry, supported by effective regulation based on strong international standards, can benefit firms, consumers, markets and global economies.
- 1.3** The sector is highly regulated. UK regulation of the sector includes both long-standing requirements and more recent additions. Many regulations derive from the UK's membership of the European Union (EU). The UK authorities have developed other measures to deal with specific aspects of UK markets. We consider we have a widely trusted and respected regulatory regime that gives confidence to millions of consumers.
- 1.4** Under the Future Regulatory Framework (FRF), the Government has proposed making the FCA responsible for those retained EU laws that set requirements for firms. This means we will need to decide whether our rules should in future copy those requirements.
- 1.5** We are publishing this discussion paper (DP) to get a broad range of views about the current UK regime for regulating funds and asset managers. It sets out some ideas about how we might modernise this regime to improve outcomes for UK markets and consumers, and to support the UK's position as a world-leading centre for asset management. We want to make sure our regime takes account of developments in technology and supports innovation.
- 1.6** We are doing this now because we want feedback as we start to think about what the FRF means for the UK rules for asset management. This feedback will help us decide what we should prioritise.
- 1.7** Because the industry is global, we want our rules to interact effectively with the requirements that firms are subject to in other jurisdictions. We do not want to create unnecessary complexity for firms operating their businesses internationally.
- 1.8** If we change any aspect of regulation of the sector, we want to ensure any changes:
- better meet the needs of investors, both domestic and international, and retail and professional
  - enable technological development, innovation and better use of data

- are consistent with international standards and take account of rules in other jurisdictions, so that firms can continue to operate efficiently on a global basis
- are effective and proportionate, simplifying and standardising requirements where possible

**1.9** The topics set out in this DP cover possible areas we could change. We will only reform the regulation of the sector where there are clear benefits from doing so. We want to understand what impact potential changes might have on stakeholders. We are unlikely to take all these specific ideas forward. Those we do take forward would take account of any feedback we receive and would be subject to a full public consultation and appropriate cost benefit analysis.

**1.10** But we recognise our regime cannot stand still. Technology has driven substantial change in the asset management industry in recent years and will continue to do so. For example, innovations such as the tokenisation of fund units might have the potential to transform how funds work.

**1.11** To make sure it stays relevant, product regulation needs to evolve as markets change. There are areas where the rules might be limiting the potential for innovation or efficient use of modern technology. There are structural features of the regime which might benefit from change. In line with our approach to the Consumer Duty, in some areas we could make our rules more focused on outcomes.

**1.12** Alongside this DP we are also seeking input into the future disclosure framework for retail investment products in another [discussion paper](#). It asks for feedback on how we can design and deliver a good disclosure regime. Some of the issues covered in that paper are relevant to the wider discussions in this paper. We will consider feedback to that paper when developing any policy proposals.

## Who does this document affect?

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**1.13** You should read this if you are interested in the future of the UK fund and asset management industry. This may be of interest if you are:

- an authorised fund manager
- an alternative investment fund manager
- a portfolio manager, including portfolio managers providing services to both professional and retail clients
- a depositary of authorised funds or alternative investment funds
- an investment platform provider
- a financial adviser
- an investment consultant or a professional investment adviser
- an investor in authorised funds or alternative investment funds

## Is this of interest to consumers?

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- 1.14** This paper will be of interest to consumers who invest in funds, or who are potentially interested in investing in funds. It explores issues including how the UK funds regime might more effectively meet both retail and professional consumers' needs. We particularly welcome feedback from consumers and potential consumers.

## Context

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### Future regulatory framework

- 1.15** The Government's Future Regulatory Framework (FRF) review was set up to decide how the regulatory framework for financial services should adapt to the UK's new position outside the EU. It aimed to ensure that the UK's regulatory framework for financial services continues to be coherent, agile and internationally respected.
- 1.16** The Financial Services and Markets Bill currently before Parliament starts this process. Once the Bill becomes law, the regulatory framework will change. The Treasury and the financial services regulators will then start to move firm-facing requirements from legislation into regulatory rulebooks. In practice, this means the Treasury repealing retained EU law and replacing it with an appropriate UK framework. The financial services regulators will then make detailed, firm-facing requirements in their rulebooks.
- 1.17** Once the Treasury begins work on this area, we will need to move the detailed requirements of retained EU law into our rules for asset managers. So we are reviewing the wider regime for asset management against our objectives ahead of this. We want to support the development of the industry, while ensuring that UK retail investors have access to a range of good value products and are treated fairly. We will use the feedback we get from this DP to help shape our approach to rule-making under the new regulatory framework.

### Our strategic aims

- 1.18** This publication covers topics that are relevant to our strategic focuses set out in Our Strategy 2022 to 2025. We want to prepare financial services for the future, tailoring our rules to better suit UK markets. We want a UK wholesale market which supports the economy and is open to innovation, underpinned by high standards of market integrity and consumer protection. We also want to see firms putting consumers' needs first. We want to reduce the impact of operational disruptions.

### Other relevant initiatives

- 1.19** In line with our strategy, over time we plan to make changes in other areas that relate to the asset management sector and the wider distribution chain.

- 1.20** In our Consumer Investments strategy we said that we want a market for consumer investments in which consumers can invest with confidence, understanding the risks they are taking and the regulatory protections they have. We have introduced a new principle and rules imposing a duty on firms to deliver good outcomes for retail customers (the Consumer Duty). We are consulting on a regime for core investment advice.
- 1.21** As noted in the introduction, we are also considering how we can prepare disclosure for retail investment products for the future. We want retail investors to get the information they need to make informed, effective decisions to pursue their financial goals.
- 1.22** Alongside this we are working to improve the way that wholesale markets operate. We are taking forward work in response to the Government's Wholesale Markets Review to reform financial markets.
- 1.23** In 2021, the Treasury published a call for input into the UK funds regime. It considered both tax and regulatory issues. We have worked closely with the Treasury in considering responses. In February 2022 the Government published a summary of responses to that call for input. This set out the Government's next steps to ensure that the UK funds regime review delivers on its objectives. This paper follows on from that call for input. It covers more detailed regulatory issues that were outside the scope of the Treasury's review.

## Summary of the discussion

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- 1.24** Our discussion is organised as follows:
- Chapter 2 gives context about the UK asset management industry and explains the main outcomes we want to achieve.
  - Chapter 3 asks for feedback on whether we could make the structure of the regulatory regime for asset managers clearer and more coherent. It covers the framework of rules for asset managers, the regime for retail funds and the regime for managers of professional funds.
  - Chapter 4 sets out areas we think we could address to make the regime for asset management and funds work better. It mainly covers possible changes to the rules relating to fund managers, depositaries and funds.
  - Chapters 5 and 6 consider how technology can drive change, looking at how fund managers, distributors and investors interact with one another, and discuss structural changes such as fund tokenisation which could support better outcomes for firms and investors.

## Equality and diversity considerations

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- 1.25** As this paper sets out our high-level thinking, with a view to getting feedback on what work we should prioritise, we have not yet carried out any equality impact assessment. We will do this when we have specific proposals to consult on.

- 1.26** However, we welcome any comments on whether any of the ideas in this Discussion Paper could adversely impact any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment. This includes any comments on whether there are other steps we could take to improve outcomes for fund investors or potential investors with any of these protected characteristics.

## Next steps

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- 1.27** Alongside this DP we plan to engage with a wide range of stakeholders in forums and roundtables as well as individual meetings. We want to rank the priority of ideas covered in this paper. Depending on feedback we will look at ways to develop some of these ideas using tools such as policy sprints.
- 1.28** Throughout this document, we have outlined questions and areas where we would like input. We are inviting you to participate in this discussion by sharing your views. A full list of the questions is set out in Annex 1. Please send us your comments by 22 May 2023.
- 1.29** You can respond to us by emailing [dp23-2@fca.org.uk](mailto:dp23-2@fca.org.uk) or you can use the online response form on our website – see the contact details on page 2.
- 1.30** We will consider your feedback and publish a Feedback Statement later in 2023, possibly as part of a consultation paper on some of the discussion topics.

## Chapter 2

# Background

## The UK asset management industry

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- 2.1** Asset managers play an important role in the economy. They manage investments to grow the savings of a wide range of customers. These include private savers, pension schemes and businesses. Most types of funds aim to deliver growth over many years. They invest in a range of assets to diversify and reduce risk.
- 2.2** The UK is a leading centre for asset management. It is the largest in Europe and the second largest globally after the United States. Based on FCA data, around 2,600 firms manage around £11 trillion of assets for a mix of UK and overseas clients. UK asset managers manage mainstream portfolios of shares and bonds. They also manage alternative assets such as hedge funds and private equity funds. Nearly 80% of these assets are managed for professional institutional investors, according to the Investment Association (IA).
- 2.3** The value of assets under management has seen strong growth over the past 20 years. This is partly a result of the long-term growth in the value of financial markets. There has also been a global shift to raising capital outside the banking sector. This has happened since the financial crisis of 2008.
- 2.4** In the UK, auto-enrolment strongly encourages workers to save for retirement. There is also now increased freedom in how pension savings can be used in retirement. These changes mean that more people have investments. They also mean people rely on their investments more.
- 2.5** Most UK households use asset management services, directly or indirectly. Around 3 in 4 UK households have pension savings. 15% of adults hold stocks and shares individual savings accounts (ISAs). Asset managers tend not to deal directly with retail investors. Instead investment platforms enable investors to access their services.

## Future regulatory framework

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- 2.6** Much UK regulation of the asset management sector comes from three pieces of EU legislation that the UK helped to develop: the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, the Alternative Investment Fund Managers Directive (AIFMD), and the Markets in Financial Instruments Directive (MiFID). There are also several pieces of retained EU law setting technical standards and regulating particular fund types. An example of this is the Money Market Funds Regulation.
- 2.7** The Government's FRF proposals, as set out in the Financial Services and Markets Bill currently before Parliament, foresee responsibility being transferred to the FCA for the

aspects of these retained EU laws that relate to firms. This is intended to enable the UK to maintain a coherent, agile and internationally respected approach to financial services regulation that has appropriate protections and promotes financial stability.

- 2.8** The Government has published a policy statement outlining an ambitious plan for enacting the repeal of retained EU law in financial services and building a smarter financial services regulatory framework specifically tailored to the UK. We will review each provision of retained EU law that relates to firms. Where appropriate, and subject to any requirements that the Government imposes on us, we will make rules in our Handbook to replace the regulations. The Government has published an illustrative example of how this will work. Where responsibilities are passed to the FCA, we will have to consider whether to reinstate rules as they are, or to make changes, if there are enough benefits from doing so. If we change any rules, we want to make sure we understand the implications on stakeholders of us doing this. Responses to this DP will help us prioritise any areas for amendments.

## Our aims for regulation of asset management

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- 2.9** In this DP we want to encourage an open discussion by setting out possible areas for regulatory reform. We want feedback so that we can understand better the costs and benefits of potential proposals and the unintended consequences that might arise. Some of the areas we discuss in this paper may require changes to legislation outside our rules. The FRF process will involve us working closely with the Government. Where appropriate, we will share relevant feedback as part of that process.

