AREF
The Association of Real Estate Funds

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Response by email to dp23-2@fca.org.uk

22 May 2023

Response to FCA DP23/2: Updating and improving the UK regime for asset management

We, the Association of Real Estate Funds[1] (AREF), welcome the opportunity to respond to the Financial Conduct Authority (FCA) regarding the above Discussion Paper (DP). We have collaborated with other associations, BPF, CREFC Europe, IPF, and INREV[2], to produce a real estate focussed response to this DP. We have used this response as the basis of AREF's own submission below.

Executive Summary

We have summarised below key responses in our submission.

Question 1: Common framework of rules for asset managers

We consider that a single common framework may be a goal too far at the present time, though we set out below our thoughts for achieving a more streamlined and consistent approach. We do not consider that wholesale revision to the rules for asset management firms is required. In particular, we suggest that separate chapters would clearly distinguish and de-lineate the rules for firms that manage unauthorised collective investment schemes and other alternative investment funds which admit retail investors; and those that admit only professional investors.

In addition, we suggest that various Statutory Instruments (SIs) that continue to implement EU secondary legislation could be repealed, and the identical text (subject to approved amendments) should be legislated for and drafted into the relevant sourcebooks of the FCA handbook instead.

Question 1: Reserved Investor Fund (RIF)

We strongly support the initiative for the RIF unauthorised contractual scheme given

- the RIF enhances the UK fund offering;
- addresses a significant gap in that offering: currently UK fund managers are forced to consider offshore alternative structures;
- there is widespread support from UK real estate fund and asset/portfolio managers for this fund structure.

We very much welcome the current consultation from HM Treasury and HMRC consultation on the RIF. We look forward to HM Treasury introducing relevant primary tax legislation that will apply to the RIF and secondary legislation as envisaged in clause 60(3) of Financial Services and Markets Bill. This will enable UK fund managers to launch and operate RIFs, we assume, from April 2024.

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[1] The Association of Real Estate Funds represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.

[2] British Property Federation (BPF), Commercial Real Estate Finance Council Europe (CREFC Europe), investment Property Forum (IPF) and European Association for Investors in Non-Listed Real Estate Vehicles (INREV)

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Question 3: Threshold for AIFM full-scope regime

We very much support increasing the threshold at which the full-scope regime applies to an AIFM, which in our view has significantly impacted access to market entry for start-up managers of real assets. The small AIFM regime is very accommodating for asset managers looking to start up in the UK but there is a very significant increase in cost base to apply the full-scope regime.

Question 4: AIFM regime – Professional investors

We welcome a separate regime for fund managers of professional funds and would be pleased to engage with the FCA on the details of this regime. We suggest a less-regulated sub-regime applying to AIFMs managing AIFs which are restricted to professional investors.

Question 4: External Valuer Liability

We strongly advocate the removal of the second paragraph of UK AIFMD 19(10) altogether.

Questions 6 – 8 inclusive: Enhancing liquidity management

Institutional investors have long recognised the illiquidity of real estate as an asset class. Following the global financial crisis, real estate industry bodies, such as AREF and INREV undertook considerable work to ensure that lessons from the crisis were learnt. Industry guidance to member funds is already in line with the 2018 IOSCO Recommendations and there is considerable disclosure to investors. We do not believe that further regulation is necessary, and we believe that industry trade bodies are well-placed to set best practice for funds for professional investors.

Questions 15 and 16: Tokenisation

We propose there should be policy review of the nature of the token and the extent to which the token will be transparent as well as the policy expectation for transparency. In the context of such a review, we suggest tokenisation of UK real estate funds or other indirect vehicles should be acceptable; but there may be challenges with tokenisation of direct UK real estate assets.

Question 24: Potential reform of the UK regulatory regime for asset managers and funds

While this DP is a useful occasion to consider opportunities for the future UK asset management framework, we note some key issues are excluded from the scope which are of significant importance to our members. For example, what approach will the UK take to future alignment with EU AIFMD? Is there any intention to maintain a framework which aligns with EU rules (with a view to benefitting from any potential future third country passport in AIFMD, for example) alongside any separate UK regimes which might be more appropriate for those firms which do not operate in the EU? We appreciate this is not just an FCA decision, but we would welcome the opportunity to discuss this with both the FCA and the Government. We have highlighted the importance to UK asset managers being able to be considered for "equivalence" for the purposes of access to professional investors in EEA member states under both AIFMD and MIFIR.

Further engagement

If you would like to engage with us further regarding any aspect of our response, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat, AREF. In addition, members of our Public Policy Committee are always willing to assist the FCA by sharing their wealth of knowledge and expertise in respect of real estate funds.

Yours sincerely

Paul Richards

Managing Director, The Association of Real Estate Funds

Responses to questions

Chapter 3: The structure of the asset management regulatory regime

Regime for fund managers and portfolio managers

Q1: Do you think that we should aim to create a common framework of rules for asset managers?

What benefits would you see from this? What costs might this create?

If you do not think we should do this, are there any areas discussed above where we should consider taking action, even if we do not create a common framework of rules?

