IN-DEPTH

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Slaughter and May

In-Depth: Asset Management (formerly The Asset Management Review) is an incisive general introduction to the complex regulatory frameworks governing asset management activities worldwide, and the related practical issues that arise in the sector. With a focus on recent trends and developments, it covers – among other things – key regulatory hurdles; common asset management structures; main sources of investment; tax implications; and an outlook for future developments.

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United Kingdom

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Summary

Introduction

The United Kingdom (UK) asset management sector remains one of the strongest in the world and an important contributor to the UK economy.[1] The industry, however, is cautious about the future, with the Investment Association (IA) noting the increasing complexity of the regulatory environment and the need for asset managers to navigate various changes to the macroeconomic and political landscape.[2]

Many of the key challenges and opportunities facing the UK asset management sector – the introduction of the Consumer Duty, the regulation of environmental, social, and governance (ESG)-focused investment funds and the prospect, following Brexit, of divergence from the EU regulatory framework – are considered in more detail in this chapter.

Year in review

Key trends

The Consumer Duty

The introduction of the Consumer Duty, intended to set higher and clearer standards of consumer protection across financial services, is having far-reaching effects in the UK financial services sector. Indeed, the Financial Conduct Authority (FCA) sees the introduction of the Consumer Duty as a paradigm shift in the expectations of firms, and it will impact all aspects of firms' operations and culture.

The Consumer Duty comprises a new consumer principle that requires firms to 'deliver good outcomes for retail clients'.[3] This is accompanied by a series of cross-cutting rules-[4] that are designed to embed the standards of care that the FCA expects firms to provide when dealing with retail customers whether directly or indirectly. The cross-cutting rules require that a firm achieves three types of behaviour: (1) act in good faith; (2) avoid causing foreseeable harm to customers; and (3) enable and support customers to pursue their financial objectives. There is also a significant number of additional rules and guidance that relate to four key areas of focus for the FCA with respect to the Consumer Duty: (1) quality of products and services;[5] (2) the price and value of products and services;[6] (3) consumer understanding;[7] and (iv) support for consumers.[8]

All firms that are involved in the design or operation of retail products will be subject to the Consumer Duty and firms are expected to work together to ensure that appropriate information is shared with other firms to ensure they each comply with their own Consumer Duty obligations. While many asset managers do not occupy a position in the distribution chain, which would result in a direct relationship with the end consumer, the scope of the Duty extends to firms that determine or have a material influence over customer outcomes. Asset management firms that manufacture products are expected to ensure that their products are delivering good outcomes for consumers on an ongoing basis.

The Consumer Duty came into force on 31 July 2023 for products and services that are currently open for sale and on 31 July 2024 for products and services that are no longer open to new customers.

Responsible and sustainable investment

Growing concerns around the impact of climate change, as well as an increased focus on equality and diversity, have resulted in a marked growth of interest in responsible and sustainable investment. This has led to a substantial growth in the number of ESG-focused investment funds and, consequentially, a growth in ESG-focused regulation.

In July 2021, the FCA published its guiding principles[9] on ESG and sustainable investment funds in response to the increase in applications to the FCA for authorised investment funds with an ESG or sustainable investment focus. The core overarching principle established by the FCA is that:

> a fund's ESG/sustainability focus [should be] reflected consistently in its design, delivery and disclosure.[10]

Three further FCA principles[11] focus on the design of a fund with respect to its name, strategy and objectives, the fund's ability to deliver upon its disclosed objectives and ensuring that investors are given sufficient information to allow them to make an informed decision about the merits of investing in the fund.

More specific disclosure and reporting obligations in relation to sustainable matters at entity and product-level have proliferated. Disclosure obligations applicable to asset managers[12] under the FCA's new ESG Sourcebook (which forms part of the FCA Handbook) were introduced in 2022, requiring firms to disclose climate-related financial information consistent with the Task Force on Climate Related Financial Disclosures's recommendations on an annual basis.[13] In addition, the ESG Sourcebook contains a range of consumer-facing disclosures[14] and detailed product and entity-level disclosure requirements are expected to enter into force in tranches between 2 December 2024 and 2 December 2026.

Additional regulatory developments relating to this area are in the pipeline or already in force – as discussed at the end of this chapter.

Stewardship and corporate governance

Stewardship and governance remain a topical issue for asset managers given increasing expectations for firms to act as responsible stewards for the companies in which they have invested on their behalf. The UK has had in place a Stewardship Code (published by the Financial Reporting Council (FRC)) since 2010 and UK-authorised asset managers have been required to disclose whether they comply with the Code since December 2010.[15]

The current edition of the UK Stewardship Code (the Stewardship Code 2020), which took effect in January 2020, represented a significant overhaul of the original Code as it sought to reflect and address growing expectations in relation to the stewardship practices of asset managers as well as the broader investment community. Firms applying the Code are

required to submit an annual 'Stewardship Report', which sets out how they have applied the Code in the preceding 12 months and serves as the means by which the FRC assesses whether a firm has met its expectations in terms of compliance in order to qualify (or remain) as a signatory to the Code.

There has been some concern among both asset managers and investee companies that the Code's focus on requiring asset managers to produce detailed reports to qualify as signatories has inadvertently created unnecessary reporting burdens and encouraged a box-ticking approach towards stewardship responsibilities. In February 2024, the FRC announced that it was undertaking a fundamental review of the Stewardship Code to consider whether the Code supports long-term value creation, creates reporting burdens on investee companies as well as asset managers, and has led to short-termism and other unintended consequences.[16] In addition, although the Code does address service providers (including proxy advisers), some industry commentators have noted that there should be more focus on the role of third-party proxy advisers given their perceived influence on voting decisions and stewardship activities of asset managers. The revised Stewardship Code is expected to be published in early 2025.

Regulatory framework

The Financial Services and Markets Act 2000

The main framework for the regulation of asset management activities in the UK is contained in the Financial Services and Markets Act 2000 (FSMA) and various instruments introduced under the powers contained in FSMA.

Regulated activities

FSMA regulates the provision of financial services, including investment services, in the United Kingdom through the concept of regulated activities that may be carried out only by persons who hold appropriate authorisations or are otherwise able to take advantage of a specific exemption from the usual authorisation requirement.[17] Regulated activities are specified activities set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (Regulated Activities Order)[18] that are carried on by way of business in connection with certain specified investments also listed in the Regulated Activities Order.[19] Specified investments include a wide range of financial products, including shares, bonds, government securities, deposits, units in collective investment schemes (CISs) and contracts of insurance. The list of specified activities includes:

1. dealing in investments as principal or agent;
2. arranging deals in investments;
3. managing investments;
4. establishing, operating or winding up a CIS;
5. managing an alternative investment fund (AIF);
6.

managing an undertaking for collective investment in transferable securities (UCITS);[20] and

7. advising on investments.

Many investment managers and certain investment fund vehicles in the UK will require FCA authorisation as they are likely to be carrying out regulated activities, such as advising clients on investments, managing investments or dealing in investments as an agent on their clients' behalf. It is a criminal offence, potentially punishable by up to two years in prison and a fine, for any person who is not authorised or exempt to carry out any regulated activity in the UK.[21]

Financial promotions

FSMA contains a basic prohibition on any person who is not appropriately authorised, acting in the course of business, from communicating an invitation or inducement to engage in investment activity.[22] Investment activity for these purposes includes entering or offering to enter into an agreement, the making or performance of which by either party would be a regulated activity. However, this prohibition will not apply where an appropriately authorised person has approved the content of the proposed communication or if an exemption to the basic prohibition applies.[23]

Collective Investment Schemes (CISs)

The concept of a CIS is a central part of the system of regulation of asset management vehicles in the UK. These are widely defined in FSMA to include:

> any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements . . . to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.[24]

Participants in a CIS must not have day-to-day control over the management of the property.[25] In addition, the relevant arrangements must involve the pooling of participants' contributions and the profits or income out of which payments are to be made to such participants, or the property must be managed as a whole by, or on behalf of, the operator of the scheme,[26] or both.[27] The potentially wide definition of a CIS included in FSMA is narrowed by the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (Collective Investment Schemes Order),[28] which excludes, among other arrangements, all bodies corporate (other than open-ended investment companies (OEICs) and limited liability partnerships), contracts of insurance, and occupational and personal pension schemes.[29] A CIS need not have any particular legal form and, subject to the exemptions outlined above, the concept attaches to a wide range of legal vehicles and contractual arrangements.

If an arrangement is classified as a CIS, a number of important regulatory consequences follow. Units (i.e., rights or interests) in a CIS are a specified investment, and establishing, operating or winding up a CIS are specified activities under FSMA that require FCA

authorisation.[30] The restrictions on financial promotion summarised above will also become relevant. Furthermore, Section 238 FSMA prohibits authorised persons from promoting or marketing unregulated CISs, such as unauthorised unit trusts (UUTs) and hedge funds, except in certain circumstances (e.g., where the promotion is made only to investment professionals).[31] The promotion of unregulated CISs, together with certain close substitutes called non-mainstream pooled investments, is prohibited for the majority of retail investors.[32]

The FCA

The FCA is the conduct-of-business regulator for all authorised firms. It is also responsible for the prudential regulation of all firms not authorised by the Prudential Regulation Authority (PRA). PRA-authorised firms (being, broadly speaking, banks, insurance companies and certain systemically important investment firms) are dual-regulated by the PRA for prudential matters and the FCA in respect of conduct of business. Most investment managers and investment vehicles requiring authorisation are regulated solely by the FCA; however, those deemed to be of significant importance to the UK's wider financial system fall within the ambit of the PRA's supervision.