## Outcomes we want to achieve

- 2.10** The FCA has a statutory strategic objective to make relevant markets function well. The Financial Services and Markets Bill, currently before Parliament, introduces a new secondary objective for the FCA to facilitate, subject to aligning with relevant international standards, the international competitiveness of the UK economy (including in particular the financial services sector) and its growth in the medium to long term. We should also have regard to matters which were set out in the Chancellor's remit letter of December 2022.
- 2.11** In particular, the following Government priorities are relevant to this DP:
- the Government's commitment to securing better outcomes for all consumers, including through improved competition in the interests of consumers and having regard to the needs of different consumers who use or may use financial services
  - the Government's aim to deliver smart regulatory reform
  - the Government's desire to swiftly implement the outcomes of the Future Regulatory Framework Review, in a planned and sequenced way, through enacting the repeal of retained EU law with rules designed for the UK
  - the Government's commitment to ensuring that the UK is attractive to internationally active financial services firms and activity

- the Government's support of innovation and new developments in financial markets and active embracing of the use of new technology in financial services, such as crypto technologies, artificial intelligence and machine learning

**2.12** We want to ensure that the UK remains an attractive domicile for internationally active asset managers. We want to see innovation in the sector, maintaining the UK as a leader in the use of technology. We also want to see the sector work in the best interests of the consumers and businesses it serves. These outcomes reflect a well-functioning asset management market.

**2.13** In some areas we think it is right to look at setting more extensive requirements for firms. For example, there may be areas where consumer needs are not being met because some firms are not operating to a high enough standard. Setting higher standards can also benefit firms that are already working to best practice.

**2.14** In other areas, current regulation may be imposing excessive costs on firms or consumers, or creating unnecessary barriers to innovation. This could lead to products and services not achieving what consumers need at an appropriate price. In other areas there may be gaps in regulation that we would like to see addressed. We want the regime to be effective at providing the right outcomes. But we do not want to make unnecessary changes if they either do not benefit consumers, create disproportionate costs, or do not improve the way the market is working.

### **Meeting the needs of both retail and professional investors**

**2.15** We want a market for asset management in the UK that meets the needs of consumers. We want a market in which consumers, both retail and professional, can invest with confidence. We want it to be clear to all consumers what service they are getting and whether (or to what extent) it is regulated.

**2.16** High-quality competition can support continuous improvement in the efficient delivery of products and services. But sometimes competition alone is not enough to make sure that consumers get what they need. We will look to intervene where market failures are preventing this from happening. We will also consider where there are regulatory barriers that prevent or hinder the development of an effective market.

### **Enabling technological development and innovation**

**2.17** Innovation creates opportunities for firms and consumers. We want firms to be able to develop technology and innovate in the interests of consumers, whether in providing better products or in improving efficiency and reducing costs. We want our rules to help this by setting appropriate high-level standards that are, where possible, supportive of innovation and that do not impose unnecessary or unjustified barriers.

**2.18** But it is also important that technological innovations do not create material gaps in consumer protection or market integrity. This should mean that consumers can benefit from technological developments and innovation without having to accept lower standards of protection.

## Consistent with international standards

- 2.19** We want the UK regulatory regime to work effectively with other international regimes. We recognise that the asset management industry is global, and many firms operate internationally. This can benefit consumers, markets and economies. We want our rules to interact effectively with the requirements that firms are subject to in other jurisdictions. We do not want to create unnecessary complexity for firms operating their businesses internationally. In considering any changes to the regime, we will have regard to relevant international standards.

## Being effective and proportionate

- 2.20** We want the regulatory regime to set clear and coherent requirements that are proportionate to the risk of harm posed by activities, and that take account of the differing abilities of investors to manage those risks for themselves.
- 2.21** Because the regime comes from different pieces of legislation, it can be difficult and expensive for firms to comply with the requirements. This can increase the risk of errors that are harmful to investors. Complexity also makes effective supervision more challenging.
- 2.22** We want our rules to lead to the outcomes we are looking for in an effective and proportionate way, with the right amount of regulation. This could involve reforming parts of our Handbook to standardise or simplify some rules and guidance, or else being clearer about how we want firms to achieve investor outcomes.
- 2.23** But where the rules currently work effectively, there may not be enough benefit to justify changing them, even if the resulting regulatory landscape is not as simple and coherent as one redesigned from first principles. We also want to be prepared to accommodate future developments that we cannot currently envisage, so that change is as straightforward as possible.

## Regulatory reporting

- 2.24** In addition to the issues raised in this paper, we intend to review regulatory reporting as part of the FRF. We will do this alongside existing work to improve regulatory reporting more generally. We will use the feedback to this paper to help us develop our thinking on what data we should collect.
- 2.25** We are a data-led supervisor. We want to collect data to see and understand areas where risks are building. We want to be able to identify outliers in the UK fund and asset management industry. We will use insights obtained from data to take appropriate and timely action where necessary. Good data that highlights potential issues will enable us to be a more efficient supervisor.
- 2.26** But we want to make our data collection effective and proportionate. We recognise that firms do not have unlimited resources to produce data, and we do not have unlimited resources to analyse it. To meet our objectives, we may need to collect more

data in some areas, but reduce our data collection in other areas. We also want to allow sufficient time for any systems development that firms need to do to produce data they submit to us.

## Previous reviews of the market

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### UK Funds Regime Working Group

- 2.27** The UK Funds Regime Working Group was set up by the Treasury's Asset Management Taskforce to think about how the UK fund regulatory and tax regimes could adapt in the context of changing customer needs, changing capital markets and the UK's withdrawal from the EU.
- 2.28** Alongside the creation of the long-term asset fund (LTAF), it called for these changes to the regulation of fund management in the UK:
- a consolidated regulatory framework through the creation of a single rulebook for funds
  - the repackaging of the non-UCITS retail scheme (NURS) fund structure and its subsets as a 'UCITS plus regime'
  - amending the rules on UCITS master-feeders
  - the creation of an alternative dealing model (Direct2Fund)
- 2.29** The FCA published final rules in November 2021 enabling firms to set up LTAFs. This paper considers how we might meet the other recommendations of the UK Funds Regime Working Group.

### The Treasury's review of the UK Funds Regime

- 2.30** At Spring Budget 2020, the Treasury announced that it would be conducting a review of the UK funds regime, which would consider both tax and regulatory issues. The overarching objective of this review was to identify options which will make the UK a more attractive location to set up, manage and administer funds, as well as support a wider range of more efficient investments better suited to investors' needs.
- 2.31** The Treasury published a wide-ranging call for input into the UK funds regime in 2021. We have worked closely with the Treasury and His Majesty's Revenue and Customs (HMRC) considering responses to the call for input. The Treasury published its response in February 2022 which summarised the feedback it had received from industry, and set out the government's next steps. This DP covers more detailed regulatory issues that were outside the scope of the Treasury's review.
- 2.32** We are also working with the Treasury and HMRC on some other changes to the regime, including around enabling the distribution of capital and amending the Qualified Investor Scheme (QIS) rules. We plan to consult on changes to the rules in the near future. Alongside this, the Treasury is exploring options for the introduction of a new unauthorised contractual scheme fund structure.

## Asset management market study

- 2.33** In 2015 to 2017 we conducted a competition market study into the asset management market. At the time, we found that price competition was weak in a number of areas of the industry. Despite a large number of firms operating in the market, based on our sample, we found evidence of sustained, high profits over a number of years. We also found that investors were not always clear what the objectives of funds are, and fund performance was not always reported against an appropriate benchmark. Finally, we found concerns about the way the investment consultant market operates.
- 2.34** To address these findings we put in place a package of remedies to make competition work better in the market, and protect those least able to actively engage with their asset manager. We strengthened the duty on asset managers to act in the best interests of investors. We also sought to enable those investors who are able, to exert greater competitive pressure on asset managers. We increased the transparency of costs so that those seeking information can get it. We also required greater clarity of fund objectives and performance reporting. Finally, the package sought to improve how effective intermediaries are for both retail and institutional investors, as intermediaries can have an important influence on how the market works. This included referring the market for investment consultants to the Competition and Markets Authority and recommending that the Treasury consider extending our regulatory perimeter to cover certain activities of investment consultants.

## Scope of this paper

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- 2.35** This paper considers the regulation of fund managers and individual portfolio managers. It focuses on the requirements around how those managers operate. It does not cover:
- point-of-sale disclosure
  - prudential regulation of fund and asset managers
  - requirements that apply to asset managers when they invest in capital markets
  - cross-cutting issues, such as those relating to the senior managers regime, sustainability and stewardship, or consumer redress (including issues relating to the Financial Services Compensation Scheme)
  - FCA processes
  - regulatory reporting
  - money-market funds
- 2.36** Some of these topics overlap with issues raised in this paper, and we note that where we consider it particularly relevant.

**Table 1: Areas covered in this DP**

Topic	Chapter	Retail funds	Professional funds	Of potential interest to consumers
Simplifying / standardising the rules for asset managers	3	Y	Y	
Regime for retail funds	3	Y		Y
Regime for professional fund managers	3		Y	Y
Rules for fund managers	4	Y	Y	
Rules for depositaries	4	Y	Y	
Rules for funds	4	Y		Y
Technology in fund operations	5	Y	Y	
Tokenisation of fund units	5	Y	Y	Y
Detailed fund disclosure and reporting	6	Y		Y
Unitholder engagement	6	Y		Y

## Chapter 3

# The structure of the asset management regulatory regime

## Introduction

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- 3.1** This chapter looks at broad issues around the rules for asset managers and funds. It considers areas where the rules could be simplified or restructured. The aim of doing this would be to set clear and coherent requirements for firms, that are proportionate to the risk of harm posed by activities, and that take account of the differing abilities of investors to manage those risks for themselves.
- 3.2** This discussion is important because it covers the framework for asset management regulation. The topics covered here are strategic. But they are also technical. They relate to the structure of our rules.
- 3.3** As explained in 2.6, the rules for UK asset managers come from several different EU directives and regulations. So the UK rules take their structure from the areas covered by EU legislation rather than the activities of firms.
- 3.4** Because of this, the regime isn't always as clear or coherent as it might be. In some cases the rules have minor differences of wording or emphasis. In others the differences are more substantive. We explain this further and give examples in this chapter. Addressing inconsistencies could remove unnecessary cost and make it easier for firms to operate and to innovate.
- 3.5** But we are open-minded about making any of the changes discussed in this chapter. We are not seeking change for the sake of change. Any changes would need to improve the way the market works to deliver better outcomes.
- 3.6** There are three major topics that we cover in this chapter:
- the rules for fund managers of different types and portfolio managers
  - the regime for retail funds
  - the regime for fund managers of professional funds

We refer to firms that manage funds subject to rules derived from the UCITS Directive and AIFMD as fund managers, and firms subject to rules derived from MiFID as portfolio managers. We refer to these firms collectively as asset managers. Unless otherwise stated, where we refer to the UCITS Directive, AIFMD and MiFID, or firms or funds subject to rules deriving from these directives, we mean the UK versions of these.

