March 8, 2023

Skadden

Investment Management Alert

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To Change or Not To Change: FCA Considers Updates to the UK Regulatory Regime for Asset Management

On 20 February 2023, the UK's Financial Conduct Authority (FCA) released a discussion paper titled "Updating and Improving the UK Regime for Asset Management" (Discussion Paper), seeking industry feedback on potential changes to the current regulatory regime for funds and asset managers. The FCA's stated aim is to ensure that any changes better meet the needs of international and domestic investors; enable technological development; are consistent with international standards to ensure that firms can operate on a global basis; and are effective and proportionate.

Although many of the changes are targeted at the retail asset management sector, there will be some direct and indirect impact on private capital businesses, particularly those considering targeting retail investment. The deadline for submission of responses is 22 May 2023. If the FCA determines that rule changes are appropriate, the next stage would be the issuance of a consultation paper on some, or all, of these topics.

Proposed Structural Changes

The FCA has acknowledged that the existing regulatory framework for asset managers, as derived from European Union directives and regulations, is not customised to suit the activities of UK firms, and is not always as clear or coherent as intended. By addressing any inconsistencies and standardising the rules, the goal is to reduce costs and improve the operational efficiency of UK firms.

Arguably the most significant structural change is the proposal to create a single rulebook with a view to addressing unnecessary differences between different types of asset managers. The rules would apply to firms which currently manage funds subject to rules derived from the EU's Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, the Alternative Investment Funds Manager Directive (AIFMD), and Markets in Financial Instruments Directive (MiFID).

In referencing technical differences in the current rules, the FCA has drawn attention to the rules relating to the management of conflicts of interest. It highlighted substantive differences in relation to applicable conduct rules, and the standards applicable to MiFID portfolio managers and full-scope alternative investment fund managers (AIFMs). While noting the possible benefits of consolidating the rules, including reducing firms' compliance burden and improving competition, the FCA have also noted that such changes could result in significant one-off costs and disruption for firms and stakeholders. In order to address the potential downsides, the FCA would allow a lengthy implementation period.

Potential Areas of Improvement

The FCA set out specific parts of the regulatory regime which it considers can be improved to deliver better outcomes for retail and professional investors. Of particular interest to private capital businesses are these proposals:

1. **Host AFMs:** Specific contractual provisions should be included in agreements between authorised fund managers and the portfolio managers to whom they delegate.
2. **Liquidity management:** The liquidity stress testing guidelines issued by the European Securities and Markets Authority should be incorporated into the FCA's rules and guidance to ensure that all asset managers carry out liquidity stress tests.
3. **Investment due diligence:** The expectations and requirements for investment due diligence should be consistent across all types of asset management activities.

This list highlights just a few of the potential changes, but the potential scope of the changes under consideration is vast. As a result, the FCA has expressed concerns about the potential impact of policy alterations on the market, the associated policy-making time and resource costs, and the operational and cost impact on firms. The FCA has also emphasised that it will "only reform the regulation of the sector where there are clear benefits from doing so", subject to a full public consultation and appropriate cost benefits analysis. It is, therefore, unclear how extensive changes to the current UK regulatory regime will be, or the timeframe for any changes to be introduced.