FSMA confers a wide range of regulatory functions and powers on the FCA. The FCA's statutory objectives include:

1. ensuring that relevant markets function well;
2. protecting and enhancing the integrity of the UK financial system;
3. promoting effective competition in the markets for regulated financial services in the interests of consumers;
4. securing an appropriate degree of protection for consumers; and
5. facilitating the international competitiveness and growth of the UK economy.

Under FSMA, the FCA has extensive rule and code-making powers; it is permitted to issue rules for the purpose of advancing one or more of its statutory objectives. The rules and guidance applicable to FCA-authorised firms are consolidated in the FCA Handbook, which includes high-level standards, conduct-of-business requirements, regulatory guides and specific specialist sourcebooks applicable to a wide range of asset management vehicles and arrangements.[33]

The FCA makes use of a number of supervisory tools in its oversight of the asset management industry, including thematic reviews and market studies, which involve investigations into key current or emerging risks relating to a specific issue or product.

Post-Brexit regulatory framework

Much of the UK's financial services regulatory framework is derived from EU law. However, following Brexit, the UK government began a programme of work reviewing its regulation of the financial services sector to assess whether it is fit for purpose. In December 2022 the government announced the 'Edinburgh Reforms',[34] a package of 30 policy initiatives

for the purpose of achieving an open, sustainable, globally competitive technologically advanced financial services sector.

A key part of the Edinburgh Reforms is an overhaul of the regulatory architecture by moving a large number of the requirements that currently derive from retained EU law from legislation into the rulebooks of the UK regulators – the intended effect being to make the regime much nimbler given the ability of regulators to update rules more quickly. This is achieved through the Financial Services and Markets Act 2023 (FSMA 2023)[35] which establishes the framework for the revocation of all retained EU law relating to financial services and a transition to new requirements under the UK regulatory regime. Given the complexity of the task, this process will take a number of years to complete.

In this context, the FCA published in February 2023 a wide-reaching Discussion Paper[36] on updating the regulation of the asset management industry as part of the general push towards developing a 'smarter' regulatory framework post-Brexit. The Discussion Paper is ambitious in scope – it considers diverse areas from fundamental changes to the structure of the regulation of the UK asset management to examining new technological advancements that could assist the industry (e.g., tokenising fund units). However, despite its ambitious scope, there are few concrete proposals in the Paper and, following discussions[37] with the asset management industry, the FCA has concluded that, apart from considering changes largely to make aspects of the alternative investment funds regime more proportionate, the UK should remain broadly aligned with EU regulation as the industry's appetite for significant divergence from the EU was limited.

Cross-border services

Passporting rights for UK asset management firms to provide cross-border services into the EEA (and vice versa) fell away following Brexit. Firms are therefore required to apply to competent authorities in the relevant EEA Member State for permission to carry out financial services on a jurisdiction-by-jurisdiction basis. Currently, the only exception to this default arrangement would be under the 'equivalence' regime, whereby under certain EU regulatory regimes, if the UK's regulatory regime is deemed 'equivalent' to that of the European Union, and if the UK establishes a reciprocal regime for EEA-based firms to market products and services into the UK, UK firms would be able to rely on their authorisation in the UK to provide their products and services into the EEA. However, this mechanism was not addressed in the UK–EU Trade and Cooperation Agreement and no determinations have been taken by the European Union or the UK that would enable firms to use this regime. The equivalence regime would in any event be of limited use to firms, given that it applies on a per-service or per-activity basis and does not cover all services and activities – for example, there is no equivalence regime applicable to UCITS schemes – and could be withdrawn at short notice.

Common asset management structures

A range of legal vehicles is commonly used for asset management activities in the UK. These include limited companies, trusts and limited partnerships, as well as certain bespoke legal forms specific to the investment funds context. The choice of legal form

of an investment fund will often be influenced by the tax treatment of that fund and the regulatory implications for both the fund and the fund manager that follow from that choice.

Open-ended investment vehicles

Open-ended funds issue and redeem securities to and from investors in a fund on an ongoing basis at a price that is based directly on the underlying net asset value of the investment portfolio held by the fund. In the UK, an open-ended investment vehicle may take the form of an 'unauthorised' unit trust or one of three forms of authorised CISs: authorised unit trusts (AUTs), OEICs and authorised contractual schemes. Such authorised CISs may, in turn, be UCITS schemes, non-UCITS retail schemes or qualified investor schemes, as discussed below.

Unit trusts and AUTs

Unit trusts are the original form of open-ended fund in the UK. Unit trusts rely upon the English common law concept of the trust, under which a trustee (typically, a financial institution experienced in offering trust services) holds the legal title to the trust property on behalf of the beneficiaries (in this case, the investors) who themselves have a beneficial interest in the underlying trust assets. Unlike other general forms of trusts, there will also be a separate fund manager to formulate and implement the unit trust's investment strategy, working alongside the trustee. Trusts themselves do not have any legal personality under English law and therefore cannot contract in their own name. Instead, they are characterised by the trust relationship between the trustee and the beneficiaries, which will be established by the relevant document constituting the trust (which, in the case of unit trusts, is typically termed the 'trust deed').

An AUT scheme is defined in FSMA as a unit trust scheme authorised in accordance with Section 243 FSMA.[38] The FCA may authorise a unit trust scheme if it is satisfied that the requirements contained in that Section are met, the rules in the FCA's Collective Investment Schemes Sourcebook (part of the FCA Handbook, commonly referred to as COLL) have been satisfied, and it has been supplied with a copy of the trust deed constituting the AUT and a certificate signed by a solicitor that states that the requirements in Section 243 and COLL have been met.

AUTs enjoy two key advantages that flow from FCA authorisation. First, an AUT is able to make invitations or financial promotions to participate in the scheme directly to the public in the UK.[39] Second, AUTs are not liable to pay UK tax on the chargeable gains realised on a disposal of assets in their underlying investment portfolios.[40]

If no FCA approval has been granted under Section 243 FSMA, the unit trust will be an 'unauthorised' unit trust (UUT). This has the advantage that the UUT is not subject to the detailed requirements in COLL, but it does not benefit from the exemption on the prohibition on financial promotions to the public in the UK. Moreover, a UUT is broadly taxed as though it was a UK-resident company, unless it is an exempt UUT (EUUT). A UUT qualifies as an EUUT only if all the investors in the UUT are exempt from UK tax on capital gains, other than by reason of their residence,[41] or the UUT benefits from pre-6 April 2014 grandfathering.

Open-ended investment companies (OEICs)

OEICs were introduced in the UK partly as a response to the unfamiliarity of overseas investors with the trust structure underlying unit trusts. In many ways, OEICs are similar to AUTs (the statutory and regulatory provisions applying to both often use similar wording and concepts), but OEICs are not based on the English law concept of the trust and are bodies corporate that will hold the beneficial interest to the investment portfolio (while the investment assets must be entrusted to a depositary, which will hold legal title to them).[42] Therefore, investors in an OEIC are, to an extent, in a similar position to shareholders in a traditional limited company. An OEIC must also have an authorised corporate director that will assume responsibility for the OEIC's ongoing operating duties.[43]

The current regulatory framework for OEICs operates through two distinct sets of regulations: the Open-Ended Investment Companies Regulations 2001 (OEIC Regulations)[44] and those parts of COLL relevant to OEICs. OEICs are not regulated by the Companies Act 2006, despite their status as bodies corporate under English law.

The formation of OEICs is governed by Part II of the OEIC Regulations, which states that an OEIC is incorporated upon the coming into effect of an authorisation order from the FCA.[45] Accordingly, it is not possible to have an unauthorised OEIC in the UK (unlike a unit trust, which may be either authorised or unauthorised).

To grant authorisation, the FCA must be provided with a copy of the company's instrument of incorporation and a certificate from a solicitor that attests that the instrument of incorporation complies with necessary requirements.[46] As with AUTs, OEICs must also permit shareholders to have their shares redeemed or repurchased on request at a price related to the net value of the OEIC's investment portfolio and determined in accordance with the OEIC's instrument of incorporation and the rules in COLL.[47] Alternatively, or in addition, shareholders must be entitled to sell their shares on an investment exchange at a price that is not significantly different from the redemption or repurchase price.[48] UK OEICs are not subject to the restriction on the promotion of CISs contained in Section 238 FSMA.[49]

Authorised contractual schemes

Authorised contractual schemes (ACS) are a form of authorised CIS introduced by the Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013. AUTs and OEICs are not tax-transparent (although neither AUTs nor OEICs are generally liable to pay UK tax on the chargeable gains realised on the disposal of investment assets, nor are they generally liable to pay UK tax on their dividend income). ACSs, which are not within the charge to direct taxes, and tax liability is at the investor level, were intended to increase the competitiveness of the UK asset management industry.