## Regime for fund managers and portfolio managers

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- 3.7** Within the sector, differing rules apply to:
- authorised funds
  - fund managers and depositaries of authorised funds
  - fund managers and depositaries of funds not authorised by the FCA
  - portfolio managers making investment decisions on behalf of funds and other clients
- 3.8** These rules mainly come from the various requirements of EU directives: the UCITS Directive, AIFMD and MiFID. All three include measures that apply to asset managers. But the law-making process for each directive was independent of the others and each of them has been amended at different times.
- 3.9** This has led to a lot of duplication, especially for the core conduct rules such as general organisational requirements, conflicts of interest management and outsourcing.
- 3.10** Our Handbook reflects the way in which EU directives for asset management were implemented. Many of the rules are contained within the COLL and FUND sourcebooks. But other rules appear elsewhere in the Handbook, including SYSC and COBS. For AIFMD and MiFID, there are additional requirements contained within the level 2 regulations. These now form part of retained EU law.

### Differences of technical detail

- 3.11** One effect of the duplication of rules is that the current rule framework often leads to identical or broadly similar activities being regulated to a slightly different standard. Different rules apply depending on whether a firm is managing a segregated portfolio for an individual client, an alternative investment fund, or a UCITS fund. Sometimes the differences in the rules are mainly technical detail but seeking to achieve the same outcomes – box 1 below gives an example relating to the conflicts of interest rules, summarising the rules for convenience.

#### **Conflicts of interest rules**

The analysis below sets out a subset of the rules around conflicts of interest to illustrate the complexity of the rules as they apply to different types of asset manager. It is not an exhaustive or comprehensive analysis of the rules.

All relevant firms must comply with Principle 8: 'a firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.'

#### **General requirements**

Managers of UCITS funds must take all appropriate steps to identify and to prevent or manage conflicts of interest (SYSC 10.1.3R). They must take all reasonable steps

to prevent conflicts of interest adversely affecting the interests of the UCITS funds they manage (SYSC 10.1.7R). They must try to avoid conflicts of interest (SYSC 10.1.20R).

When a conflict cannot be avoided and the risks of damage to the interests of the UCITS funds cannot be prevented, the manager must disclose information about the conflicts to the UCITS funds (SYSC 10.1.8R) and ensure that the UCITS funds they manage are fairly treated (SYSC 10.1.20R).

Full-scope alternative investment fund managers (AIFMs) must take all reasonable steps to identify conflicts of interest that arise (SYSC 10.1.23R), and to avoid such conflicts. Where they cannot be avoided, they must manage, monitor and where applicable disclose them to prevent them from adversely affecting the interests of the alternative investment funds (AIFs) and their investors and to ensure that the AIFs they manage are fairly treated (SYSC 10.1.24R).

Like managers of UCITS funds, a MiFID portfolio manager is also subject to the rules in SYSC 10.1.3R, SYSC 10.1.7R and SYSC 10.1.8R in relation to conflicts relating to its clients.

### ***Conflicts of interest policy***

Rules for managers of UCITS funds are set out in our Handbook (SYSC 10.1.10R / SYSC 10.1.11R).

For portfolio managers and full-scope UK AIFMs there are provisions in onshored regulations of the MiFID Org Regulation (art 34) and the AIFMD L2 Regulation (art 31).

The requirements are very similar, but the existence of three different sets of requirements might make it unclear exactly what the expectations are in different circumstances.

### ***Organisational arrangements***

Managers of UCITS funds and MiFID portfolio managers must comply with the requirements around organisational arrangements in SYSC 10.1.7R. UCITS fund managers are subject to additional organisational requirements in SYSC 10.1.19R, and specific safeguards in relation to conflicts in the risk management function in COLL 6.11.

Full-scope UK AIFMs must comply with a slightly different set of organisational requirements in SYSC 10.1.25R. There are additional relevant requirements in the AIFMD delegated regulation (arts 32-34), as well as specific safeguards against conflicts of interest in the risk management function (art 43) and the valuation function (FUND 3.9.7R and FUND 3.9.8R).

### ***Disclosure of conflicts***

UCITS fund managers must disclose conflicts in line with SYSC 10.1.8R and SYSC 10.1.21R. MiFID portfolio managers must do so in line with SYSC 10.1.8R.

Full-scope UK AIFMs must follow the disclosure requirements in SYSC 10.1.26R, supplemented by rules in the AIFMD delegated regulation (art 36). In addition to this, full-scope UK AIFMs must disclose certain specific conflicts to investors in the rules in FUND 3.2. These rules have differing levels of detail.

#### ***Additional requirements***

As well as the requirements in SYSC 10, there are additional requirements in the fund rules, at COLL 6.6.17R / COLL 8.5.7R / COLL 15.7.11R and for LTAFs specifically a requirement to assess conflicts of interest (among other matters) in an annual report. There are also specific requirements to manage conflicts in the context of inducements and stewardship.

### **Differences of substance**

- 3.12** Other differences in rules are more material.

### **Conduct rules**

- 3.13** In several areas specific rules apply to fund managers, but similar rules don't apply to portfolio managers. For example, there are no specific rules for portfolio managers on investment due diligence or managing liquidity. These might sometimes be implicit in other rules. Contracts between the portfolio manager and its client might also deal with these matters. But without regulatory standards there could be uncertainty about what a portfolio manager is expected to do, at a minimum, in these areas.
- 3.14** In other areas standards for portfolio managers have been updated after the rules for fund managers were made. In these cases we have generally aimed to apply consistent standards to all asset managers. For example, when the rules around best execution were updated, we applied the updated standard to UCITS managers. But because of the EU legislative framework we were unable to apply this to full-scope AIFMs.
- 3.15** Our working assumption is that the conduct rules for fund managers are broadly appropriate in what they cover and how prescriptive they are. If this is correct, we might add to the rules for portfolio managers to meet the same standards. Compared to the changes discussed in 3.11, these changes might have a material one-off impact on existing portfolio managers. But this would depend on whether those firms also manage funds and are already applying a common standard through their systems and controls.

### **Requirements for financial stability**

- 3.16** There are different rules for financial stability risks of asset management activities. Fund managers must consider the risks they pose to financial stability. Similar rules also apply to manufacturers of financial instruments.
- 3.17** But portfolio managers do not have any specific regulatory requirement in this area. In some cases, another party is clearly responsible for this issue. But in others the portfolio manager may be responsible for designing services that could create financial stability

risks. This has been highlighted by recent difficulties in the market for liability-driven investment services. This has also highlighted how the services of portfolio managers interact with services provided by other parties, including unregulated service providers such as investment consultants. We could consider whether there is a gap in the regulatory framework and, if so, how it might be filled.

### **Portfolio management for retail investors**

- 3.18** The current rules for portfolio managers apply to individual portfolio management of all types. This includes the management of portfolios for retail clients. Individually managed portfolios for retail clients may be based on a standard service. This may have limited customisation, and limited scope for the client to negotiate terms and conditions.
- 3.19** Developments in technology mean that it may be almost as efficient for an asset manager to manage multiple individual portfolios as to manage a fund. This type of service may be very similar in economic terms to the management of a fund. But the rules arguably enable firms to set up a service of managing multiple individual portfolios without needing to comply with some of the specific rules that apply to fund managers. So there is a risk that investors in portfolios might be harmed by not receiving the right level of protection.
- 3.20** We are considering whether to use this opportunity to apply a consistent set of rules for management of both funds and individual portfolios.

### **Differences for managers of authorised retail funds**

- 3.21** There are also differences in the rules between fund managers of UCITS funds and fund managers of AIFs. This is particularly noticeable in how the rules apply to managers of authorised retail funds.
- 3.22** The authorised retail funds regime consists of UCITS funds and NURS. NURS are AIFs, so managers of NURS are subject to different rules from managers of UCITS. We think it is unlikely that retail consumers perceive a difference between UCITS and NURS and there may be benefits in setting consistent standards.

### **How we might deal with this**

- 3.23** The areas described above are examples of where the regulation of asset managers is inconsistent. This creates complexity. In turn, this can lead to inefficiencies.
- 3.24** The UK Funds Regime Working Group recommended creating a single rulebook for asset managers. The FCA Handbook includes many rules that apply to a wide range of different types of firms, including asset managers. So it is unlikely that we would try to consolidate all relevant rules into a single sourcebook (such as for example COLL or FUND). But there are likely to be benefits in making the rules that are common to all types of asset management more coherent and consistent. So we could potentially create a common framework that would set standards for all types of asset manager.

- 3.25** A consolidation of the rules could significantly simplify regulation of the sector. The same rules could apply to a firm's fund management and portfolio management activities, except where differing treatment is appropriate. This approach might have long-term benefits for firms and consumers. It might improve competition by simplifying the compliance burden for new firms entering the market or accommodating future financial product innovations. It may also be easier for us to supervise efficiently.
- 3.26** But if we were to change large areas of our rules, it could cause significant one-off costs and disruption for many firms, as well as other stakeholders, at least in the short term. Where the current rules seek to achieve similar outcomes, a change like this might not have a significant impact on individual firms. But where the differences are substantive there could be greater costs. To reduce the impact of this, we could allow a lengthy timetable for implementation.
- 3.27** It would also take significant policy-making time and resource. So it may not be appropriate for us to prioritise this work over other, more immediate, issues affecting consumers and markets.
- 3.28** We see a potential benefit from having a clear common standard for asset managers regardless of type of firm. But we want feedback on whether this would be outweighed by other factors.

**Q1: Do you think that we should aim to create a common framework of rules for asset managers? What benefits would you see from this? What costs might this create? If you do not think we should do this, are there any areas discussed above where we should consider taking action, even if we do not create a common framework of rules? What would we need to consider around the timing of implementing a change like this?**

## Regime for retail funds

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### UCITS and NURS regimes

- 3.29** As described above, the authorised retail funds regime consists of UCITS funds and NURS. The UCITS and NURS regimes each allow firms to operate a wide range of fund propositions. Both UCITS funds and NURS can be low or higher risk, simple or more complex.
- 3.30** We set out in our consumer investments strategy that we wanted a market for consumer investments in which consumers can invest with confidence, understanding the risks they are taking, and the regulatory protections provided. We have introduced a new principle and rules imposing a duty on firms to deliver good outcomes for retail customers (the Consumer Duty).

- 3.31** We want the market for authorised funds to work well for consumers who wish to access it either with or without advice. We are currently consulting on a new core investment advice regime. It aims to help mass-market consumers with straightforward needs by allowing firms to provide greater access to simplified advice on investing into mainstream products.
- 3.32** The UCITS regime is recognised internationally as an attractive regime for retail funds. It was originally designed to create a basic unified standard for mainstream products which could be sold to retail investors in an unrestricted way. Over time, the regime for these funds has evolved so it has been possible for firms to create relatively complex products under the UCITS label. The market for UCITS funds has also evolved, with many professional investors using UCITS funds.
- 3.33** But there are also restrictions which make it unattractive to structure a fund as a UCITS fund even where the product would be appropriate for a target market of mainstream retail investors. For example, UCITS funds have many restrictions when investing in other funds. The rules for setting up a feeder UCITS investing into a master UCITS are complex. Very few fund managers have used them. The equivalent rules for feeder NURS are simpler and more widely used. There might be benefit from reducing the complexity of the rules for UCITS feeders if this can be done without materially reducing consumer protection.
- 3.34** We have previously identified that the market for authorised funds can be hard to navigate for consumers, and it can be difficult to distinguish between different types of funds. There might be benefits in having a regime, or a sub-category of the retail funds regime, that helps retail investors to navigate it more effectively.

