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Updating and improving the UK asset management regime

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Modernising the COLL regime to suit current and possible future requirements of UK funds is an important initiative. It is some time since Discussion Paper 23/2 was issued in February 2023 setting out plans for updating and improving the UK regime for asset management. Thankfully, we do now have a few specific initiatives taken forward, hidden within the *FCA's Quarterly Consultation CP23/25* issued in December 2023 .

This Consultation Paper contains a set of proposals covering some of the more straightforward themes for changes and rules agreed to be modernised or clarified. More radical proposals though are still awaited. There are some initial easy wins proposed with the promise of more to come.

Future plans?

Consultation Paper 23/25 is not the end of the process. The Consultation Paper indicates that the FCA is working with the Government on the repeal and replacement of retained EU law and, alongside that, the FCA plans to consult on other amendments to the rules during 2024.

A speech by Ashley Alder, Chair with the FCA, on 11 October 2023 explained about the FCA's more wide-ranging plans, discussing various bigger issues:

General approach

- **a proportionate regulatory approach**

  This means proportionality in a variety of senses. First in relation to a firm's size but also there are indications given that there will be a sensible and proportionate sequencing and management of an intensive multi-year reform agenda. The FCA recognise that some firms suffer policy overload given the sheer volume of reform proposals.

  It is welcome that it is indicated that the FCA wants its rules to interact effectively with requirements of firms that are subject to requirements in other jurisdictions and that they indicate they do not wish to create unnecessary complexity for firms which operate internationally. Their assertion is that they "can right-size and rationalise unnecessarily complex regulation that creates barriers to entry and impedes effective competition". Again, the theme is for focus on proportionality.

Planned workstreams

Proposals set out or heralded in Ashley Alder's speech include:

- **AIFMD regime**

  Whilst retaining the core framework of AIFMD, the FCA would like to set out consistent rules across all managers of alternative funds. Instead of having two different categories of manager and applying different rules to each, the FCA would ensure the regime operates proportionately depending on the nature and scale of a firm's business. This involves working with the Treasury to explore how to make regulation work better for small registered, small authorised and full scope managers.

  A consultation on amending the AIFMD regime and re-evaluating the AIFMD Rules for non-UCITS retail funds is expected in 2024 and, in 2025, a review of the regulatory reporting regime.

  The FCA is also considering changes to some of the requirements – e.g. reporting to regulators for newly established funds, material changes and when there is an acquisition or disposal of major holdings in relation to control of non-listed companies. Thankfully the FCA is considering changes to ease some of these requirements.

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- **Updating the regime for retail funds**

  The FCA herald a far clearer distinction between requirements applying to managers of authorised retail funds and managers of alternative investment funds. The result they indicate is simplification of the retail rules for non-UCITS funds. Thankfully the FCA is going to explore whether non-UCITS funds should be rebranded to help rationalise the regime.

- **Supporting technological innovation**

  On innovation, the Technology Working Group which sits under the Treasury's Asset Management Taskforce has now provided a blueprint for fund tokenisation since this speech. The FCA refer to their tech sprint with the industry to test policy initiatives and rule changes to support work on fund tokenisation.

  The FCA is also building extra capacity to support innovation including the Direct2Fund proposal that they acknowledge could make the fund dealing model and interactions with investors far more efficient, even if direct marketing of tokens maybe some time off.

Use of technology, and fund tokenisation

Before looking at the CP 23/25 specific proposals, it is worth looking at the progress made by the Technology Working Group of the Asset Management Taskforce, with Government regulators and wide-range of market participants. Their Interim Report: A Blueprint for Implementation: Interim Report from the Technology Working Group to the Asset Management Taskforce was published in November 2023 setting out the outcome of this industry collaboration exercise.

We now have a tangible proposal which, within the scope of what is called Phase 1, is a blueprint for fund tokenisation, focussing only on the unit register as an achievable objective that will enable industry to progress in the short term and provide forward momentum. What would change is that the traditional fund register would be replaced by DLT records.

For this initial limited approach, the assertion is that the FCA has not identified any obvious or significant barriers to this baseline approach in the FCA's Rules in COLL, FUND and CASS that apply to authorised funds. This however is subject to further work by firms wishing to take the step – and the FCA is currently reviewing its custody rules for digital assets – see Chapter 5 of the FCA's DP 23/4.

There is an agreed blueprint for implementation of such tokenisation set out in Section 3 of the Interim Report publication. The baseline model characteristics are set out, subject to navigating three items:

- Given that individual models of fund tokenisation will differ, the FCA expect firms to undertake their own due diligence to ensure they comply with their legal and regulatory obligations.
- There have been numerous pilots, proofs of concept etc and the idea is to ensure that there is an ability to leverage a collaborative engagement with the authorities. The IA will act as a conduit between the industry, FCA and HM Treasury over the next three months and ongoing and will also work with relevant stakeholders to promote industry standards and encourage an open market based upon inter-operability and avoiding fragmentation within a three to eighteen month timescale.
- The FCA is exploring whether it could more quickly determine money-laundering regulations registration applications for firms already authorised by the FCA to carry out regulated financial services activities – within a three to six month timeframe. Currently, if there is use of DLT for fund tokenisation purposes, this may require firms to register with the FCA as a crypto-asset exchange provider or a custodian wallet provider, or both, under the money laundering regulations which could be a potential barrier to using fund tokenisation.