The ACS may take the form of a co-ownership scheme or a limited partnership scheme.[50] An ACS is defined in FSMA as a contractual scheme that is authorised in accordance with Section 261D(1) FSMA.[51] The FCA may authorise a contractual scheme if it is satisfied that the scheme complies with the requirements of Sections 261D and 261E FSMA, the scheme meets the requirements of the contractual scheme rules (set out in COLL), and it has been provided with a copy of the contractual scheme deed and a certificate signed by a solicitor stating that the deed complies with the necessary requirements.[52]

The general restriction on the promotion of CISs does not apply to ACSs.[53] However, to protect retail investors, an ACS must not allow retail investors to be participants in a scheme unless they invest £1 million or more.[54]

UCITS schemes

UCITS schemes are not a separate type of open-ended investment vehicle; rather, they are AUTs, OEICs or ACSs that meet the criteria laid down in the UCITS Directive (EEA UCITS) or the Collective Investment Schemes (Amendment etc) (EU Exit) Regulations 2019 (SI 2019/325) (CIS EU Exit Regulations) (UK UCITS). The UK implemented the requirements of the UCITS Directive primarily through the FCA's COLL Sourcebook and the insertion and amendment of certain provisions in FSMA by the UCITS Regulations 2011.[55] Following the UK's withdrawal from the European Union, UK-authorised funds lost their legal status as UCITS under the UCITS Directive, and therefore as part of the onshoring process of the UCITS Directive, the CIS EU Exit Regulations amended provisions in FSMA to establish a separate UK regime for the authorisation, marketing and management in the UK of UK-authorised UCITS.

UK UCITS schemes must comply with the following criteria to be marketed in the UK: it must be an AUT, an OEIC or an ACS; the sole object of a UCITS scheme must be collective investment in transferable securities[56] or in other permitted financial instruments[57] operating on the principle of risk spreading; and the units in the fund must, at the request of the unitholders, be repurchased or redeemed, directly or indirectly, out of the scheme's assets (which includes action taken by or on behalf of the scheme on a stock exchange to ensure that the value of its units does not vary significantly from their net asset value).

Alternatively, a UCITS scheme may be an umbrella scheme, having sub-funds that each would be a UCITS scheme if they had separate FCA authorisation.

A scheme will not constitute a UCITS scheme for the purposes of the rules in the FCA Handbook if its instrument of incorporation (for an OEIC), trust deed (for an AUT) or contractual scheme deed (for an ACS) contain a provision that means that its units may be sold to the public only in non-UK or non-EEA states, depending on the domicile of the fund.

UCITS schemes must comply with the general obligations applicable to UCITS funds under the UCITS Directive,[58] as implemented in the UK through the Undertakings for Collective Investment in Transferable Securities Regulations 2011 (as amended) and the UCITS IV Directive Instrument 2011 (FSA 2011/39), as well as specific investment and borrowing power rules.[59] The general UCITS investment limits have been incorporated into the UK regulatory regime through COLL and include spread limits and specific rules for government securities and for derivatives.[60] The investment powers and borrowing limits for UCITS feeder funds are also included in COLL; these include a general obligation that a feeder UCITS must invest at least 85 per cent in value of its property in units of a single master UCITS.[61]

Non-UCITS retail schemes

Like UCITS schemes, non-UCITS retail schemes (NURSs) are not a separate type of investment vehicle but rather are AUTs, OEICs or ACSs that do not comply with the

requirements to be a UCITS. The UK regulatory regime applying to NURSs is less stringent than to the regulatory regime for UCITS schemes, and the applicable investment restrictions are therefore more relaxed. For example, NURSs are permitted to invest up to 20 per cent of the value of the scheme property in unlisted securities or unregulated investment schemes and may also invest in gold and real estate assets.[62] In addition, the limit for investment in the units of another authorised scheme is 35 per cent of the NURS's assets[63] (which permits a higher level of investment concentration than the 20 per cent limit applicable to UCITS schemes),[64] while the limit for a NURS's exposure to a single counterparty in an over-the-counter derivative transfer is limited to 10 per cent of the scheme value,[65] rather than the usual 5 per cent limit for UCITS schemes.[66]

Nonetheless, there are still important limitations on the investment powers of NURSs that are intended to retain a degree of investor protection. A NURS (except for a feeder NURS)[67] cannot invest in the units of a CIS unless that CIS meets certain minimum requirements, including that the CIS is effectively subject to an equivalent level of regulation as a NURS or UCITS fund (or otherwise that no more than 20 per cent by value of the NURS's assets are invested in that CIS); the CIS operates on the principle of the prudent spread of investment risk; and the CIS is prohibited from having more than 15 per cent in value of its property in units in other CISs.[68]

NURSs are also subject to certain of the same provisions in COLL[69] regarding:

1. limiting the amount of cash that can be retained in the scheme property;[70]
2. general borrowing powers;[71]
3. the ability to lend money and other property;[72] and
4. the power to provide guarantees or indemnities.[73]

As part of the FCA's Discussion Paper (DP23/2) on the future of asset management regulation in the UK, it discussed rebranding the NURS funds to clarify the nature of the fund. The FCA has also, following the Discussion Paper, stated[74] that it is considering reforming the regulation of NURSs to create a far clearer distinction between how the managers of alternative investment managers are regulated and retail fund managers are regulated.

Funds of alternative investment funds

COLL includes provisions governing the operation of funds of alternative investment funds (FAIFs) that are NURSs (or sub-funds of umbrella NURSs) operated in accordance with specific rules set out in COLL 5.7 (some of which incorporate general rules that are applicable to all NURSs from COLL 5.6). The regulatory regime for FAIFs is therefore essentially a relaxed version of the rules that apply to NURSs, providing increased flexibility in respect of investment powers.

The key attribute of FAIFs is that they are permitted to invest all of their assets in CISs, provided that those CISs prudently spread risk and do not themselves invest more than 15 per cent in value of their assets in units in CISs (or, in the absence of any such restriction, provided that the fund manager of the FAIF is satisfied on reasonable grounds that no such investment will in fact be made).[75] There is no requirement that the CIS in which a FAIF

invests must itself be subject to the rules governing NURSs or the UCITS requirements. However, the fund manager of a FAIF must carry out appropriate due diligence on any CIS in which the FAIF intends to invest.[76]

Qualified investor schemes

As with UCITS schemes and NURSs, qualified investor schemes (QISs) are not a specific legal form of investment vehicle. Rather, QISs are authorised CISs that are designed to be marketed only to certain types of sophisticated investors,[77] rather than to general retail customers, and the fund manager of a QIS is required to take reasonable care to ensure that the units in the QIS are sold only to such persons.[78]

The regulation of QISs is more relaxed than that of UCITS schemes and NURSs, and QISs have greater flexibility in respect of their investment and borrowing powers. The assets in which a QIS invests must be permitted investments under the QIS's constitution and its marketing prospectus,[79] but otherwise they can consist of a wide range of assets.[80] Unlike UCITS schemes and NURSs, there are no specific rules that would limit concentration of a QIS's assets in certain investments (except for units in certain CISs), although the fund manager of a QIS must take reasonable steps to ensure that the investments provide a suitable spread of risk in light of the scheme's investment objectives.[81] A QIS may invest only in regulated CISs or schemes that otherwise meet certain minimum requirements (and if the scheme is of the latter type, the QIS must not invest more than 20 per cent in value of its assets in unregulated schemes or other QISs unless the fund manager has taken reasonable care to ensure that the target scheme complies with all relevant legal and regulatory requirements).[82]

The limitations on the borrowing powers of QISs are similarly relaxed. There is a general rule that the borrowing of a QIS must not exceed 100 per cent of the value of its assets, and the fund manager must take reasonable care to ensure that arrangements are in place that will enable borrowings to be closed out to ensure compliance with that rule.[83] However, there is no requirement that borrowings can be only of a temporary nature.

Long-term asset fund

Long-term asset funds (LTAF) are a distinct form of authorised open-ended funds that can invest in long-term illiquid assets. The purpose of the regime is to allow greater access to such assets that previously were restricted to professional investors. Similarly to UCITS schemes, NURSs and QISs, LTAFs are not a separate type of investment vehicle but rather are AUTs, OEICs or ACSs. Relative to UCITs and NURSs an LTAF has relatively relaxed borrowing and investment powers, with LTAF fund managers being able to invest in alternative asset classes including alternative credit. LTAFs are required to invest predominantly in assets that are long-term and illiquid in nature.[84] The FCA expects the investment strategy of an LTAF to be predicated on at least 50 per cent of the value of the scheme property being invested in unlisted securities and other long-term assets such as immovables and CISs investing in such assets.

An LTAF is treated as a restricted mass market investment, which means it can only be marketed to professional investors, certified and self-certified sophisticated investors, certified high net worth investors, defined contribution pension schemes and

self-invested personal pension schemes. This makes LTAFs more restrictive than UCITSs but less restricted than typical alternative investment funds. To ensure that there is no misalignment between an LTAF's redemption period and the liquidity of the investments that it holds, an LTAF manager is allowed to utilise a wide array of liquidity management tools including noting periods. An LTAF is required to have notice periods for redemptions of at least 90 days and if the FCA deems this notice period is insufficient given the nature of the assets to be held by the LTAF the FCA will not authorise it.

Closed-ended investment vehicles

Closed-ended funds differ from open-ended funds in that they issue a fixed number of securities, usually determined by the fund's constitutional documents or by the general requirements of the law regulating the type of fund entity, or both, with investors realising their investment either by selling the securities in the secondary market or upon the winding up of the fund at the end of its life. Therefore, unlike open-ended funds, closed-ended funds do not undergo the constant expansion and contraction of the number of securities in issue throughout their life in response to ongoing investment and redemption. In the UK, the most common closed-ended structures are investment trusts and partnerships.