### **Possible approaches to change the regime**

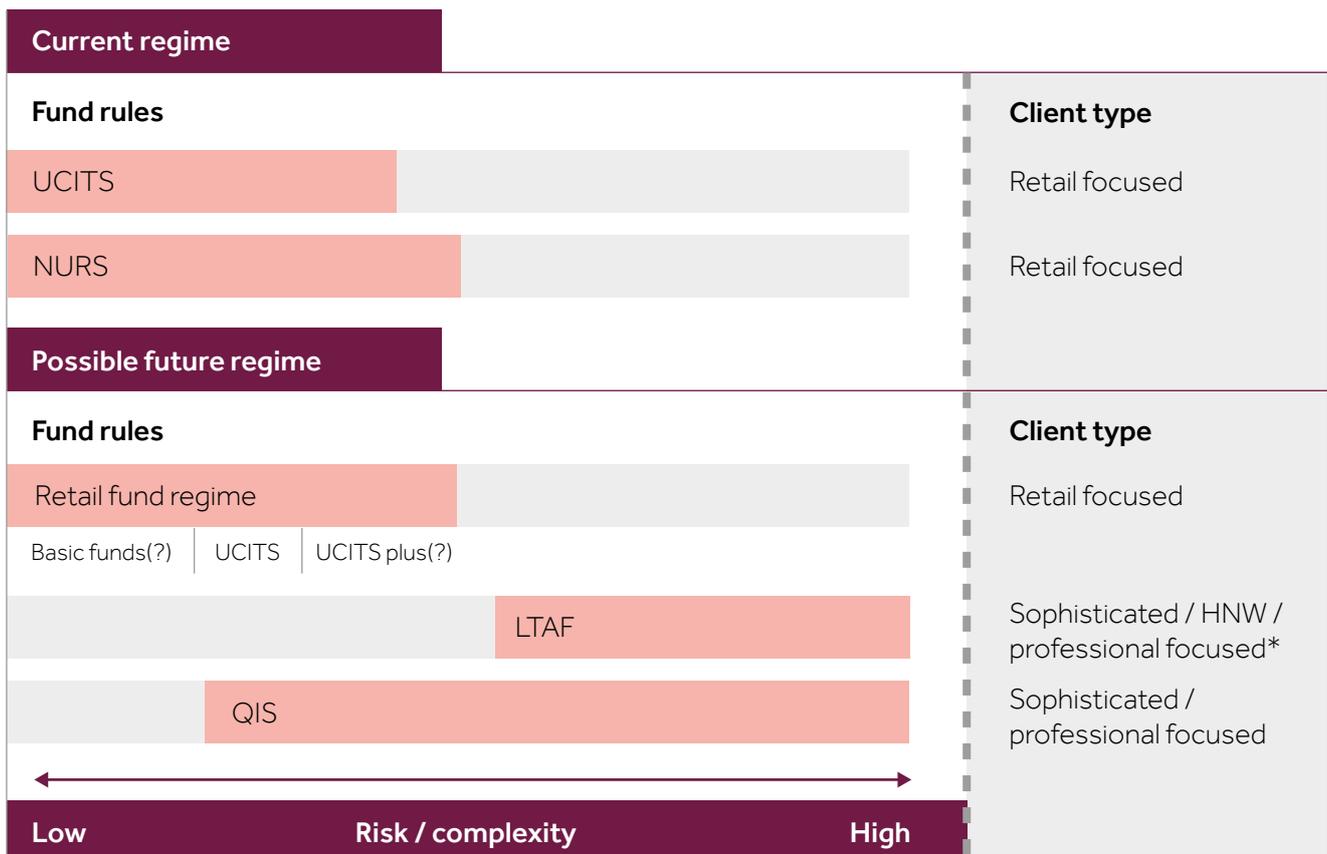
- 3.35** Currently differences between the UCITS and NURS regime are driven by what is permitted under the UCITS Directive. The boundary between the UCITS and NURS regimes could be set in a different place.
- 3.36** One approach would be to remove the boundary. This would mean that all authorised funds that can be widely distributed to retail investors would be subject to a single set of rules. This could reduce the complexity of the funds regime. We could simplify specific requirements, for example by reducing the barriers to investing in units of other funds, or by creating a more flexible regime for master-feeder fund structures.
- 3.37** Another approach would be in line with a recommendation of the UK Funds Regime review. This was to rebrand the NURS regime as 'UCITS plus'. Mainstream retail products would fall under the UCITS banner and more complex retail products under the UCITS plus banner. This could create a clearer differentiation between the regulatory categories of product. We would need to decide whether all funds that are currently NURS should be within the UCITS plus category, or if we would limit this only to more specialist categories of fund.
- 3.38** A third approach would be to create a category of basic funds. This could be done on its own or as well as one of the other approaches. A boundary could be set up to distinguish

basic funds from other retail funds. Basic funds would be limited in the types of investments that they could make. They might be restricted, for example, to investing in only the largest and most liquid investments, or in their use of derivatives, or be required to have a high level of diversification.

**3.39** There might be benefits in categorising certain funds in a way that enables retail investors to identify them as a basic type of fund. But any such regime might be difficult to set up in a way that avoids distorting the market. Previous attempts to define investment products as 'simple' have struggled to be effective. We would not want to discourage retail investors from taking investment risk, if they understand the risk they are taking.

**3.40** Against the potential benefits from changing the boundaries of the UCITS and NURS regimes there may be costs. It may create significant complexities. It could take a long time to prepare for a structural change like this. We recognise that UCITS is an internationally recognised and trusted framework for retail funds. We would not want to undermine this.

**Figure 1: Possible approach to retail fund rules**



\* We have consulted on allowing greater retail access to the LTAf

**3.41** But we would welcome feedback on whether we should make any changes to the UK authorised retail funds regime. We want to understand if this would create a more coherent and clearer regime, and what factors we should consider if we were to make changes here. We would also like to understand the timeframe it might take firms to adapt to changes like this.

**Q2: Do you think we should change the boundary of the UK UCITS regime? If so, do you think we should take any of the three approaches set out here? Should we consider any alternative approaches? What timeframe would be needed to allow firms to change their existing product offering or to develop new products?**

## Regime for managers of professional funds

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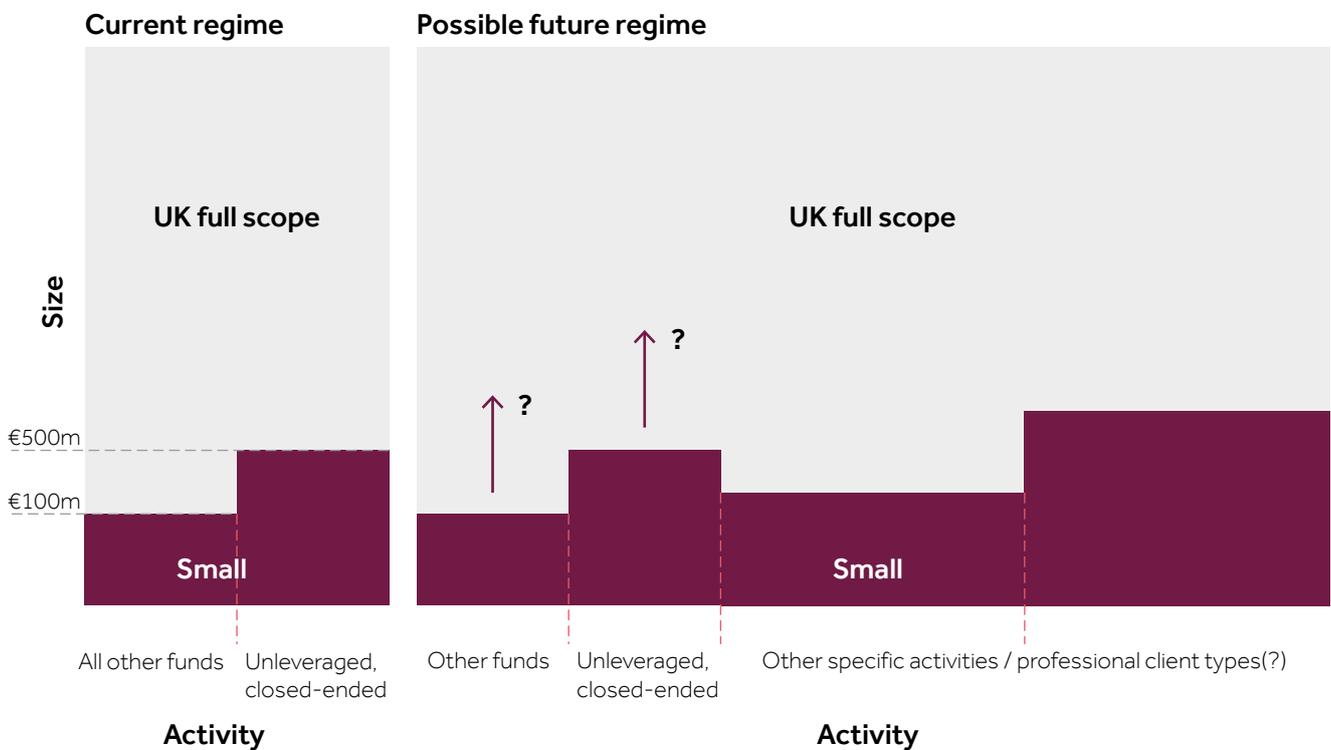
- 3.42** Many AIFs are operated exclusively for professional investors. Most AIFs are not FCA authorised funds. Their fund managers, if they manage assets above a size threshold, are subject to rules derived from AIFMD. These rules are in many areas detailed and prescriptive. We refer to these fund managers as full-scope UK AIFMs.
- 3.43** Firms below the size threshold are subject to much less prescriptive requirements. They can choose to operate in line with the full-scope AIFMD rules but are not required to do so. We refer to these fund managers as small AIFMs. There are two regimes for small UK AIFMs: an authorisation regime for firms carrying out regulated activities, and a registration regime for other firms who do not need to be authorised but who meet criteria set out in regulation 10 of the [Alternative Investment Fund Managers Regulations 2013](#).
- 3.44** The market for asset management for professional clients forms part of the wider UK wholesale markets. We want to tailor our rules for wholesale markets to better suit UK markets. We want these markets to be open to innovation, underpinned by high standards of market integrity and consumer protection.
- 3.45** Professional investors use a wide range of investment services. They invest in funds but can also use other arrangements. They can access advice if they need it. Advisers and service providers to professional investors are regulated under different regimes. In some cases, for example some investment consultancy services, they are not regulated at all. Where they are regulated, the requirements of the different regulatory regimes vary in how detailed and prescriptive they are.
- 3.46** Managers of professional funds are an important service provider to professional investors. We want to retain high standards for these managers, in line with international standards. But we have had feedback that, in some areas, the full-scope AIFM standards go beyond what professional investors consider enough to protect their interests.
- 3.47** We do not plan to significantly change the rules derived from AIFMD. But we would welcome feedback from professional investors on their interest in investing in funds that are managed by managers who are above the current size threshold, but who would not need to meet the full requirements of AIFMD.