The November Interim Report also heralds two further stages:

- a Phase 2 working on further fund tokenisation and exploring further stages – to February 2024; and
- Phase 3, looking at issues around artificial intelligence and other technology utilising new opportunities across the sector – within the first half of 2024.

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So we can look forward to further innovative work on how to use technology to modernise fund operational issues.

CP 23/25 proposals

Within CP 23/25, the "minor adjustments" include the following:

Changes

Some proposals are substantive amendments purported to be designed for a variety of purposes, including making the relevant structure more internationally competitive. Whether or not these minor changes though will succeed in that, given that UK funds are essentially now used for the market place, is a moot point.

- **Enabling virtual or hybrid general meetings of unitholders**

  This involves updating COLL 4.4 to enable the option of electronic participation at general meetings where the instrument constituting the fund permits it. There may be a physical meeting, a virtual meeting or a hybrid meeting.

- **Reinstating clarification on giving notice to joint holders**

  Providing service of a notice or document on any one of the joint holders will be effective service on the other joint holders.

- **Allowing under the COLL Rules something that has previously been allowed by modification and so enabling Shariah-compliant funds**

  COLL 6.7.4R(1) is to be updated, stipulating payments that may be made from the scheme property of an authorised fund so that the portion of investment that is not Shariah-compliant can be identified and segregated for redistributing to a registered charity when they represent the required percentage of dividends for income purification of Shariah-complaint funds. This could relate to establishing Shariah-compliant funds or a Shariah-compliant class of units within a fund.

- **Where a fund invests in units of other funds, "correcting" the rules around investment in second schemes**

  The FCA propose to follow through on LTAF rule COLL 15.6.2R for funds generally – COLL 5.7.1R(2)(b)) in relation to FAIFs and COLL 8.4.1AR(1) in relation to QIS schemes. These other provisions indicate that, where the second scheme is a feeder scheme, each of those rules identified the second scheme as the scheme into which the feeder scheme's master scheme invests, whereas the intention should be to apply the second scheme rules to the master scheme itself – not any other funds into which it in turn invests. A transitional period will be allowed for any FAIF or QIS which might incur a breach because of the change.

  One point to note is that the FAIF regime was likely intentionally different in this regard, as explained in the time of their introduction in 2010. Any consequences of what is now proposed should therefore be carefully reviewed.

- **Broadening the range of investments available under the QIS regime**

  Thankfully they propose to amend the QIS rule, COLL 8.4.4R, to incorporate a new paragraph 1(a) which would be similar to that already available for LTAFs at COLL 15.6.8R(2) so that a QIS can invest in the same types of investments of the LTAF – including investment in loans subject to certain conditions. The rules on investment in collective investment schemes will also be aligned (COLL 8.4.5R and the LTAF rule COLL 15.6.9R).

- **Clarifying comprehensive cover requirements for global exposure in transactions in derivatives and forward transactions in the QIS**

  The aim is to make the QIS a more attractive vehicle by facilitating a broader range of investments and so there is a need to clarify expectations on how a QIS maintains cover for transactions in derivatives and forward transactions. The proposal now is that a QIS should not be subject to any more restrictive requirements when investing in derivatives than either UCITS schemes or NURS and so, to be consistent and more proportionate, there is to be new guidance at COLL 8.4.7-AG setting out expectations for how cover may be determined for a QIS, including the use of a VaR methodology.

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Clarification/updates

Some points are just minor clarifications – or indeed confirmations of the existing position or pre-existing position.

- Clarifying that the accounting date rules apply to new funds at sub-fund level not the umbrella level (which is purely clarification).
- An amendment to COLL 6.7.10R to state that, where a fund has at least one accumulation share class and one income share class in the same fund, it is permissible for the manager to decide to take charges to capital for the income share class and to income for the accumulation share class – subject of course to disclosure in the prospectus and appropriate investor notification.
- Minor amendments to the LTAF rules: Although only recently settled, there are to be minor clarificatory changes to ensure the LTAF rules are consistent with the amendments proposed for the QIS rules. COLL 15.6 is to clarify that the term "dedicated" should be the Glossary term - the same as in the equivalent QIS rules, COLL 8.4. Also, the Glossary definition of "scheme" is to be used in LTAF rule COLL 15.6.9R to align it with the QIS rule.
- Correction of references to IMA SORP to SORP, given that references to the IMA SORP in the Rules and Glossary are no longer accurate with the responsibility for the SORP being with the Investment Association, as it is not called (rather than as formerly The Investment Management Association).

Whilst all these Consultation Paper 23/25 proposals may be perfectly helpful, none is particularly exciting. Any more interesting proposals are yet to come.

It is incumbent on those in the asset management industry to work with the FCA to make sure that there is comprehensive follow through on the wider agenda heralded in Ashley Alder's October speech, and soon.

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