Investment trusts

Investment trusts, despite their misleading name, are not trusts but rather are public limited companies that are listed on a recognised stock exchange. As such, insofar as the investment trust is UK-incorporated, the usual company law provisions contained in the Companies Act 2006 apply to investment trusts. However, to constitute a valid investment trust for tax purposes, a company must meet the criteria set out in Section 1158 of the Corporation Tax Act 2010 and be approved as such by HM Revenue & Customs (HMRC).

Unlike open-ended funds, the shares in an investment trust may trade at a discount or a premium to the net asset value of the company's underlying assets. It is usual for the shares of investment trusts to trade at a discount, which can lead to considerable time being spent on attempting to manage the level of this discount. In particular, investment trusts commonly seek general shareholder authority (usually on an annual basis) to make purchases of their own shares in the market from time to time to support the price at which their shares trade.

As listed entities, investment trusts are subject to the Listing Rules that form part of the FCA Handbook. The UK's listing regime has recently been significantly overhauled as part of a package of reforms designed to make UK capital markets more attractive – with the new rules (found in the new UK Listing Rules Sourcebook (UKLR)) coming into force on 29 July 2024. However, the rules that apply to closed-ended investment funds (which include investment trusts) will continue largely unchanged from the previous rules. Under the new regime, UKLR 11 contains specific rules with which listed closed-ended investment funds (which includes investment trusts) must comply.[85] In addition to meeting the minimum requirements for listing that apply to all listed securities, investment trusts must invest and manage their assets in such a way as to spread investment risk,[86] and that the board of directors of the investment trust must be able to act independently from its investment manager.[87] In addition, an investment trust must make investments in accordance with a

published investment policy,[88] and any material changes to that policy must be approved by shareholders and, if the change is not proposed to enable the winding up of the investment trust, by the FCA.[89]

Investment trusts themselves do not require authorisation under FSMA. However, as investment trusts normally constitute Alternative Investment Funds (AIFs – see below), managers of investment trusts require either FCA authorisation or, in certain limited instances, to be registered with the FCA to carry out the activity of managing the investment trust.

Under the Collective Investment Schemes Order,[90] investment trusts do not qualify as CISs; therefore, the restrictions on the promotion of CISs in Section 238 FSMA do not apply.[91]

Limited partnerships

Limited partnerships are formed under the Partnership Act 1890 and registered under the Limited Partnerships Act 1907 (LPA 1907). A limited partnership is defined as consisting of one or more general partners who are liable for all the debts and obligations of the partnership, and one or more limited partners whose liability is limited to the amount of capital that they contribute.[92] Limited partnerships must be registered with the Registrar of Companies (which acts, for these purposes, as the Registrar of Limited Partnerships) in accordance with the provisions of the LPA 1907.

It is a key requirement of limited partnerships that the general partner alone is responsible for the day-to-day operation and management of the partnership's affairs: if a limited partner becomes involved in the management of the partnership's business, that limited partner will lose the benefit of limited liability and will be treated as a general partner.[93] For this reason, in the asset management context, it is usual that an entity connected with the investment manager of a fund that is established as a limited partnership acts as general partner, while investors act as limited partners.

English limited partnerships do not have separate legal personality and therefore cannot hold property or contract in their own name. Scottish limited partnerships differ in this respect: a Scottish partnership is a legal person distinct from the persons of whom it is composed.[94] Both English and Scottish limited partnerships are treated as fiscally transparent in the UK. With the enactment of the Economic Crime and Corporate Transparency Act 2023 (ECCTA 2023) in October 2023, various aspects of LPA 1907 will be modernised, although the reforms mostly relate to increasing the transparency of such partnerships. Broadly, the changes brought in by ECCTA 2023 will result in limited partnerships being required to provide much more information both on registration and on an ongoing basis.

Limited liability partnerships

Limited liability partnerships (LLPs) are a form of hybrid legal entity that are bodies corporate with their own legal personality[95] but that enjoy the organisational flexibility and tax transparency of traditional partnerships coupled with limited liability for each member. LLPs, which are primarily governed by the Limited Liability Partnership Act 2000, must be incorporated through the Registrar of Companies.[96]

It is possible for an investment fund incorporated as an LLP to constitute a CIS under Section 235 FSMA in circumstances where the investors do not have control over the day-to-day management of the property of the LLP.[97] In practice, this will depend upon how the LLP is established and operates. Unlike limited partnerships, every member of the LLP is capable of being involved in its day-to-day operation. Similarly, FCA guidance confirms that it is possible for LLPs to fall within the definition of an AIF under the AIFMD.[98] In such cases, the appropriate FCA authorisation will be required.

Qualifying asset-holding companies

While the UK does have a range of legal forms that can be used to establish fund vehicles, it has been seen as lacking a competitive and coordinated holding company regime, which has resulted in some UK asset managers, particularly managers of private funds, locating their fund and holding structures in other jurisdictions (notably Luxembourg) where there are established combined regimes which are more attractive. The qualifying asset holding company (QAHC) regime was introduced in April 2022 to address this gap to enhance the UK's competitiveness as a location for asset management and investment funds. The QAHC regime is an elective tax-privileged regime that is available to certain asset-holding companies provided they meet certain eligibility conditions relating to their activity and owners. Broadly, the company must be UK tax resident, unlisted and held by at least 70 per cent 'Category A investors', such as investment funds and various types of institutional investors.

The regime 'ring fences' the QAHC's investment business; activities and investments outside the ring fence are subject to normal corporation tax rules, but the QAHC benefits from modified tax rules in respect of its investment business, including that gains arising on disposals of overseas land and qualifying shares inside the ring fence are exempt from corporation tax, and the overseas profits of a QAHC are exempt from corporation tax to the extent that those profits are taxable in a foreign jurisdiction.

Alternative investment funds

The Alternative Investment Fund Managers Directive (AIFMD) – the European regime that applies to managers of alternative funds – was implemented by means of, among other things, the Alternative Investment Fund Managers Regulations 2013 (AIFM Regulations),-[99] resulting in a further regulatory category for investment funds: Alternative investment funds (AIFs). With the onshoring of this regime (with modifications) pursuant to the Alternative Investment Fund Managers (Amendment etc) (EU Exit) Regulations 2019 (SI 2019/328) (AIFM EU Exit Regulations) following Brexit, the UK version of AIFMD remains the primary regime that applies to managers of professional funds in the UK.

An AIF is a collective investment undertaking[100] that raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and that is not a UCITS scheme.[101] Like UCITS schemes, AIFs are not a separate type of investment vehicle. Rather, the AIFMD regime constitutes a further layer of regulation applicable to managers of investment funds that meet the definition above. An AIF can be open-ended or closed-ended and constituted in any legal form, including under a contract, by means of a trust or under statute.[102] This

broad definition of AIF means that many of the categories of investment fund described above and below fall within its scope, including authorised CISs that are NURSs or QISs, investment trusts, hedge funds, real estate funds and private equity funds. The majority of pension funds (unless they are co-investing with other pension funds) and all insurance funds are excluded. Where a fund does constitute an AIF, the fund itself will remain regulated in the manner set out above, but the manager of such a fund will be regulated pursuant to the AIFMD (although some obligations may indirectly affect how the manager operates AIFs).

Authorisation

An AIFM must be authorised under Part 4A FSMA to carry on the regulated activity of managing an AIF. To be so authorised, the AIFM must comply with a number of obligations, including the following:

1. an initial capital requirement;[103]
2. the AIFM must be the only AIFM of each AIF it manages;
3. the persons who conduct the business of the AIFM must be of sufficiently good repute and sufficiently experienced; and
4. the shareholders or members of the AIFM must be suitable, taking into account the need to ensure prudent management.

The AIFMD allows for managers of portfolios of AIFs the value of whose assets under management does not exceed €100 million, or €500 million where each managed AIF is unleveraged and has a lock-in period of five years (small AIFMs),[104] to be subject to a lighter regulatory regime.

Full-scope UK AIFMs authorised under Part 4A are subject to the full requirements of the AIFMD as set out in the AIFM Regulations and the Investment Funds Sourcebook (FUND). Small AIFMs may also be authorised to carry out the regulated activity of managing an AIF; however, certain small AIFMs that meet the conditions in Regulation 10 of the AIFM Regulations need not be authorised under Part 4A and need only be registered as a small registered UK AIFM.[105] Small AIFMs are not required to comply with the requirements of the AIFMD, with the exception of certain registration, reporting and notification requirements contained in Article 3 of the AIFMD.[106] A small authorised UK AIFM will also be subject to the relevant parts of the FCA Handbook. In light of responses to its Discussion Paper[107] on improving the UK asset management regime, rather than having different categories of AIFMs, the FCA is considering simplifying the regime to apply a set of consistent rules across all managers of alternative funds, but in a proportionate manner depending on the nature and scale of a firm's business.[108]

A UK AIFM may manage a non-EU AIF that is not marketed in the European Union provided that it complies with the AIFMD (with the exception of the requirements for a depositary and annual report). There must also be appropriate cooperation arrangements in place between the FCA and the supervisor in the country in which the AIF is established. This is the continuing position under the temporary permissions regime set out in the AIFM EU Exit Regulations.