## Possible approaches to change the regime

- 3.48** If the current approach is not retained, one option would be to change the size threshold at which firms must apply the full-scope UK AIFM regime. This could for example reflect the growth in markets since the threshold was originally set.

- 3.49** An alternative option would be to allow firms that meet criteria other than their size to use the small authorised UK AIFM exemption. For example this could relate to the types or strategies of AIF that they manage, or the types of clients they have. This is already a feature of the current regime to an extent. The size threshold is higher for AIFMs who manage AIFs that meet conditions around leverage and redemption rights.
- 3.50** If greater use of the small AIFM exemption is allowed, we want to make sure that it is used appropriately. Many small authorised AIFMs operate to high standards. But some do not. We set out in our [2022 Alternatives portfolio letter](#) that we are concerned about firms inappropriately marketing high-risk alternative investments to retail or elective professional clients. So we would need to be confident that our rules, including our [new rules on promoting high-risk investments](#) are not circumvented.
- 3.51** Whether or not the threshold at which firms must apply the full-scope regime is changed, we are considering making our expectations of small authorised AIFMs clearer. If the exemption were to be broadened significantly, we may need to introduce a set of high-level rules setting minimum standards on core fund areas such as valuation, liquidity management and investor disclosure. This would be less prescriptive than the full-scope AIFM regime. But we would want to continue to set high standards around areas such as financial stability and market integrity.

**Figure 2: Possible approach to regime for authorised UK AIFMs**



- 3.52** If a much wider range of firms is allowed to benefit from an exemption from the full-scope AIFM regime, we will also need to consider whether it would be right to allow full-scope AIFMs to comply with elements of this regime in some circumstances. This might

be appropriate in areas that set requirements for specific funds. If the exemption is restricted to firms whose business is entirely exempt, this has the potential to create distortions in competition.

### Small registered AIFMs

- 3.53** Alongside the areas discussed above, we are engaging with the Treasury on the regime for small registered UK AIFMs. We are concerned that consumers may not understand the difference between a small authorised AIFM and a small registered AIFM. Because most fund managers are FCA authorised, the existence of a registration regime might mislead consumers into thinking that a registered firm is FCA authorised. As part of the FRF changes we will be considering whether it is possible to deal with the issue we have identified here. This might involve requiring some types of small registered AIFMs to be authorised and removing the registration requirement for others.
- 3.54** Some of the issues covered here will need the Government to take decisions about the extent to which they are the responsibility of the FCA. We will work with the Government on these issues as appropriate.

**Q3:** Do you think we should work with the Treasury to amend the threshold at which AIFMs must apply the full-scope rules? If so, do you have any comments on the options described above? Are there any other areas we would need to consider if we were to do this?

**Q4:** Are there aspects of the current AIFM regime that professional investors do not value? Would there be benefit in us removing any of these?

## Chapter 4

# Improving the way the regime works

## Introduction

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- 4.1** This chapter sets out areas where we consider that there may be an opportunity to improve how the regime works. We want the asset management regime to deliver good outcomes for retail and professional investors.
- 4.2** Acting in these areas does not depend on us making the structural changes to the rules set out in Chapter 3. In some cases our supervisory experience is that the current rules do not always lead to good outcomes. In others we want to explore areas where we could modernise the rules.

## Rules for authorised fund managers (AFMs)

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### Responsibilities of host AFMs

- 4.3** Most AFMs do not manage the assets of their funds but another firm acts as portfolio manager. This firm might be within the AFM's group, or it might be an independent third party. Some firms operate a business model where they act as a host AFM and hire out their services to portfolio managers, who are generally smaller firms. This allows the portfolio manager to package its services in a fund structure without having to set up its own AFM. This can reduce the barriers to entry, facilitate competition and offer consumers choice.
- 4.4** The AFM is responsible for ensuring the fund complies with our fund rules. It also has a range of responsibilities in operating the fund. Alongside this, we expect portfolio managers of funds to understand what the AFM must do, as part of their responsibility for managing the assets of a fund. This includes considering whether an investment is suitable for the fund.
- 4.5** We see benefits in the rules allowing funds to use third-party portfolio managers. We consider that this model, when done to a good standard, offers consumers the ability to access a wide range of investment expertise in an efficient manner. But our supervisory experience of host AFMs is that they sometimes fall below appropriate standards.
- 4.6** Some of the functions that a fund manager must or should do can be easily carried out by a firm that is independent of the portfolio manager. But other functions may be more integral to the day-to-day management of the portfolio. These activities may need in-depth knowledge of the assets in which the fund invests to be able to carry them out to a good enough standard to ensure an appropriate degree of consumer protection.

- 4.7** Some of our concerns come about because of misunderstandings by some portfolio managers about the role of the AFM. We could clarify our expectations in rules by creating specific contractual requirements between the AFM and the portfolio manager. Clearly articulated contractual provisions could reduce the risk that the portfolio manager misunderstands the obligations of the fund manager. Alternatively, if there is appetite to do this, a trade body or other group could help develop industry guidance to set appropriate standards and act as a guide for host AFMs.
- 4.8** In addition, new rules or guidance could make clearer the responsibilities of a portfolio manager of a fund, aligning their responsibilities more closely to the function they are carrying out. We would not remove any responsibility from the host AFM but make clearer the expectations on a portfolio manager.

**Q5: Do you think that we should amend our fund rules or add guidance either to make clearer the requirements on portfolio managers of funds, or to set minimum contractual requirements between host AFMs and portfolio managers? Do you think this would lead to any other consequences that we need to consider?**

## Enhancing liquidity management

- 4.9** The regulatory framework contains rules around liquidity management. Many of these rules are designed to protect consumers. They aim to ensure that funds pass on appropriately the costs of dealing in investments and that all unit holders are treated fairly.
- 4.10** But the growth of the fund industry means that liquidity management in funds is also relevant to the good functioning of markets. This is consistent with findings of global standard setters, for example the [Financial Stability Board \(FSB\)](#). The International Organization of Securities Commissions (IOSCO) recently [recognised](#) that the UK is fully consistent with the recommendations of its [2018 report on liquidity risk management for collective investment schemes](#). But we think there are areas where we can further reinforce best practice.
- 4.11** We want to see fund managers carrying out effective liquidity risk management. We expect firms to comply with the [liquidity stress testing guidelines](#) issued by the European Securities and Markets Authority (ESMA). We plan to convert these into rules and guidance in our Handbook. We are also considering removing or significantly restricting the limitation around liquidity stress testing in COLL 6.12.11R(2), so that the qualification 'where appropriate' does not give fund managers a reason not to carry out stress tests.
- 4.12** We are also considering making clearer our rules around dilution adjustments (sometimes referred to as 'swing pricing') and other anti-dilution mechanisms. We consider that the rules enable fund managers to deal with the costs to investors of dilution. But we have found that firms use these rules in different ways, which could cause harm to consumers. Differing practices in this area could increase the risk of a first mover advantage. This could be seen as posing a risk to financial stability. We

could make clearer our expectations about the factors that a fund manager should or must consider when calculating a dilution adjustment. We want our rules to work effectively and would welcome feedback on areas that we could helpfully make clearer through rules or guidance.

**4.13** Relatedly, we are considering what reporting may be necessary to ensure we have appropriate regulatory oversight. We currently receive reporting of liquidity categories (or 'buckets') for alternative investment funds. We could extend this to UCITS funds. We are also considering whether there would be benefits in requiring funds to make any form of public disclosures of the liquidity of their investments.

**Q6: Do you have any comments on us potentially amending the rules and guidance around liquidity stress testing?**

**Q7: Do you have any comments on whether we should make our rules on liquidity management and anti-dilution clearer?**

**Q8: Do you have any comments on the benefits or costs associated with public disclosure of fund liquidity?**

## Investment due diligence

**4.14** In our supervisory work we have found that practice around investment due diligence (including credit assessment) appears inconsistent. Weaknesses in this area sometimes appear to contribute to harm. We have seen investments made in illiquid or complex securities without significant due diligence. In some cases material risks appear to have been overlooked. Consumers have suffered losses as a result. So, we are considering making our expectations clearer.

**4.15** For portfolio managers, there are rules on suitability. These concentrate on the information that the portfolio manager needs to know about the client to decide whether an investment is suitable. The rules on what the portfolio manager needs to know about the investment are very high-level.

**4.16** For fund managers, there are rules on due diligence. These set out at a high level what they need to know about the investments their funds make. For AIFMs, when they invest in assets of limited liquidity, there are rules setting out more detailed requirements.

**4.17** In all cases, financial services professionals are expected to apply due skill care and diligence, and this would seem to require due diligence being performed on investments. Therefore, we are considering whether it would be better to set out regulatory expectations around investment due diligence for all types of asset management activity. This is consistent with the UK's reputation as a centre of quality investment activity with deep pools of investment expertise.

**4.18** We would not intend to create complicated or onerous restrictions in this area, particularly when asset managers are investing in widely traded, publicly listed securities. But we think there could be benefits from having clearer standards that apply to all asset managers.

**Q9: Do you have any comments on us making our expectations on investment due diligence clearer for all asset managers?**

## Clarifying rules for depositaries

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**4.19** The depositary plays an important function in ensuring that the assets of a scheme are appropriately protected, and in overseeing the activities of the fund manager. The depositary oversees how the manager manages the fund in line with the rules and the fund prospectus. This includes monitoring what the fund can invest in. It also includes monitoring the pricing and dealing in units of the fund.

**4.20** But our experience has been that depositaries have not always intervened or challenged fund managers although we would have expected them to. They do not always achieve effective outcomes when conducting their oversight duties. Our supervisory expectations of depositaries sometimes differ from depositaries' own interpretations of our rules. Requirements also differ by fund category. We think there's benefit in updating and making our rules clearer for depositaries, fund managers and investors relying on these activities taking place.

**4.21** There may also be areas where our rules require depositaries to carry out oversight functions that are of limited benefit. We would be interested in understanding if there are rules that fall into this category which we could remove.

