

## FCA COMMENCES WIDE-RANGING REVIEW OF ASSET MANAGEMENT REGULATION

In February 2023, the UK's FCA published a [discussion paper](#) (DP23/2) on updating and improving the UK regime for asset management. The discussion paper forms part of the UK's current work of reviewing and assimilating EU-derived financial services regulation into UK law and the UK regulators' rulebooks. It seeks views on a vast spectrum of issues, from the structure of UK asset management regulation to fund tokenisation. Responses to the discussion paper will shape the future regulation of the UK's asset management sector.

### BACKGROUND

When the UK withdrew from the EU in the process known as Brexit, it 'onshored' EU financial services regulation. This ensured the continuity of regulatory requirements in the UK post-Brexit, preventing any "cliff-edge" in which voids were left in UK regulation when EU regulation ceased to apply. Onshoring was, however, only intended to be a temporary measure, not least because it left the UK with a complex regulatory system in which requirements are spread throughout multiple sources.

Since Brexit, the UK has conducted a series of reviews to seek views on how the UK's financial services regulation should adapt to the UK's position outside the EU. These were followed by the publication in 2022 of the Financial Services and Markets Bill. Under powers contained in the Bill, HM Treasury, the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) will start to move financial services requirements from the complex web of onshored EU legislation into the FCA and PRA rulebooks, ultimately repealing the onshored EU legislation. This is intended to simplify the regulatory framework from a procedural perspective, and to create a more flexible body of rules for the future.

With this process of moving requirements from onshored legislation into UK sources comes the opportunity to review and modernise the substance of those requirements. The FCA's February 2023 discussion paper on updating and improving the UK regime for asset management begins a discussion around whether and how to do this in the asset management sector.

#### Key issues

- The UK's FCA has published a discussion paper on updating and improving the UK regime for asset management.
- Responses to the discussion paper will shape the FCA's approach to its forthcoming task of reviewing EU-derived financial services requirements, amending them where appropriate, and incorporating them into the FCA Handbook.
- The discussion paper indicates willingness to consider a fundamental reshaping of the UK's asset management regulation, including by replacing the existing differing regimes for UCITS management companies, AIFMs and MIFID portfolio managers with one unified ruleset for asset managers.
- The discussion paper also extends beyond reviewing and revising EU asset management requirements, into discussion of potentially implementing rulesets to facilitate a Direct2Fund model and fund tokenisation. It also refers to potentially clarifying rules and expectations for custodians and depositaries.
- The discussion paper closes for responses on 22 May 2023.

## DISCUSSION POINTS

The discussion paper seeks input on a range of issues, with a particular (but not exclusive) focus on the authorised retail funds space. It also extends beyond discussion of onshored EU requirements, asking questions relating to developing fund tokenisation in the UK, and beyond the requirements for asset managers, asking questions relating to depositaries and custodians and their own rulesets. Key discussion points include:

- **Consolidating requirements into one common regime for all types of asset managers**

The discussion paper notes the existing structure of UK asset management regulation, in which there are different types of asset manager (broadly: managers of alternative investment funds (AIFMs); managers of undertakings for collective investment in transferable securities (UCITS management companies); and firms that carry on portfolio management within the scope of the Markets in Financial Instruments Directive (MiFID portfolio managers), each of which is subject to a different regulatory regime with differing requirements.

The discussion paper seeks views on whether to create a single, common framework for all types of asset managers. Creating a single common framework could have significant long-term advantages, removing legal and operational complexity for firms, particularly those that fall within more than one of the above regulatory regimes, and ultimately resulting in a more cohesive ruleset. It would also, to an extent, reflect the direction of travel in the EU. As part of its proposed AIFMD2 package, the EU is considering potential amendments to the UCITS Directive which would, in some areas, align UCITS requirements with those under the AIFMD. However, the FCA may find that some managers are concerned that realigning the rules in this manner would involve material change to those rules, and that with change comes cost, at least in the short term. As a result, the appetite for this fundamental restructuring of the UK's asset management regimes remains to be seen.

- **Investigating the boundary between UCITS and NURS**

The UK currently has two key regimes for authorised retail funds: (i) the onshored version of the EU UCITS regime; and (ii) the non-UCITS retail scheme (NURS) regime. Like the UCITS regime, the NURS regime is designed for retail investment but is a purely domestic regime, with differing requirements to those under the UCITS regime.

The discussion paper questions the current boundary between UCITS and NURS, noting that the FCA thinks it unlikely that retail investors perceive a difference between UCITS and NURS and that there may be benefits in setting consistent standards. Managers will need to consider whether they do value the flexibility to choose between UCITS and NURS standards when establishing and operating their funds or whether the two regimes could simply be consolidated into one consistent ruleset.