Prudential and conduct of business requirements

AIFMs must comply with a number of conduct, organisational and prudential requirements.

In particular, AIFMs must implement adequate risk management systems, including by monitoring liquidity risks for each AIF under management and setting a maximum level of leverage.[109] AIFMs must also have adequate procedures and policies in relation to conflicts of interest.[110] AIFMs must establish, implement and maintain remuneration policies that promote effective risk management and apply to, inter alia, any senior managers and other staff whose professional activities have a material impact on the risk profiles of the AIFM or AIFs under management.[111] There are also restrictions on the levels of remuneration paid to such staff: at least 40 per cent of variable remuneration (i.e., bonuses) must be deferred for a period of at least three to five years unless the life cycle of the AIF concerned is shorter than this period. If the bonus is particularly high, at least 60 per cent must be deferred.[112]

In respect of delegation, there are a number of restrictions.[113] An AIFM must notify the FCA before any delegation arrangements become effective, and the AIFM must be able to justify the delegation objectively.[114] The AIFM must not delegate its functions to the extent that it becomes a 'letterbox entity'[115], and the services provided by the delegate must be reviewed on an ongoing basis. The AIFM's liability towards the AIF and its investors is not affected by the AIFM delegating its functions to a third party or by any further sub-delegation.

AIFMs must appoint a single depositary for each AIF, and the AIF's assets must be entrusted to the depositary for safekeeping.[116] Rules and guidance relating to the use of such depositaries are set out in FUND 3.11. AIFMs must also ensure the proper valuation of AIF assets, conduct at least annual valuations (either internally or through an independent valuer) of the assets of each AIF and disclose the results of the valuation to investors.[117]

Transparency and disclosure

The AIFMD requires certain information to be made available to investors and the FCA by AIFMs. A UK AIFM must disclose specified information to investors (set out in FUND 3.2) for each AIF that it manages or markets, both prior to investment and on a periodic basis thereafter. For instance, it must disclose the investment strategy of the AIFM, a description of the AIF's risks and risk management, and a description of all fees that are borne directly or indirectly by investors.

The AIFM must also make an annual report available to investors[118] and regularly report to the FCA on the matters set out in FUND 3.4 (including the main instruments in which it is trading, its risk profile and, if the AIF employs leverage on a substantial basis, details of the level of leverage employed). Managers of private equity funds and hedge funds, among others, may have to report significantly more information to their investors under this regime than they previously had to.

Private equity provisions

An AIFM must notify the FCA when an AIF that it manages acquires, disposes of or holds significant holdings in a non-listed company.[119] Further, when an AIF acquires, individually or jointly, control of a non-listed company, its AIFM must notify the company, the company's shareholders and the FCA, and must make various disclosures as to the intentions of the AIF with regard to the future business of the company.

In addition, there are asset stripping provisions whereby the AIFM must use its best efforts to prevent any distributions, capital reductions, share redemptions or the acquisition by the company of its own shares in the first two years after the AIF acquires control.[120-] This restriction is subject to certain qualifications; for instance, only distributions that would cause the company's net assets to fall below the subscribed capital or that would exceed available net profits are prohibited.[121] These requirements are particularly relevant to managers of private equity funds; hence, they are known colloquially as the private equity provisions.

Marketing and passporting

Guidance on management and marketing for UK purposes is set out in the FUND, Supervision (SUP) and PERG Sourcebooks in the FCA Handbook. Following the cessation of passporting rights after Brexit, the AIFM EU Exit Regulations introduced the temporary marketing permission regime (TMPR) to enable AIFs that had previously been passported into the UK prior to continuing being marketed in the UK on a temporary basis until funds obtained authorisation from the FCA.

The TMPR was set to cease to operate on 31 December 2025, but on 30 January 2024 the UK government announced its intention to extend the date to the end of 2026 (for EEA UCITS), to allow for a smooth transition to the Overseas Fund Regime (OFR).[122] The OFR is a gateway to allow certain funds established outside the UK to be promoted in the UK, including to retail clients.[123] At the outset, the OFR will be available to most funds established in EEA and EU member states that have been authorised under the UCITS Directive with the exception of EEA UCITS that have been authorised as money-market funds.[124] Funds currently in the TMPR will need to apply for recognition under the OFR by the end of 2026 to continue marketing in the UK. The OFR gateway will also open for non-TMPR funds in September 2024, allowing them to also apply for recognition.[125]

The UK government announced its first equivalence decision under the OFR in relation to UCITS funds,[126] which will pave the way for European asset managers to market their funds in the UK on a permanent basis, once secondary legislation to implement this has been enacted. EEA funds will not be required to comply with any additional UK requirements as part of this equivalence decision at this time. As this recognition has only been granted in respect of UCITS with the exception of money-market funds, it is unclear what the future holds for all other funds following the expiry of the TMPR but the FCA stated in its statement that there is ongoing regulatory development in this area.[127]

Main sources of investment

Following a significant drop to an estimated £8.8 trillion per cent at the end of 2022 (a 12 decrease from £10 trillion in the previous year), assets under management in the UK saw

a 2 per cent growth in 2023 and are expected to see further modest growth in 2024.[128] London remains the leading centre for fund management in the UK, followed by Edinburgh, with other large fund management centres in Aberdeen, Liverpool, Manchester, Edinburgh, Bristol, Oxford, Cambridge, Glasgow and Birmingham.[129]

The UK fund management industry has a strong international orientation: approximately 48 per cent of UK assets under management are managed on behalf of overseas clients, the majority of these clients being European (56 per cent of the total), with North American clients being the second largest group (20 per cent) and Asian clients rising marginally to 16 in 2022.[130]

Sectoral regulation

Insurance

The UK insurance and long-term savings market is the largest in Europe and the third-largest in the world. It contributes significantly to the UK economy, managing investments of over £1.5 trillion.[131] UK insurance funds represented 25 per cent of funds under management in the UK in 2022.[132]

In terms of asset allocation, the proportion of UK quoted shares held by insurance companies was estimated at 2.6 per cent at the end of 2022,[133] continuing the fall seen in recent years and the second lowest percentage since 1963 (when records began).[134] This decrease reflects a move from investment in UK equities to overseas securities and mutual funds. This trend is partly attributable to the introduction under the Solvency II Directive (Solvency II)[135] of, among other things, higher capital charges on certain asset classes compared with others.

HM Treasury is considering regulatory reform to support the UK insurance sector. Existing aspects of the UK regulatory regime that may affect investments made by insurers include the permitted links regime and requirements that apply to with-profits business.

Real property

Background

Traditionally, UK commercial property has often been held through various offshore vehicles, such as Jersey property unit trusts, due to the ease with which they can be established and several tax advantages they offer. This remains the case even after the regime for taxing non-residents' gains on UK commercial real estate came into force in 2019. It is also common for investors to hold property through UK-listed property companies (in addition to unit trusts) that allow pooling of assets to overcome cost-related barriers to entry into the property market and to take advantage of a lower rate of stamp duty levied on transactions involving shares than is payable in respect of direct transactions involving real property. However, investing in this manner puts shareholders at a disadvantage when compared with investing directly in property, because of the possibility of double taxation.

Real estate investment trusts

Since 2007, it has been possible in the UK to establish real estate investment trusts (REITs), which, like other investment trusts, are actually companies that invest specifically in real estate and receive an advantageous tax treatment in that profits and gains arising from the company's property rental business are exempt from corporation tax. To obtain this tax treatment, a number of detailed conditions have to be fulfilled.[136] These conditions include requirements that the REIT distributes at least 90 per cent of the profits from its property rental business and all UK REIT investment profits, and that the REIT's ordinary share capital is listed or admitted to trading (and is actually trading) on a 'recognised stock exchange' or at least 70 per cent of the REIT's ordinary share capital is owned be relevant 'institutional investors' such as pension funds. The listing requirement is satisfied if the shares are traded on the Alternative Investment Market (AIM) of the London Stock Exchange or a similar recognised stock exchange overseas.

There are 55 REITs with a market cap of over US$70 billion listed on the London Stock Exchange.[137] Data published by the Investment Property Forum indicates that, in 2022, UK REITs and listed property companies together held commercial property valued at £76 billion, up from £71 billion in 2018.[138]

UK REITs are not CISs for the purposes of the definition in Section 235 FSMA; however, they may be AIFs.[139] The FCA has indicated that a REIT is a concept used for tax purposes, so there is no presumption as to whether a REIT is an AIF: this will be considered on a case-by-case basis.[140]

Property-authorised investment funds

Since 6 April 2008, it has also been possible to establish a property-authorised investment fund (PAIF) in the UK to act as a tax-efficient vehicle for a property investment business. In contrast to REITs, PAIFs do not need to be listed or traded on a recognised stock exchange, but they must be structured as OEICs, meaning that they do not benefit from the exemption from the definition of CISs available to other bodies corporate and must therefore be authorised by the FCA.

To constitute a valid PAIF, a number of detailed conditions have to be fulfilled, and the fund manager must have given notice to HMRC for the PAIF rules to apply. Once an OEIC comes within the ambit of the regime, it benefits from favourable corporation tax treatment relating to its property investment businesses.