**4.22** We are considering making clearer our expectations around several areas, including:

- the systems and controls that a depositary must have in place to identify breaches of the rules and constituting documents of a scheme
- the resources and knowledge, skills and experience that we expect of a depositary
- actions we expect to be taken when a breach is identified
- what the depositary should do if the manager does not take action to deal with the breach
- the depositary's oversight of the AFM's liquidity management, including liquidity stress testing
- the depositary's oversight of the AFM's pricing and dealing in units of the fund

**Q10: Do you agree that we should make our expectations of depositaries clearer? Do you have any comments on the areas where greater clarification would be desirable? Are there any areas where we should consider removing oversight functions from depositaries? Are there areas where the contribution of depositaries is particularly valuable for the interests of investors?**

## Improving the fund rules

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- 4.23** The fund rules cover a wide range of detailed situations. In some cases, markets have changed significantly since the rules were written. This may mean that the rules are more complex than is needed or may not envisage situations that occur in modern markets. It may be difficult to monitor whether a fund complies with the rules, or to write code to automate compliance monitoring.
- 4.24** In line with our approach to have a greater focus on outcomes, we want the fund rules to deliver the appropriate outcomes in a way that is effective and proportionate. We want the rules to be smart and have an appropriate level of detail. This section provides some examples of areas where we could consider making changes to modernise or improve the fund rules. We want to understand whether there would be enough benefit from making changes to rules like this.

### Eligible assets

- 4.25** The eligible assets regime for UCITS sets out the requirements for what a UCITS fund can invest in. There are two sets of rules, one relating to the individual assets, and one relating to the eligible markets on which those assets are traded.
- 4.26** The rules require that assets must have certain characteristics to be eligible. Some of these are absolute, for example whether a security is a transferable security. But firms may consider that others allow more scope for judgement.
- 4.27** The rules on eligible markets limit which markets a UCITS fund can invest in. There have been significant changes in what constitutes a market since these rules were written. The rules allow investments in markets that meet certain criteria. Some of these criteria could be seen to apply to all investments on those markets. But even if the overall market meets the criteria, it does not necessarily make sure that all investments on the market are appropriate investments.
- 4.28** UCITS funds are permitted to invest up to 10% of their portfolio into assets that do not meet the eligible markets criteria (the 10% rule). But these assets must meet the other eligible asset criteria, for example around reliable valuation. The eligible asset rules also refer to the liquidity characteristics of the asset. These rules interact with the requirements around liquidity risk management in COLL 6.12. We have concerns that some UCITS managers might perceive the 10% rule as a general permission to invest this part of the fund in a wider range of assets without considering the implications for suitability or risk management.
- 4.29** We see value in the rules having flexibility so that managers can deal with circumstances that arise outside their control. For example, we would not want the rules to force managers to sell investments that stop being eligible under the eligible markets rules, if to do so would clearly not be in the best interests of investors. But we are concerned that these rules might not be entirely compatible with the core offering of UCITS, which is to create a fund structure that mainstream retail investors can invest in with confidence. The complexity of this regime also potentially makes it more difficult for fund managers and depositaries to make judgments about investments.

**4.30** One option would be for us to give guidance on our expectations around the 10% rule. For example we could say that we would expect managers not to use the 10% rule in a way that undermines the liquidity of the fund, or their ability to deal with changes in the fund over time. We would like to understand the consequences for AFMs and investors of us doing this.

**Q11: Do you have comments on the analysis of the eligible assets rules for UCITS set out here? Do you think we should update or provide guidance on these rules? If we did so, what impact would this have for managers of UCITS funds?**

### Prudent spread of risk

**4.31** Authorised funds (other than QIS) must have a prudent spread of risk. In addition, there are detailed rules on spread in COLL 5 which set out the maximum amount which a fund may hold in specific assets. Authorised funds also must have policies, processes, and people in place to manage their risk.

**4.32** The detailed rules on spread aim to limit the risk that a fund can take. They set specific limits which AFMs and depositaries can monitor. But some stakeholders have suggested we should remove the prescriptive quantitative requirements in favour of a more principles-based regime to allow greater investment flexibility. This would be underpinned by the rules on risk management. These stakeholders argue that quantitative limits restrict portfolio managers from investing in ways that would be reasonable and in line with sound risk management. Specific limits also create the potential for inadvertent breaches, which take time to deal with.

**4.33** One example of a rule of this nature is the rule on spread for UCITS funds that sets a limit of 5% of investments in any individual issuer. This limit can be raised to 10% in respect of 40% of the value of the fund (the 5/10/40 rule). Some stakeholders argue that a prudent spread of risk can be achieved in other ways that are not excessively high risk.

**4.34** We are considering whether changing the rules in this area could be of benefit. We are not currently minded to remove quantitative restrictions. But we would welcome feedback on whether we should consider removing or loosening any specific restrictions.

**Q12: Do you have any comments on whether we should consider removing or modifying detailed or prescriptive requirements in the rules on prudent spread of risk?**

**Q13: Are there any other areas where you think we should consider removing or modifying prescriptive requirements in the retail fund rules?**

## Chapter 5

# Technology and innovation

- 5.1** This chapter and the next one set out our thinking on the role of technology in supporting better outcomes from authorised funds. They consider areas in which we might amend our fund rules to support technological changes that could modernise fund propositions. Some technological changes impact on other cross-cutting rules, such as those for custody of client assets, which are outside the scope of this DP.

## Technology as a driver of better consumer outcomes

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- 5.2** Technology is an essential part of financial markets, and of the operating model of financial services firms. Firms have to make many commercial decisions about how they use technology, and those decisions collectively shape market standards. Regulation needs to reflect those standards and the opportunities that technology creates. If it doesn't, it may hold firms back from making changes in the best interests of investors. It might also increase operational risk, or entrench poor practices that would otherwise have been corrected because of market pressure.
- 5.3** The pace of change in technology may mean that developments break new ground not previously considered by regulation. Our Handbook may lack clarity about whether and how firms are able to adopt new processes. It may contain rules that obstruct change. This DP looks to identify areas where improvements could be made to fund regulation, so that firms can take advantage of technological developments in their customers' best interests.
- 5.4** This discussion takes account of other FCA initiatives on technology in the financial sector, including:
- the work of the [Innovation Hub](#), including the Regulatory Sandbox, Innovation pathways support, our Digital Sandbox pilots, and our various regtech initiatives
  - our recent discussion papers on artificial intelligence (DP22/4 issued jointly with the Bank and the PRA), and the potential competition impacts of Big Tech entry and expansion in retail financial services (DP22/5)
  - the joint initiative between the Bank and the FCA on [digital regulatory reporting](#)
  - our March 2022 [call for input](#) on the use of synthetic data to support financial services innovation
  - our series of consumer research publications on [cryptoasset ownership](#), most recently updated in 2021
- 5.5** We want to build on this work to identify opportunities for technological change in the funds industry and to think strategically about longer-term trends. For example, the Investment Association's 'Investing for the Future' paper analyses future short-term and long-term trends and opportunities. UK Finance recently published a [report](#) looking at how unbacked cryptoassets (e.g. exchange or payment tokens) could be regulated in the UK.

- 5.6** Some firms have specific initiatives under way. We are actively engaging with firms and trade associations (for example in relation to proposals for fund tokenisation) to develop our thinking and consider possible necessary rule changes.
- 5.7** We want firms planning their response to technological changes to think about how those changes could drive competition in the interests of consumers, while also balancing consumer protection. New products and services may increase investor choice, or lead to growth in assets under management which is then reflected in economies of scale that benefit both firms and their customers. Consumer-friendly use of technology may encourage consumers, especially younger people, to seek out and engage with a wider range of products and services that meet their financial needs.
- 5.8** Change can bring about better outcomes for customers, including where:
- customers have a better understanding of how their investment is performing and whether it is meeting their needs
  - customers are more engaged in the way their investment is run, with an improved ability to ask questions, express views and hold the fund manager to account
  - increases in efficiency improve the customer proposition for the same costs, or enable fees to be reduced

## Technology in fund operations

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- 5.9** The use of technology is important to the operation of funds management. This includes interaction with clients as well as back-office functions such as transaction settlement and fund accounting. Generally, regulation does not dictate exactly how technology might be used, but it is sometimes prescriptive about processes. This could act to deter firms from finding better solutions. Long-standing processes might be made more efficient through a combination of better technology and fresh thinking about investor outcomes.
- 5.10** Some fund managers are keen to be able to modernise the way units are bought and sold, as an alternative to the traditional UK business model. The IA's '[Direct2Fund](#)' proposition is an optional model which would make it possible for investors to transact directly with the fund when buying and selling units. This would offer an alternative to the current model where the AFM buys and sells units on behalf of the fund and its investors.
- 5.11** We have been engaging with the IA's working group to identify and analyse several different regulatory issues in introducing this new dealing model. These include how investor protections currently afforded by the COLL and CASS rules could be appropriately maintained. Depending on other priorities, if we are able to make satisfactory progress in dealing with these issues, we would hope to be able to consult on rule changes to establish the new model.

**Q14: Do respondents agree that we should work towards consulting on rules to implement the 'Direct2Fund' model?**

## Fund tokenisation

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- 5.12** 'Fund tokenisation' is a phrase in increasing use, though it may be used in different ways. We understand it to mean the ability to issue a fund's rights of participation (units or shares) to investors as digital tokens, usually by means of a distributed ledger. In this case, tokenisation is at the level of the interactions between the fund manager, the fund, and its investors, and doesn't affect either the choice of investments that the fund holds or the way they are bought, held, and sold.
- 5.13** Advocates of fund tokenisation think it will simplify the way units of funds are bought and sold. It would do this by potentially eliminating some of the participants in the process and making remaining interactions more efficient. In principle, where a fund issues its units via a distributed ledger, the ledger is the sole and incorruptible record of the number of units held by each participant. Assuming the ledger accurately reflects ownership at the time the record is created, there should be no need for a separate unitholder register to be maintained. Operating funds in this way could lead to greater efficiency with resulting cost savings, and faster transactions, as well as eliminating potential administrative errors.
- 5.14** Existing rules that govern how units are created, transferred, registered, and ultimately cancelled might not be flexible enough to allow firms to operate a 'digital register'. We are open to exploring what would need to be done to enable this. We would also need to consider specific new risks associated with using the technology, for example in relation to operational resilience.
- 5.15** Work is already under way on this, and the level of priority that is assigned to tokenisation will determine when we might consult on rule changes. We welcome input from stakeholders about any areas where rules or guidance would be necessary or helpful to enable tokenisation of units in authorised funds, and an indication of how much of a priority this should be for us to take forward.
- 5.16** We would like to understand better what interest there would be, in the short to medium term, from investors able to use this technology. Some large intermediate unitholders – either institutions or retail platform providers – might be interested in using it to handle their interactions with the fund itself, which generally involve aggregation of multiple client instructions. In the longer term, once the technology has been properly trialled in the wholesale market, it could start to become more practical and cost-efficient for at least some private retail investors to hold units directly in this way.