- **Streamlining requirements for AIFs that have only professional investors**

The discussion paper states that the FCA has had feedback that, in some areas, the AIFMD requirements go beyond what professional investors consider enough to protect their interests. This reflects the sentiments of many operating in the market for private, professional funds and appears to be aligned with certain findings in the [report](#) commissioned by the European Commission into the AIFMD. The latter included statements that "The large majority of institutional investors and trade bodies representing institutional investors (including from third countries) said that AIFMD had not influenced their decisions to invest (or not) through AIFs [...]" and that "There was a strength of opinion among respondents and interviewees that the Article 23 AIFMD requirements on disclosures to investors are excessive in quantity and therefore are ignored or prevent investors from obtaining a clear understanding of the AIF's investment proposal. Experienced and well-informed investors have different reporting needs, it was said."

As a result, the discussion paper questions whether there are aspects of the current AIFMD regime that professional investors do not value and whether there would be any benefit in those aspects being removed. This presents an opportunity for managers and professional investors alike to provide feedback to the FCA on requirements that they find unhelpful or simply lacking any useful function.

- **Implementing a Direct2Fund model**

The FCA's discussion paper asks whether the FCA should consult on rules to implement a Direct2Fund model. The "Direct2Fund" model refers to a model proposed by the UK's Investment Association (IA), under which it would be possible for investors to transact directly with funds when buying and selling units. In the authorised fund market, this would remove the Authorised Fund Manager (AFM) as a counterpart to investors' transactions. This model is already used in several non-UK jurisdictions and has the benefit of removing the risk of loss to investors arising from the potential failure of the AFM. However, the FCA is likely to be conscious that designing and implementing this model will use resource that may need to be directed towards the substantial task of reviewing and incorporating EU requirements into the FCA Handbook in the immediate term.

- **Enabling fund tokenisation**

Fund tokenisation refers to the ability to issue funds' units as digital tokens, which can then be transferred, stored and managed on distributed ledger technology (DLT). This could lead to a reduction in administrative errors relating to maintaining investor registers and, potentially, a reduction in associated costs and faster transactions.

The discussion paper seeks views on the benefits of fund tokenisation, the regulatory changes needed to enable fund tokenisation and the extent to which the FCA should prioritise

enabling fund tokenisation. Implementing rules to facilitate fund tokenisation will involve interesting questions around the extent to which different types of funds, e.g. UCITS and AIFs, would be permitted to use the token structure and the marketing of and access to tokenised funds. The time that may be needed to consider these points is clearly reflected in the FCA's question regarding the extent to which it should prioritise this workstream.

- **Clarifying rules for depositaries**

The discussion paper asks whether there is benefit in clarifying the FCA's rules for depositaries, whether there are areas in which the FCA should remove oversight functions from depositaries and whether there are areas in which the contribution of depositaries is particularly valuable for the interests of investors. The commentary accompanying these questions states that the FCA has found that depositaries have not always intervened or challenged fund managers when the FCA would have expected them to do so. This reflects the FCA's 2022 [letter](#) to custody and fund services firms, in which the FCA emphasised the importance of depositaries' oversight roles (itself a response to recent issues in which the FCA felt that depositaries could have gone further when overseeing certain authorised funds).

- **Refining investor information and investor engagement rules**

The discussion paper seeks views on improving requirements for fund prospectuses, managers' reports and accounts and investor meetings. The FCA's commentary in this section refers to its concern 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 standard consumer disclosure documents, that managers' reports are hard to review, interrogate and compare, and that the FCA's investor engagement rules may no longer achieve their aim of ensuring a fair balance between the interests of investors and the fund manager.

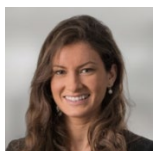
- **Improving technical requirements**

Finally, the discussion paper poses questions relating to technical aspects of existing requirements, including on enhancing liquidity management, improving investment due diligence, clarifying the rules for AFMs, and amending eligible assets requirements for UCITS.

## **NEXT STEPS**

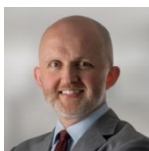
The FCA's discussion paper closes for comments on 22 May 2023. It will be accompanied by a series of roundtables, forums and individual meetings. The FCA states that it expects to publish a feedback statement later in 2023, possibly as part of a consultation paper on some of the topics raised. More broadly, the feedback received will shape the decisions that the FCA makes regarding how to transfer EU-derived requirements into the FCA Handbook and the extent of the changes to make when doing so.

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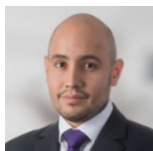
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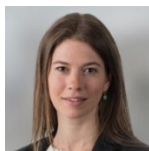
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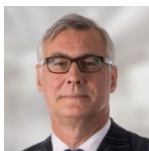
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