Hedge funds

As hedge funds are typically located in offshore jurisdictions (largely owing to the favourable tax treatment that can be obtained in those territories), there are relatively few UK-based hedge funds. However, London remains one of the largest global centres for hedge fund managers. In practice, the regulation of hedge funds under English law has therefore tended to focus on the managers themselves, rather than the fund entities. All hedge fund managers, like other investment managers, are likely to be undertaking activities that constitute a regulated activity for the purposes of FSMA and the Regulated

Activities Order.[141] As a result, they must have the necessary FCA authorisations to carry out such activities.

Certain funds that invest in underlying hedge funds (funds of funds) may be based in the UK and may be listed on the London Stock Exchange as investment trusts. As discussed earlier, investment trusts are not CISs for the purposes of FSMA and do not require FCA authorisation themselves. Nonetheless, the investment manager of an investment trust will still need to be authorised. The advantage of a UK-listed fund of funds is that it can provide an indirect route to investment in multiple underlying hedge funds while still requiring adherence to the continuing obligations and reporting requirements contained in the UK listing authority's LRs.

Having historically taken a light-touch approach to hedge fund supervision, the FCA has significantly increased its scrutiny of the hedge fund industry, including through enforcement action taken against hedge fund managers and their staff. Hedge funds pose potentially systemic risks by their disorderly failure, particularly as counterparties to trades with financial institutions and others within the financial markets.[142] In January 2020, the FCA published a 'Dear CEO' letter to firms managing 'alternative' investment vehicles (such as hedge funds and private equity firms) highlighting a number of risks that AIFMs posed to customers, such as low standards of governance, insufficient consideration of the appropriateness of investment products offered and insufficient controls around client assets. The letter suggested that the FCA intended to take future action in this sector to address these issues.

UK regulation of hedge funds is also led by the overarching provisions introduced by EU legislation such as the AIFMD. There has been recent growth in the number of UCITS-compliant hedge funds,[143] the managers of which are not required to comply with the AIFMD but require FCA authorisation for carrying out regulated activities as described above.[144] Non-UCITS hedge funds are likely to fall within the definition of AIFs; the managers of such funds, as AIFMs, are subject to the requirements of that regime.

Private equity

In the UK, private equity firms typically use limited partnerships as investment vehicles to take advantage of their tax-transparent nature and their lower disclosure requirements (as compared with limited companies or LLPs). The limited partners in the partnership are typically the institutional investors in the private equity fund, while an entity controlled by the private equity firm will usually act as the limited partnership's general partner and manager.

Traditionally, private equity has been a relatively lightly regulated area of asset management in the UK, although, in common with other asset management entities, private equity firms have required FCA authorisation if they are undertaking regulated activities specified in the Regulated Activities Order. Private equity funds have, on occasion, voiced concern over the impact of the AIFMD regime, as implemented in the UK, on private equity activities.[145] For example, rules on remuneration have an impact on private equity firms' policies regarding deferred remuneration. Furthermore, the private equity provisions (intended to limit asset stripping of companies) may interfere with some of the usual funding structures adopted by private equity funds, potentially restricting corporate reorganisations and targeted disposals of parts of a target company's business.

In August 2022, the FCA published a 'Dear CEO' letter addressing issues of conflict of interest, market abuse and market integrity, among others, and importantly, raising concerns that some private equity funds with retail or professional investors were not adequately meeting their obligations in relation to investor protection.[146]

There are ongoing initiatives to improve the transparency of the private equity industry in the UK to address criticism that the activities of private equity funds are opaque and to counteract the perception that they are insufficiently regulated. The Walker Guidelines were introduced in 2007 to encourage improved disclosure by private equity bodies.[147] These voluntary guidelines recommend that private equity firms that meet certain specified criteria[148] should publish annual reviews or regular updates on their websites containing information about their investment approaches and portfolios and should provide various performance data on a confidential basis to an independent third party appointed by the British Private Equity and Venture Capital Association (BVCA). In 2022, the Private Equity Reporting Group (PERG) and the BVCA began updating the Guidelines, taking into consideration current and forthcoming changes to reporting requirements and increased stakeholder interest in the industry following notable transactions involving well-known UK businesses.[149] This work is ongoing.

Furthermore, the Institutional Limited Partners Association has published (most recently in June 2019) private equity principles to encourage improvements in private equity practice by furthering the relationship between general partners and limited partners for the long-term benefit of participants in the industry and encouraging a greater focus on transparency and governance.

Tax law

According to the UK Treasury's February 2022 summary of responses to its call for input into the review of the UK funds regime,[150] the UK's approach to funds taxation should seek to ensure that investor decisions are not distorted by tax considerations. A detailed discussion of the UK tax treatment of investment funds and investors is beyond the scope of this publication, which can highlight only a few key aspects.

Taxation of domestic funds

Taxation at the fund level is determined by the type of fund vehicle and, depending on the vehicle type, detailed eligibility criteria may have to be met and notifications given to, or approvals obtained from, HMRC before the desired treatment is available. Generally speaking, the differences between fund types in respect of the taxation of income are more pronounced than in respect of the taxation of capital gains.

In most cases, capital gains should not be taxable at the fund level. Notable exceptions are REITs (as gains from investments other than real estate would generally be taxable at the normal corporation tax rate, which is currently 25 per cent, and non-exempt UUTs (where all gains would be subject to corporation tax).

Dividend income should not generally be subject to tax at fund level, given that most types of funds are taxable on corporation tax principles or transparent. Other types of income

may also be exempt depending on the fund type (e.g., income from real estate investment would, for instance, be exempt for REITs and PAIFs) or a tax charge may not arise as the fund is transparent or distributions to investors are treated as tax deductible. To the extent that income is taxable at fund level, tax may be charged at corporation tax rates (e.g., in the case of a REIT or investment trust) or at the basic income tax rate of 20 per cent (e.g., in the case of an AUT or an OEIC).

Taxation of foreign funds and investors

Subject to certain exceptions (some of which are highlighted below), a foreign fund would not be subject to UK tax unless it carries on a trade in the UK, and a foreign fund will not be treated as carrying on a trade in the UK merely by virtue of engaging an independent investment manager in the UK to carry out transactions on its behalf, provided that certain conditions as to the manager's activities, relationship with the foreign fund and remuneration are met.[151]

Even if a foreign fund does not carry on a trade in the UK, the fund may be liable to tax in the UK in the form of transfer taxes, withholding taxes on UK-source payments (other than dividends as the UK does not generally impose a withholding tax on dividends), taxes on income from a UK property business and taxes on gains from the disposal of UK real estate or shares in a UK real estate rich company. It is also possible that foreign investors in domestic or offshore funds holding UK real estate or shares in UK real estate-rich companies may also be subject to UK tax on a disposal of their interest in the fund or, if the fund is treated as fiscally transparent for the purpose of the UK taxation of capital gains, a disposal by the fund of such real estate or shares.

Investors, regardless of their jurisdiction of tax residence, are unlikely to suffer UK withholding tax on distributions from UK domestic funds. A notable exception to this general rule is distributions from PAIFs and REITs, which may attract withholding tax at 20 per cent. In most cases, it should be possible for investors to transfer or surrender their interests in UK domestic funds without having to pay stamp taxes. Exceptions to this general position include the transfer of shares in an investment trust or a REIT.

Outlook and conclusions

Technological developments

A significant part of the FCA's February 2023 Discussion Paper was focused on the use of technology in improving the UK's asset management regime. One product that has been heavily promoted is fund tokenisation – the process by which an investor's share or unit in a fund is converted into a digital token that is then recorded and traded on a distributed ledger (DLT) in place of a traditional system of records. This is advantageous due to its efficiency and speed, demonstrated through simplifying books and records, and in turn reconciliations and in aligning settlement profiles of underlying assets with settlement of fund units.

In November 2023, the industry-led Technology Working Group, which falls under the government-convened Asset Management Taskforce, produced an interim report,[152] which concluded that there are no regulatory issues with implementing a baseline 'Stage One' model for fund tokenisation. This Stage One model envisages a scenario where the only changes relevant to a typical UK investment fund operating today are in the deployment of DLT in the registry and transaction functions. A private, permissioned chain would act as the master record for the fund unit register. In March 2024, the Group published a Phase 2 report,[153] which focused on possible use cases for fund tokenisation. The FCA, which has emphasised its commitment to innovation, has also launched a permanent 'digital sandbox', which is a testing environment for firms at the early stage of product development.[154]

Artificial Intelligence (AI) also made headlines in 2023, with its potential for use in asset management cases being considerable, from streamlining internal processes to data analyses and risk management. The Bank of England and the FCA published a Discussion Paper in October 2022 and summarised responses to the paper in October 2023,[155] which gives a useful gauge of what stakeholders consider would be most useful to regulation in this area. The regulators are at present focused on governance, oversight and consumer outcomes, particularly where data sharing and behavioural biases may arise due to heavy AI involvement in financial decision-making.[156] This will be a complex area to regulate and how the regulators will tackle this is yet to be seen.

Regulatory scrutiny

In its business plan for 2022–2023, the FCA identified certain priority themes relevant to the UK asset management industry. Chief among these is putting consumers' needs first, strengthening the UK's position in wholesale markets globally and focusing on whether asset managers present the ESG properties of products in a way that is clear, fair and not misleading.[157] The influx of regulatory developments, including the introduction of the Consumer Duty, will increase the levels of regulatory scrutiny as the FCA is focused on ensuring that the Duty is prioritised and well implemented by firms. Sustainable investment – and ESG more generally – continue to be key areas identified by the FCA as being relevant to the asset management market.