**Q15: What benefits would tokenised units in authorised funds provide for investors? What regulatory changes would be needed to enable tokenised units to be issued? How much of a priority should we put on enabling tokenisation of units?**

## Tokenised portfolio assets

- 5.17** For some managers, fund tokenisation might be of interest as part of a wider programme in which existing assets could be held in the underlying portfolio of the fund and traded in a secondary market in tokenised form, with fully digitised clearing and settlement. An authorised fund may be able to hold securities tokens where the instrument represented by the token is itself eligible for investment.
- 5.18** This kind of initiative would obviously be dependent on progress involving a wide range of market participants, not only in the UK but in other jurisdictions with large securities markets. The government's Digitisation Taskforce will be considering many of the relevant issues in this area. Tokenisation also raises regulatory issues which we would want to consider in a cross-cutting way, such as the implications for the role of custodians and how to manage the distinction between regulated and unregulated activities.
- 5.19** We welcome input from stakeholders about how fund regulation should respond to the implications of a growing market in tokenised financial instruments. We think that this could be of particular interest to managers of QIS and LTAFs, for example in the context of holding tokens representing fractional interests in real estate or an infrastructure project. These could be more easily transferable than traditional forms of title and so be helpful for a fund's liquidity management.

**Q16: Are there specific rules that could impact firms' ability to invest in tokenised assets, where the underlying instrument is itself an eligible asset? How much of a priority should we put on enabling investment in tokenised assets?**

## Investment in cryptoassets

- 5.20** Some stakeholders might want us to explore the possibility of broadening the scope of eligible assets to include unregulated tokens, such as stablecoins and other forms of cryptocurrency. Since these are not currently permitted investments, it is not currently possible for authorised funds to hold them.
- 5.21** The Government has recently consulted on the next phase of its plans for regulating cryptoassets in the UK. At this stage, it is considering whether there is a case for bringing the activity of portfolio management of cryptoassets into the regulatory perimeter. Until the Government has advanced its thinking on this matter, it would not be appropriate for us to do further work on the scope of the authorised funds regime.
- 5.22** We will continue to engage with industry stakeholders to enhance our understanding of market trends.

**Q17: How important do you think the different kinds of 'fund tokenisation' discussed above are for the future of the industry? Are there examples from other jurisdictions that could be models for UK fund regulation?**

**Q18:** What other regulatory changes, if any, would you like to see to enable fund managers to make wider use of advances in technology without weakening investor protection?

## Chapter 6

# Improving investor engagement through technology

- 6.1** In this chapter, we look at how our fund rules could be revised, in the light of developments in technology, to improve investor engagement. This is particularly relevant to the experience of retail investors once they have invested in their chosen fund(s). This chapter covers the post-sale information that fund managers give investors and the wider market about the fund and its activities, and how retail investors can interact with the fund manager and make their views known.

## Ongoing information needs of investors

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- 6.2** Regulation has focused on ensuring prospective investors have the right information about a product or service before they commit money to it. This enables investors to be confident it will meet their needs and their risk appetite. Our [discussion paper DP22/6](#) sets out our thinking on the future disclosure framework, with a particular focus on designing and delivering a framework that supports retail investors in making informed investment decisions.
- 6.3** The new Consumer Duty will require fund managers, in line with other firms, to give consumers the information they need, at the right time, and presented in a way they can understand. It also requires firms to provide a level of support that meets consumers' needs throughout their relationship with the firm. This will bring more focus to the ongoing information needs of investors after their investment decision has been made, since most investments in funds are medium to long-term commitments.
- 6.4** In this chapter, we consider the fund prospectus, and the periodic manager's reports and accounts. We want to focus on how these documents, required by regulation, could be redesigned to engage investors' attention and interest, especially if presented in a digital format. This builds on our previous work on [smarter consumer communications](#) as well as some of the themes in DP22/6 on the delivery, presentation and content of disclosure information.
- 6.5** We could then consider further rules or guidance on the content and design of fund documents that are published and transmitted by electronic means. This could not only benefit investors directly, but improve transparency to the market more widely, driving more effective comparisons between products which in turn would support competition in consumers' interests.

## The fund prospectus

- 6.6** For authorised fund investors, the fund prospectus is the formal source of information about a fund. It complements the shorter, more focused disclosure document, such as the UCITS key investor information document, given to retail investors at the

point of sale. The prospectus and the constituting instrument (eg the instrument of incorporation of an investment company with variable capital or the trust deed of an authorised unit trust) are effectively the terms and conditions of the contract between the AFM and the investor. Scrutiny of the draft prospectus is an important part of our fund authorisation process that we are updating this year.

- 6.7** However, prospectuses are generally written in legal, technical language, often including generic elements such as a copy-out of FCA rules. Although they must be made available to prospective and existing investors on demand, some AFMs put little effort into making it easy to find them online. The term 'prospectus' is itself rather opaque and unhelpful, which might deter some investors from accessing the document.
- 6.8** Current rules about what must be explicitly included in the prospectus might not reflect all the elements important to investors. For example, there is no explicit requirement for the manager of a UCITS fund to set out the fund's investment strategy (as opposed to its objective and investment policy), or to say how it intends to vote on proposals that relate to underlying holdings.
- 6.9** A prospectus must include any other material information which investors would reasonably require (COLL 4.2.5R (27)). However, in practice some of the most important pieces of information could be hard to find.
- 6.10** We have concerns that the prospectus is not fulfilling its primary function of providing in-depth information to fund investors who want to know more than is set out in the standard consumer disclosure documents. We might modernise prospectus disclosures in several ways. For example, we could consider:
- Redefining and aligning to international best practice what we consider to be the important elements that all investors should understand, so those elements are given sufficient prominence, including for example information and labelling around environmental, social and governance (ESG) matters
  - making the prospectus more modular so that its important elements could be more easily accessed
  - altering the content requirements to support clearer and easier segmentation and allowing incorporation by reference for standard text
  - renaming the prospectus so that it is easier for investors to understand its purpose
  - requiring firms to use tagging, data, or other forms of machine-readable content, to enable more efficient search functions, making the documents more useful to advisers and other intermediaries carrying out comparisons of funds
  - requiring the prospectus to be stored and published under a central repository, such as the FCA's National Storage Mechanism (NSM) which is used by issuers of listed securities, allowing it to be accessed by a wide range of online users to compare, test legitimacy, and comment about
- 6.11** These techniques would help investors and advisers by making the content more easily comparable and available for public scrutiny and give confidence that the document was not a scam. It would be more efficient for us to authorise and supervise.

- 6.12** We welcome any other ideas about how prospectuses could be improved, to give investors a better understanding of the fund and to help fund managers explain their products and services more clearly and consistently. We are open to suggestions about how we can best align our work with future changes to the regime for public offers and admissions to trading, which aims to replace existing requirements for corporate prospectuses.

**Q19: Do you agree that improving the content and readability of the prospectus will improve investor engagement? What specific changes would you like to see?**

### Managers' reports and accounts

- 6.13** The rules around reporting to existing investors centre on the periodic managers' reports and accounts, which are produced yearly (with audited financial statements) and half-yearly, between two and four months in arrears. Fund reports contain much information likely to be of interest to at least some investors, and they also support transparency to the wider market, enabling third parties to analyse, comment on, and compare the activities of funds.
- 6.14** Although all the contents of a manager's report are prescribed, the rules say little about its design, layout, or accessibility. Reports can be published and provided electronically, but they are conceived as paper-based documents and are typically created as flat files (eg PDFs) that are hard to review or interrogate on a screen. It is also hard to extract information from them to compare multiple funds. Managers' reports are often unengaging documents, given little prominence by fund managers, so it is unsurprising that few investors seek them out.
- 6.15** Investors' lack of interest in managers' reports does not necessarily demonstrate a market failure. Ideally, effective competition for business between firms should create disclosure of the information that investors want and need. Monthly factsheets about funds are widely produced, but regulation does not prescribe their content or when firms need to publish them. This may suggest that the needs of many investors are already being met.
- 6.16** We believe there is important information in a manager's report that any reasonable investor would wish to know. This includes details of how the fund is invested, precise and consistent past performance information, and the report on the findings of the AFM's annual assessment of value review. Disclosures about sustainability targets are also essential for those funds that have them. So we continue to think that provision of periodic reports containing key information is an essential element of consumer protection.
- 6.17** However, when the manager's report rules were written, they aimed to take account of the burden of producing and distributing paper-based consumer information. It is now practical for firms to produce and publish digital content relatively quickly and easily, in an accessible format. So arguably, investors have a right to expect more timely and well-presented information from firms than was the case a generation ago, and regulatory standards in this area could be more ambitious on behalf of investors.

- 6.18** In addition, digitally accessed information could be more comprehensive than now, provided it is presented so as not to overwhelm readers. A balance could be struck by using suitable presentation techniques such as layering to make sure the essential elements are presented clearly and concisely, while allowing investors to access another area to look at the details if they wished.
- 6.19** Actively managed funds could be more transparent about their portfolio holdings. Many commentators complain about the lack of regular lists of detailed portfolio holdings (even though these are contained in annual and half-yearly reports). We could consider requiring portfolio holdings to be published more frequently (quarterly or even monthly). A published update might also be useful for investors when there are significant portfolio changes or adjustments to investment strategy, especially after unexpected events such as the Russian invasion of Ukraine or the recent turbulence affecting the gilt market.
- 6.20** Publishing the information in annual and half-yearly reports in a machine-readable format could be of benefit. It might enable aggregators of information to extract data and repackage it in a user-friendly way. This in turn could allow easier comparisons to be made between competing products. There are already [standards for digital financial reporting](#) that apply to companies whose transferable securities are admitted to trading on UK regulated markets. Although the specific standards for those reports might not be suitable for authorised funds, they set a precedent for how we could approach longer-term developments to drive transparency. A common template to allow machine readability could be developed alongside, or as part of, future revisions of the accounting standards for authorised funds (the Statement of Recommended Practice).
- 6.21** We could enhance our rules to explicitly require the prospectus and the reports and accounts of each fund to be published in a prominent and easily accessible place on the fund manager's website.
- 6.22** Alternatively, or in addition, we could look at using a mechanism such as the NSM to store fund reports alongside company reports, allowing public access through a single portal to information across the whole range of UK authorised funds.
- 6.23** A more radical option would be to rethink the purpose and structure of periodic reports and accounts. The Financial Reporting Council published a [consultation paper](#) in 2021 on the future of corporate reporting, looking at how company reports could be modernised, for example by breaking them down into a set of interlinked reports, each of which is focused on a specific area. Some of the proposals set out in that document could be relevant to fund reports as well, with advances in digital publication acting as the catalyst for cost-efficient change.
- 6.24** If there is support for these more radical approaches, we could introduce flexibility to our rules so that AFMs can decide for themselves how much they wish to adapt existing disclosures to take advantage of new technology. On the other hand, there might be significant one-off costs for fund managers and distributors, who might prefer to direct their resources to other developments enhancing customer service. A more prescriptive regulatory intervention might bring about longer-term benefit, such as increased investor engagement at individual fund level, and greater consumer confidence in the market.

**6.25** We would especially like to hear from consumers and their representatives about whether the existing market is meeting investors' ongoing information needs, and what improvements they would like to see delivered through better use of technology.

