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# A Regulatory Tightrope: Updating the UK Regulatory Regime for Asset Managers

In a speech at the Investment Association's Annual Dinner on 11 October 2023, Ashley Alder, chair of the UK's Financial Conduct Authority (FCA), expanded upon the FCA's discussion paper, "Updating and Improving the UK Regime for Asset Management" (Discussion Paper) published in February 2023. Mr. Alder discussed the strategic objectives guiding the FCA's proposals, and outlined the FCA's regulatory priorities:

1. Making the Alternative Investment Fund Manager (AIFM) regime more proportionate.
2. Updating the regulatory framework for retail funds.
3. Supporting technological innovation, including the tokenisation of funds.

In this alert, we consider the key elements of the speech and what UK asset managers can take away from it. See also our 8 March 2023 alert "To Change or Not To Change: FCA Considers Updates to the UK Regulatory Regime for Asset Management" for analysis of the Discussion Paper.

## Strategic Objectives

Following the adoption of the Financial Markets and Services Act 2023 in June, the FCA is subject to a new secondary statutory objective of advancing competitiveness and growth in the UK financial services industry. In his speech, Mr. Alder explained that he believes the competitiveness objective is to be fulfilled by promoting proportional regulation, which he described as proportionality in relation to firms' size and customer base.

Speaking just five days after Mr. Alder at the City Dinner, Nikhil Rathi, the FCA's chief executive, echoed Mr. Alder's message, saying that the five essential ingredients for international competitiveness are "an effective regulator, an international standard-bearer, far-reaching reforms to support a bolder risk appetite, a raised ambition on data and digital infrastructure and the best talent".

Mr. Alder acknowledged the potential for firms to suffer from "policy overload" regarding proposed reforms and noted that the FCA is aware that global firms will be striving to comply with requirements in multiple jurisdictions. In particular, the speech noted that, while some new rules may differ from the existing European Union regulations, the FCA is pursuing reforms which "interact effectively" with other jurisdictions and prevent "unnecessary complexity" for firms operating internationally.

## Changes to the AIFM Regime

The FCA proposes to retain the core of the EU's AIFM Directive, while reforming it at the margins to make it more proportionate for in-scope firms and to tailor the regime to the UK market. The key proposed changes are as follows:

 

- Introduction of a "set of consistent rules" applying across all of the categories of AIFMs. The FCA considers the current sharp distinction between sub-threshold and over-threshold AIFMs, to which different rules apply, to be unsatisfactory. Instead, the FCA wants a more nuanced and gradual application of the rules, which is proportionate to the nature and scale of a firm's business.
- Possible repeal of the rule preventing AIFMs carrying out other activities through the same legal entity.
- Possible easing of some of the current reporting requirements under the EU's AIFM Directive.

The review and consultations on amending the AIFM regime are scheduled to take place in 2024, while the reporting requirements will only be reviewed in 2025.

An initial proposal by the FCA to consolidate the rules for different types of asset managers, which are currently scattered across different legal acts and retained EU law, and in different sections of the FCA Handbook, has been abandoned. Instead, the FCA will prioritise "targeted reforms intended to make a tangible, positive difference".

## Reforms to the Retail Funds Regime

In the Discussion Paper, the FCA observed that the complexities in the Undertakings for Collective Investment in Transferable Securities (UCITS) regime stifle investment from mainstream retail investors without providing an increased level of consumer protection. Specifically, the FCA cited the rules on UCITS feeder funds and the sharp divergence in the rules applying to UCITS and Non UCITS Retail Scheme (NURS) funds as potential areas of improvement.

Mr. Alder reiterated the FCA's desire to unlock domestic retail investment, in tandem with the government's plans to funnel domestic savings into UK productive assets. Responding to the feedback to the Discussion Paper, Mr. Alder underlined the need for a "far clearer distinction" in in the regulation applicable to managers of authorised retail funds, on the one hand, and managers of alternative investment funds, on the other, with the objective to "simplify the retail rules for non-UCITS funds". The FCA is also considering "rebranding" non-UCITS funds to "rationalise the regime", and has welcomed further dialogue on branding options.

It remains to be seen whether these policy changes will support or hinder the "retailisation" of private funds for UK investors. The consultation and review of the retail funds regime is scheduled to start in 2024 but, given the abstract nature of the current proposals, we are unlikely to see any concrete rule changes in the short term.

## Supporting Technical Innovation

In the Discussion Paper, the FCA also addressed the topic of fund tokenisation, to allow a fund's rights of participation to be issued to investors as digital tokens, and how fund managers may use distributed ledger technology to achieve this.

Mr. Alder outlined the FCA's efforts to enable fund tokenisation, including plans by the Treasury's Technology Working Group to publish a blueprint for fund tokenisation later this year. However, he provided no updates regarding the possible classification of stablecoins and cryptocurrencies as permitted fund investments. Consequently, it is likely that authorised funds will remain barred from holding them for the foreseeable future.

The chair of the FCA also highlighted the regulator's commitment to staying abreast of technological advancement by holding "tech-sprints with the industry to test policy initiatives and rule changes" in anticipation of a potentially widespread adoption of distributed ledger technology, and participating in the Investment Association's Direct2Fund initiative, which aims to facilitate direct transactions between investors and funds, bypassing the authorised fund managers, thereby increasing efficiency.

In the area of new technology, it appears that the FCA is only "dipping its toe in the water". With the acceleration of technology like artificial intelligence, the FCA may soon find it has to dive deeper.

## Conclusion

While the FCA has a difficult tightrope to walk, the speech emphasised that the authority would like to establish a regime for the asset management sector that both sets and tests high standards, but that does not create unnecessary complexity for firms and can promote competitiveness, growth and innovation in the UK market. In order to achieve this aim, the regulator appears to be focused on tailored and targeted reform, rather than wholesale change that may affect the ability of global funds to operate on a cross-jurisdictional basis.

Fund managers operating in the UK are likely to welcome efforts by the FCA to ensure the UK remains a robust and competitive market. However, it remains unclear how soon any of these changes will be brought in. As an example, notwithstanding an extensive consultation on the topic, the FCA proposed rules regarding environmental, social and governance (ESG) fund labelling and "greenwashing" remain unpublished even as other regulators around the globe press ahead in that area. This means that fund managers will need to manage updates in compliance with global standards while sticking to the status quo in the UK.