ESG developments and greenwashing risks

Notwithstanding pushback in certain jurisdictions, as noted elsewhere in this chapter, UK asset managers have come under increasing pressure to play a role in directing more capital toward sustainable investments. The UK continues to be keen to be seen as a global leader in 'greening' the financial system, and regulatory developments are, in many respects, aligned with that objective.

The regulatory landscape for asset management has been subject to a number of major ESG-related developments since 2022. Among other changes, in June 2023, the International Sustainability Standards Board (ISSB) introduced its landmark sustainability standards, IFRS S1[158] and S2,[159] providing new global standards for sustainability-related disclosures in general, and specifically in relation to the climate. The UK government has committed to model its UK Sustainability Disclosure Standards on the ISSB standards, with plans to endorse the standards by the first quarter of 2025.[160]

Greater transparency obligations, more sophistication in understanding and unpicking ESG credentials, and pressure on firms to be able to market a 'green' product solution have combined to increase the risk of litigation or enforcement for 'greenwashing'. The FCA and other UK regulators are beginning to take a tougher stance on greenwashing risks, and it is likely that there will continue to be more enforcement in this space.

FCA-regulated firms, including asset managers, are now subject to a general 'anti-greenwashing' rule.[161] This requires firms to name and market financial products and services in the UK in a manner that is clear, fair and not misleading, as well as being consistent with the sustainability characteristics of the product or service.[162]

As of 31 July 2024, a new labelling and classification regime intended to enable customers to distinguish between products on the basis of their sustainability characteristics will start to apply. UK asset managers that manufacture and market funds or other investment products with sustainability characteristics aimed at retail investors will have to consider the use of certain prescribed labels for their products.[163] Although firms will be able to choose whether or not to label their products, they will not be able to use those labels without meeting the FCA's qualifying criteria first. Where firms do not use these labels, sustainability-related features must still be conveyed to customers in a proportionate way under naming and marketing rules, which will come into force on 2 December 2024.[164] These rules prevent asset management firms from using sustainability-related terms such as 'environmental' or 'green' for products made available to retail investors unless they comply with certain rules.

In addition, to facilitate the reliability and credibility of data used for transparency and reporting obligations, the FCA has published a Code of Conduct for ESG Data and Ratings Providers in December 2023,[165] with a view to improving practices across several key areas such as governance, systems and controls.

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Endnotes

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18 SI 2001/544. ^ Back to section

19 Section 22 FSMA. ^ Back to section

20 Activities (5) and (6) were introduced from 22 July 2013 by the Alternative Investment Fund Managers Regulations 2013. If a person has permission to manage an AIF or a UCITS scheme, they need not obtain permission to operate a CIS in respect of that AIF or UCITS scheme; however, an investment manager that manages AIFs and UCITS schemes must hold permissions for both activities. ^ Back to section

21 Section 23(1)(b) FSMA. ^ Back to section

22 Section 21(1)(a) FSMA. ^ Back to section

23 Section 21(2) and 21(5) FSMA. The exemptions to the basic prohibition on financial promotions by unauthorised persons are set out in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (SI 2001/1335) (as amended). ^ Back to section

24 Section 235(1) FSMA. ^ Back to section

25 Section 235(2) FSMA. The meaning of the term 'day-to-day control' was considered by Laddie J in *Russell Cooke Trust Co v. Elliott & Ors* [2001] All ER 197, in which he concluded that the mere fact that investors have a right to be consulted or can give directions to an investment manager of a fund did not necessarily mean that they had day-to-day control over the property of that fund. ^ Back to section

26 The glossary in the FCA Handbook makes clear that the term 'operator' means the person or entity responsible for the management of the scheme or property held for or within the scheme. ^ Back to section

27 Section 235(3) FSMA. ^ Back to section

28 SI 2001/1062. ^ Back to section

29 Schedule to Article 3, Paragraphs 17, 20 and 21 Collective Investment Schemes Order. ^ Back to section

30 Articles 81 and 51ZE Regulated Activities Order. ^ Back to section

31 Exemptions from Section 238 FSMA are set out in the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (SI 2001/1060) and the FCA's Conduct of Business Sourcebook (COBS). ^ Back to section

32 COBS 4.12B. ^ Back to section

33 The FCA Handbook is available at www.handbook.fca.org.uk/handbook. ^ Back to section

34 https://www.gov.uk/government/news/edinburgh-reforms-hail-next-chapter-for-uk-financial-services ^ Back to section

35 FSMA 2023 received Royal Assent in June 2023. ^ Back to section

36 FCA Discussion Paper DP23/2: Updating and improve the UK regime for asset management. ^ Back to section

37 https://www.fca.org.uk/news/speeches/our-ambitious-agenda-uk-asset-management.- ^ Back to section

38 Section 237(3) FSMA. ^ Back to section

39 Section 238(4)(a) FSMA, which disapplies the general restriction on the promotion of CISs in Section 238(1). ^ Back to section

40 Section 100 Taxation of the Chargeable Gains Act 1992. ^ Back to section

41 Regulation 3 of the Unauthorised Unit Trusts (Tax) Regulations 2013, SI 2013/2819. ^ Back to section

42 Regulation 5 OEIC Regulations. ^ Back to section

43 See Chapter 6 of COLL, which sets out the ongoing operating duties and responsibilities of the authorised corporate director of an OEIC. ^ Back to section

44 SI 2001/1228. ^ Back to section

45 Regulation 3(1) OEIC Regulations. ^ Back to section

46 These include, for example, that the OEIC's shareholders are not liable for its debts (Paragraph 2(c)) and that the charges and expenses of the OEIC may be taken out of the scheme property (Paragraph 2(e)). In addition, the instrument of incorporation must contain provisions stating the object of the OEIC (Paragraph 3(1)(a)), the currency in which its accounts are to be prepared (Paragraph 3(1)(c)), the maximum and minimum sizes of its capital (Paragraph 4(1)(c)), and the rights attaching to each class of its shares (Paragraph 4(1)(f)). ^ Back to section

47 Regulation 15(11)(a) OEIC Regulations. ^ Back to section

48 Regulation 15(11)(b) OEIC Regulations. ^ Back to section

49 Section 238(4)(b) FSMA disapplies the general restriction on the promotion of CISs in Section 238(1) FSMA. ^ Back to section

50 Section 235A(1)(a) and (b) FSMA. ^ Back to section

51 Section 237(3) FSMA. ^ Back to section

52 Section 261D(1) FSMA. ^ Back to section

53 Section 238(4)(aa) FSMA disapplies the general restriction on the promotion of CISs in Section 238(1). ^ Back to section

54 Section 261E FSMA. ^ Back to section

55 SI 2011/1613. ^ Back to section

56 Transferable securities are defined in COLL 5.2.7 as shares, debentures, alternative finance investment bonds, government and public securities, warrants or certain certificates conferring contractual or property rights in connection with such securities. However, under COLL 5.2.7(2), investments will not constitute transferable securities if the title to them cannot be transferred, or cannot be transferred without third-party consent (except, in the case of a body corporate, any consent required by the body corporate itself, its members or its debenture holders, which may be excluded under COLL 5.2.7(3)). ^ Back to section

57 COLL 5.2.6A sets out the permitted types of property that may be included in the portfolio of a UCITS scheme. This includes transferable securities, approved money-market instruments (broadly speaking, liquid instruments normally traded on money markets), units in CISs, derivatives and forward transactions, and deposits. In the case of OEICs, this also includes any movable or immovable property that is essential for the direct pursuit of the OEIC's business. ^ Back to section

58 COLL 1.2.2 and COLL 3.2.8R. ^ Back to section

59 COLL 5.2 to COLL 5.5. ^ Back to section

60 COLL 5.2. ^ Back to section

61 COLL 5.8.2. ^ Back to section

62 COLL 5.6.4 and COLL 5.6.5. ^ Back to section

63 COLL 5.6.7(6). ^ Back to section

64 See COLL 5.2.11(9). ^ Back to section

65 COLL 5.6.7(5). ^ Back to section

66 COLL 5.2.11(7) (although the limit for UCITS schemes is raised to 10 per cent if the derivative counterparty is a financial institution recognised by the FCA rules as an approved bank). ^ Back to section

67 A feeder NURS is a NURS that invests in units only in a single CIS that is itself a NURS, a UCITS scheme or a recognised overseas scheme. ^ Back to section

68 COLL 5.6.10. ^ Back to section

69 COLL 5.6.22. ^ Back to section

70 COLL 5.5.3. ^ Back to section

71 COLL 5.5.4(1)–(3) and (8), although significantly a NURS's borrowing powers are not limited only to borrowings on a temporary basis, as COLL 5.5.4(4) and (5) do not apply to a NURS. ^ Back to section

72 COLL 5.5.6 and COLL 5.5.7(1), (2) and (4). ^ Back to section

73 COLL 5.5.9. ^ Back to section

74 https://www.fca.org.uk/news/speeches/updating-and-improving-uk-regime-asset-management-our-priorities. ^ Back to section

75 COLL 5.7.2 and COLL 5.7.7. ^ Back to section

76 COLL 5.7.9. ^ Back to section

77 QISs fall within the definition of non-mainstream pooled investment and therefore are subject to the marketing restrictions in COBS 4.12B (see Section II.i). ^ Back to section