**Q20: What changes to the rules for managers' reports and accounts could enable firms to make best use of technology to meet investors' information needs? How else could disclosure of ongoing information to fund investors be improved? For example would there be benefit in us consolidating ongoing annual disclosure reports for funds?**

## Investor engagement

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- 6.26** In the past twenty years, the way ordinary retail investors interact with fund managers has been transformed. Historically, an investor would contract directly with the fund manager when buying units (whether or not they also used a financial adviser) and would be registered as the holder of the units. This business model has largely become obsolete, with the growth of platform service providers and wealth managers allowing investors to manage their relationships with multiple product providers through a single gateway. Platform providers and other intermediaries are now estimated to hold approximately £950 billion of client assets on behalf of over 8.8 million retail customers.
- 6.27** The growth of intermediaries has transformed the concept of the 'unitholder' – the natural or legal person in whose name units are registered. In most cases, the unitholder is now a nominee of whichever service provider the end investor has chosen. Our rules for authorised funds still assume, in several places, that investors are also the registered unitholders. This supposes that the fund manager and the investor are able and willing to interact directly with each other, whereas in fact the platform provider or other intermediary has a crucial role to play in the relationship as 'intermediate unitholder'.
- 6.28** Our rules may no longer achieve their aim of ensuring a fair balance between the interests of the investor and the fund manager. For example, unitholder meetings are an important fund governance mechanism, allowing participants in a fund to approve or reject strategic proposals such as a future change to its investment aims, or a merger with another fund. These meetings ought to maximise opportunities for investors to participate and have their voices heard. Rules that fail to recognise the presence of the intermediate unitholder may inadvertently disenfranchise investors, at the same time making it difficult for fund managers to deliver changes in a timely way.
- 6.29** When the Covid-19 lockdowns were introduced in March 2020, we recognised that the rules requiring unitholder meetings to be convened in a physical location could not be enforced. As a supervisory forbearance measure, we allowed unitholder meetings to be held in virtual form, so that AFMs could continue to seek approval for important changes. We intend to consult on changing those rules to allow virtual or hybrid meetings as a permanent arrangement, while ensuring that all formats respect unitholders' rights and enable appropriate participation.

**6.30** As suggested above, we think better use of technology could improve attendance and participation at unitholder meetings. For example, customers of platforms could be enabled to attend and take part in virtual meetings through suitable online identity validation. Platforms, as the registered holders of the units, could enable their customers to vote electronically on proposals and then submit those consolidated votes to the meeting. Firms could also explore how to introduce straight-through processing of votes from the registered unitholder to the AFM and depositary. We could review the prescribed timelines for these processes, either extending or shortening them to take account of stakeholders' needs.

**Q21: Do you agree we should review the rules for unitholder meetings? What changes should we make so that these meetings maximise the participation of fund investors?**

**6.31** Better use of technology could also improve interactions between the fund manager and fund investors in other ways where an intermediate unitholder is involved. Fund managers may be relatively unsighted about the profile of investors in their funds where they lack a direct relationship, making it harder for the manager to assess how to act in their best interests. Conversely, investors may find it hard to make their voice heard by the fund manager over issues such as the fund's strategy, its approach to ESG considerations, or its stewardship policy for engaging with the companies in which the fund invests.

**6.32** The market already offers solutions to some of these problems. There are firms offering an online service to customers that hold securities indirectly, so they can see which underlying companies in their portfolio have upcoming shareholder votes and can express a voting preference on the proposals. Some managers already hold online forums to present and explain their strategies and take questions from investors. Others have been trialling tools for fund investors to direct the AFM how to vote the portion of portfolio shares represented by their units, according to a predetermined strategy.

**6.33** We would like to hear views about whether such initiatives should be considered best practice, for firms to do if they choose, or whether regulatory intervention should drive wider adoption by managers and intermediate unitholders. We recognise there is a discussion to be had around the costs and benefits, in particular whether there is merit in us requiring fund managers to provide such services as a general good (potentially out of the overall fee paid by all investors). There are also questions of fairness, as the AFM must act in the interests of the fund and its investors as a whole. So it would need to consider how it could give due weight to the views of a potential minority of very engaged investors while respecting the interests of other investors.

**Q22: How could the relationships between fund manager, intermediary and investor be better reflected in rules for authorised funds? Should the FCA do more to enable investors to engage with the manager of their fund?**

## Chapter 7

# Conclusion

- 7.1** This paper has set out some possible options for change in the regulation of fund and asset management in the UK. We want feedback from a wide range of stakeholders, including consumers and those representing consumers. We want to make sure that we have a balanced viewpoint on which areas we should focus on and prioritise. We want to understand if there are relevant market developments that we have not considered. We also want to understand if there might be unintended consequences if we took any of the approaches suggested in this paper.
- 7.2** Alongside this DP we plan to engage with a wide range of stakeholders in forums and roundtables as well as individual meetings. As we develop specific policy proposals, we may also convene groups or run policy sprints to support us in considering potential options and understanding the consequences of taking different approaches.
- 7.3** Our next steps following consideration of the responses will be to consider what, if any, amendments we should make to the UK regime for funds and asset managers as we incorporate elements of the retained EU law for funds and asset managers into the FCA Handbook. This will be subject to the FRF changes going ahead as proposed and the Treasury's timelines for repealing the relevant areas of EU law. We will also consider whether there are other aspects of our rules that may need changing. Where these are within the powers of the FCA to deal with, we will consider consulting on them. Where these will require action from other stakeholders such as the Treasury, we will work with them.

**Q23: Do you have any comments on the relative benefits of the topics raised in this paper which you think we should consider as part of prioritising our work? How would you rank the areas covered in this paper in terms of priority? (The response form for this question provides a tool for ranking the 10 major topics set out in Table 1 on p.14)**

**Q24: Do you have any comments on potential reform of the UK regulatory regime for asset managers and funds in areas that are in scope of this paper but have not been discussed in detail?**

## Annex 1

### List of questions

- Q1:** Do you think that we should aim to create a common framework of rules for asset managers? What benefits would you see from this? What costs might this create? If you do not think we should do this, are there any areas discussed above where we should consider taking action, even if we do not create a common framework of rules? What would we need to consider around the timing of implementing a change like this?
- Q2:** Do you think we should change the boundary of the UK UCITS regime? If so, do you think we should take any of the three approaches set out here? Should we consider any alternative approaches? What timeframe would be needed to allow firms to change their existing product offering or to develop new products?
- Q3:** Do you think we should work with the Treasury to amend the threshold at which AIFMs must apply the full-scope rules? If so, do you have any comments on the options described above? Are there any other areas we would need to consider if we were to do this?
- Q4:** Are there aspects of the current AIFM regime that professional investors do not value? Would there be benefit in us removing any of these?
- Q5:** Do you think that we should amend our fund rules or add guidance either to make clearer the requirements on portfolio managers of funds, or to set minimum contractual requirements between host AFMs and portfolio managers? Do you think this would lead to any other consequences that we need to consider?
- Q6:** Do you have any comments on us potentially amending the rules and guidance around liquidity stress testing?
- Q7:** Do you have any comments on whether we should make our rules on liquidity management and anti-dilution clearer?

- Q8:** Do you have any comments on the benefits or costs associated with public disclosure of fund liquidity?
- Q9:** Do you have any comments on us making our expectations on investment due diligence clearer for all asset managers?
- Q10:** Do you agree that we should make our expectations of depositaries clearer? Do you have any comments on the areas where greater clarification would be desirable? Are there any areas where we should consider removing oversight functions from depositaries? Are there areas where the contribution of depositaries is particularly valuable for the interests of investors?
- Q11:** Do you have comments on the analysis of the eligible assets rules for UCITS set out here? Do you think we should update or provide guidance on these rules? If we did so, what impact would this have for managers of UCITS funds?
- Q12:** Do you have any comments on whether we should consider removing or modifying detailed or prescriptive requirements in the rules on prudent spread of risk?
- Q13:** Are there any other areas where you think we should consider removing or modifying prescriptive requirements in the retail fund rules?
- Q14:** Do respondents agree that we should work towards consulting on rules to implement the 'Direct2Fund' model?
- Q15:** What benefits would tokenised units in authorised funds provide for investors? What regulatory changes would be needed to enable tokenised units to be issued? How much of a priority should we put on enabling tokenisation of units?
- Q16:** Are there specific rules that could impact firms' ability to invest in tokenised assets, where the underlying instrument is itself an eligible asset? How much of a priority should we put on enabling investment in tokenised assets?

- Q17:** How important do you think the different kinds of 'fund tokenisation' discussed above are for the future of the industry? Are there examples from other jurisdictions that could be models for UK fund regulation?
- Q18:** What other regulatory changes, if any, would you like to see to enable fund managers to make wider use of advances in technology without weakening investor protection?
- Q19:** Do you agree that improving the content and readability of the prospectus will improve investor engagement? What specific changes would you like to see?
- Q20:** What changes to the rules for managers' reports and accounts could enable firms to make best use of technology to meet investors' information needs? How else could disclosure of ongoing information to fund investors be improved? For example would there be benefit in us consolidating ongoing annual disclosure reports for funds?
- Q21:** Do you agree we should review the rules for unitholder meetings? What changes should we make so that these meetings maximise the participation of fund investors?
- Q22:** How could the relationships between fund manager, intermediary and investor be better reflected in rules for authorised funds? Should the FCA do more to enable investors to engage with the manager of their fund?
- Q23:** Do you have any comments on the relative benefits of the topics raised in this paper which you think we should consider as part of prioritising our work? How would you rank the areas covered in this paper in terms of priority? (The response form for this question provides a tool for ranking the 10 major topics set out in Table 1 on p.14)
- Q24:** Do you have any comments on potential reform of the UK regulatory regime for asset managers and funds in areas that are in scope of this paper but have not been discussed in detail?

## Annex 2

# Abbreviations used in this paper

<b>Abbreviation</b>	<b>Description</b>
<b>AFM</b>	Authorised fund manager
<b>AIF</b>	Alternative investment fund
<b>AIFM</b>	Alternative investment fund manager
<b>AIFMD</b>	Alternative Investment Fund Managers directive (Directive 2011/61/EU)
<b>COBS</b>	Conduct of Business Sourcebook
<b>COLL</b>	Collective Investment Schemes sourcebook
<b>DP</b>	Discussion paper
<b>ESG</b>	Environmental, social and governance
<b>ESMA</b>	European Securities and Markets Authority
<b>EU</b>	European Union
<b>FCA</b>	Financial Conduct Authority
<b>FRF</b>	Future regulatory framework
<b>FSB</b>	Financial Stability Board
<b>FUND</b>	Investment Funds sourcebook
<b>HMRC</b>	His Majesty's Revenue and Customs
<b>IA</b>	Investment Association
<b>IOSCO</b>	International Organization of Securities Commissions
<b>ISA</b>	Individual Savings Account
<b>LTAfF</b>	Long-term asset fund
<b>MiFID</b>	Markets in Financial Instruments directive (Directive 2014/65/EU)
<b>NSM</b>	National storage mechanism

Abbreviation	Description
NURS	Non-UCITS retail scheme
QIS	Qualified investor scheme
SYSC	Senior Management Arrangements, Systems and Controls sourcebook
UCITS	Undertakings for collective investment in transferable securities
UK	United Kingdom

We have carried out this work in the context of the existing UK regulatory framework, which includes the onshored EU regulations.

We will make all responses to this Discussion Paper available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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