78 COLL 8.1.3. ^ Back to section

79 COLL 8.4.3. ^ Back to section

80 COLL 8.4.4. ^ Back to section

81 COLL 8.4.2. ^ Back to section

82 COLL 8.4.5. ^ Back to section

83 COLL 8.4.10. ^ Back to section

84 COLL 15.6.5R. ^ Back to section

85 UKLR 11.1.1R. ^ Back to section

86 UKLR 11.2.3R. See also UKLR 11.4.6R(1). ^ Back to section

87 UKLR 11.2.10R(1). ^ Back to section

88 UKLR 11.4.6R. ^ Back to section

89 UKLR 11.4.14R and UKLR 11.4.15R. ^ Back to section

90 SI 2001/1062. ^ Back to section

91 See Paragraph 21 of the Schedule to the Collective Investment Schemes Order. ^ Back to section

92 Section 4 LPA 1907. ^ Back to section

93 Section 6(1) LPA 1907. ^ Back to section

94 Section 4(2) of the Partnership Act 1890. ^ Back to section

95 Section 1(2) Limited Liability Partnerships Act 2000. As such, they may hold property and enter into contracts in their own name. ^ Back to section

96 Section 3 Limited Liability Partnerships Act 2000. ^ Back to section

97 LLPs are specifically excluded from being able to take advantage of the general exclusion for bodies corporate in Paragraph 21 of the Schedule to the Collective Investments Schemes Order. ^ Back to section

98 The FCA's Perimeter Guidance Manual (PERG) 16.2, question 2.2. ^ Back to section

99 SI 2013/1773. ^ Back to section

100 PERG 16.2, question 2.15 provides further guidance on the definition of a collective investment undertaking. Broadly, the following characteristics should, if all apply, show that an undertaking is a collective investment undertaking: it does not have a general commercial or industrial purpose; it pools together capital raised from its investors with a view to generating a pooled return; and the investors, as a collective group, have no day-to-day discretion or control. ^ Back to section

101 Regulation 3(1) AIFM Regulations. ^ Back to section

102 Regulation 3(2) AIFM Regulations. ^ Back to section

103 Regulation 5(3)(c) AIFM Regulations and Article 9 AIFMD. ^ Back to section

104 Regulation 9 AIFM Regulations. ^ Back to section

105 Broadly, Regulation 10 allows for the registration of: internally managed, closed-ended investment companies (such as investment trusts); external managers of certain property funds; and managers of European social entrepreneurship funds and European venture capital funds. Schedule 8 of the Regulated Activities Order provides for small registered UK AIFMs to be excluded from the regulated activity of managing an AIF. ^ Back to section

106 These reporting requirements are contained in the FCA's Supervision Sourcebook (SUP) 16.18. ^ Back to section

107 ^ Back to section

108 FCA's priorities for updating and improving the UK asset management regime, speech by FCA chair, Ashley Alder, 11 October 2023. ^ Back to section

109 FUND 3.6.3 and 3.7. ^ Back to section

110 Senior Management Arrangements, Systems and Controls (SYSC) 10.1. ^ Back to section

111 SYSC 19B.1.2 and 19B.1.3. ^ Back to section

112 SYSC 19B.1.18. ^ Back to section

113 FUND 3.10. ^ Back to section

114 FUND 3.10.2. ^ Back to section

115 Article 82 AIFMD Level 2 Regulation (reproduced in FUND 3.10.9 of the FCA Handbook) lists a number of non-exhaustive situations in which an AIFM will be deemed a 'letterbox entity' and not the manager of the AIF ^ Back to section

116 FUND 3.11.4. ^ Back to section

117 FUND 3.9. ^ Back to section

118 FUND 3.3. ^ Back to section

119 Regulation 38 AIFM Regulations. ^ Back to section

120 Regulation 43(1) AIFM Regulations. ^ Back to section

121 Regulation 43(2) AIFM Regulations. ^ Back to section

122 UK Parliament Update on the Overseas Funds Regime: The UK's Equivalence Assessments of the EEA states, 30 January 2024. ^ Back to section

123 Overseas Funds Regime: Update for firms, FCA. ^ Back to section

124 CP23/26: Implementing the Overseas Funds Regime (fca.org.uk) ^ Back to section

125 HM Treasury/FCA joint publication: A roadmap to implementing the Overseas Funds Regime, May 2024. ^ Back to section

126 Ibid. ^ Back to section

127 Written statements – Written questions, answers and statements – UK Parliament. ^ Back to section

128 IA, Asset Management in the UK 2022–2023, The Investment Association Annual Survey, October 2023. ^ Back to section

129 ibid. ^ Back to section

130 ibid. ^ Back to section

131 Association of British Insurers, UK Insurance & Long-term Savings – Annual Review 2023. ^ Back to section

132 IA, Asset Management in the UK 2022-23, The Investment Association Annual Survey 2022-23, UK Institutional Market. ^ Back to section

133 Office of National Statistics, Ownership of UK Quoted Shares: 2022, 4 December 2023. ^ Back to section

134 ibid. ^ Back to section

135 Directive 2009/138/EC. ^ Back to section

136 Formerly, an entry charge based on the real estate asset value also had to be paid, but this was abolished under the Finance Act 2012. ^ Back to section

137 https://www.londonstockexchange.com/raise-finance/funds/listed-real-estate-hub/reits?tab=list-of-reits&lang=en. ^ Back to section

138 Property Industry Alliance, Property Data Report 2023, January 2024. ^ Back to section

139 See the discussion of CISs in Section II. ^ Back to section

140 FSA, CP13/9, Implementation of the Alternative Investment Fund Managers Directive, March 2013 and PERG 16.2, question 2.30. ^ Back to section

141 For example, such managers are likely to be managing investments under Article 37 of the Regulated Activities Order, advising on investments under Article 53 of the Regulated Activities Order or managing an AIF under Article 51ZC of the Regulated Activities Order. ^ Back to section

142 See, for example, FCA, Hedge Fund Survey, June 2015. ^ Back to section

143 The CityUK, Hedge Funds, May 2013. ^ Back to section

144 ibid. ^ Back to section

145 See, for example, the statement by Simon Walker, chief executive of the BVCA, on the AIFMD on 26 October 2010, in which he referred to the AIFMD as a 'defective Directive' and argued that the European Union had taken a 'hostile interest in the wrong industry at the wrong time and for the wrong reasons'. ^ Back to section

146 FCA Portfolio Letter: Our Alternatives Supervision Strategy 2022. ^ Back to section

147 Sir David Walker, Guidelines for Disclosure and Transparency in Private Equity, November 2007. ^ Back to section

148 Under the Walker Guidelines, a private equity firm is defined as 'a firm authorised by the FSA that is managing or advising funds that either own or control one or more UK companies or have a designated capability to engage in such investment activity in the future where the company or companies are covered by the enhanced reporting guidelines for portfolio companies'. In turn, a portfolio company is defined as 'A UK company (a) acquired by one or more private equity firms in a public to private transaction where the market capitalisation together with the premium for acquisition of control was in excess of £300 million, more than 50 per cent of revenues were generated in the UK and UK employees totalled in excess of 1,000 full-time equivalents; [or] (b) acquired by one or more private equity firms in a secondary or other non-market transaction where enterprise value at the time of the transaction is in excess of £500 million, more than 50 per cent of revenues were generated in the UK and UK employees totalled in excess of 1,000 full-time equivalents.' ^ Back to section

149 The Walker Guidelines and Private Equity Reporting Group (bvca.co.uk). ^ Back to section

150 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/955542/REVIEW_OF_THE_UK_FUNDS_REGIME_-_CALL_FOR_INPUT.pdf. ^ Back to section

151 Sections 1142 and 1146 Corporation Tax Act 2010. See also HMRC Statement of Practice 1 (2001) (as amended). ^ Back to section

152 UK Fund Tokenisation – A Blueprint for Implementation.pdf (theia.org). ^ Back to section

153 Further Fund Tokenisation – Achieving IF3 Through Collaboration Mar24.pdf (theia.org). ^ Back to section

154 Digital Sandbox | FCA. ^ Back to section

155 DP5/22 - Artificial Intelligence and Machine Learning | Bank of England and FS2/23 – Artificial Intelligence and Machine Learning | Bank of England. ^ Back to section

156 Our emerging regulatory approach to Big Tech and Artificial Intelligence | FCA. ^ Back to section

157 Business Plan 2022/23, FCA. ^ Back to section

158 IFRS S1. ^ Back to section

159 IFRS S2. ^ Back to section

160 Sustainability_Disclosure_Requirements__SDR__Implementation_Update_2024.pdf (publishing.service.gov.uk); UK Sustainability Reporting Standards - GOV.UK (www.gov.uk). ^ Back to section

161 ESG 4 - FCA Handbook. ^ Back to section

162 ESG 4.3.1R and see also 4.3.9G. ^ Back to section

163 PS23/16: Sustainability Disclosure Requirements (SDR) and investment labels (fca.org.uk), Chapter 5. ^ Back to section

164 PS23/16: Sustainability Disclosure Requirements (SDR) and investment labels (fca.org.uk), Chapter 7. ^ Back to section

165 Code of Conduct for ESG Ratings and Data Products Providers (icmagroup.org). ^ Back to section

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