What would we need to consider around the timing of implementing a change like this?

We welcome the FCA's consideration of rationalising rules for asset management firms and seeking to create more consistency and common ground between firms. We consider that a single common framework may be a goal too far at the present time, though we set out below our thoughts for achieving a more streamlined and consistent approach.

We do not consider that wholesale revision to the rules for asset management firms is required for two reasons. First, the sunk cost that firms have already invested in implementing the current regime and, second, the importance to UK asset managers in being considered for "equivalence" for the purposes of access to professional investors in EEA member states under both AIFMD and MIFIR. However, we have set out in our response some areas where we think changes would allow UK firms to remain broadly equivalent whilst gaining operating efficiencies and promoting market access to new entrants.

For example, we consider the current, hard-wired distinction between fund managers that are required to be separately licensed as UCITS management firms, alternative investment fund managers, MIFID firms and/or operators of collective investment schemes to be unwieldy and excessively costly for firms to implement, particularly new entrants and smaller firms into the market. A regime which focuses on the Part IV permissions that an asset management firm holds, and under which the requirements for prudential capital, conduct of business rules and systems and controls relate and attach to such permissions, would seem to capture all of the protections of the current regime, whilst allowing fund managers to operate out of a single operating entity. In other words, a firm would be able to hold permissions which would currently have to be divided between a UCITS management firm/full-scope alternative investment fund manager and a separately licensed MIFID affiliate.

As far as conduct of business and product rules set out in the FCA handbook are concerned, we expect it is unrealistic to achieve a common framework for fund/asset management firms within a single sourcebook without unjustified effort and delay in implementation.

However, some reorganisation of sourcebooks for ease of use and consistency would be worth considering. For example, COLL could remain as a single sourcebook for all rules applicable to authorised fund managers (those firms, as now, which hold permissions to manage the various categories of authorised collective investment scheme) and would continue to contain the product rules applicable to retail authorised collective investments schemes and qualified investor schemes.

FUND might then be expanded to contain all the rules that apply to "fund management firms" which are not authorised fund managers. In other words, firms with permissions to manage or operate unauthorised collective investment schemes and alternative investment funds other than non-UCITS retail schemes (NURS) or qualified investor schemes (QIS). We suggest that separate chapters would clearly distinguish and de-lineate the rules for firms that manage:

- unauthorised collective investment schemes and other alternative investment funds which admit retail investors (like the RIF that will admit investor categories such as certified high net worth investors, certified sophisticated investors, and self-certified sophisticated investors); and
- unauthorised collective investment schemes and alternative investment funds which admit only professional investors (like the RIF that will only admit professional investors).

Certain rules currently set out in SYSC or PROD, which relate to conduct obligations of asset management firmsmight sensibly find their way into FUND, COLL or COBS and some rules in COBS, for example governing operation of collective investment schemes, would be moved to FUND.

We suggest that various SIs that continue to implement EU secondary legislation could be repealed, and the identical text (subject to approved amendments) should be legislated for and drafted into the relevant sourcebooks of the FCA handbook instead.

As far as possible, the amendments to the sourcebooks would simply involve movement and insertion of new chapters rather than wholesale rewriting, with the exception of a targeted exercise to rationalise inconsistencies between the rules governing fund management firms, such as those governing conflicts of interest highlighted in the DP, and those changes to the rules that are promoted in response to the DP. As such, we are hopeful that such an exercise would not lead to a significant delay in implementation.

We also suggest the revised FUND sourcebook would be appropriate for the inclusion of new rules in relation to the new RIF (as an additional "Specialist AIF Regime"), which we understand that the FCA continues to explore with the Treasury. We set out further thoughts on this topic, and proposed amendments to the Financial Services and Markets Bill for this purpose, below.

Reserved Investor Fund (RIF) / new unauthorised contractual scheme fund structure

We very much welcome the 27th April 2023 HM Treasury and HMRC consultation on the RIF.

We are delighted that:

- in paragraph 2.32 of the DP, the FCA indicates that the Treasury is exploring options for the introduction of a new unauthorised contractual scheme fund structure (which we envisage to be branded the Reserved Investor Fund or RIF); and
- on 28th February 2023 the FCA confirmed in its Regulatory Initiatives Grid (page 45) that "*The Government is progressing work on proposals on the establishment of an unauthorised contractual scheme for professional investors…. through the [Financial Services and Markets] Bill".*

We strongly support this initiative for the RIF given:

- the RIF enhances the UK fund offering;
- it addresses a significant gap in that offering: currently UK fund managers are forced to consider offshore alternative structures;
- there is widespread support from UK real estate fund and asset/portfolio managers for this fund structure.

In light of the Government's decision *"to proceed with the introduction of the RIF, and in what form*" and Royal Assent of the Financial Services and Markets Bill we look forward to HM Treasury introducing relevant:

- primary tax legislation that will apply to the Reserved Investor Fund; and
- secondary legislation as envisaged in clause 60(3) of this Bill:

  "(3) After section 261Z5 insert—

  "CHAPTER 3B UNAUTHORISED CO-OWNERSHIP AIFS

  261Z6 Power to make provision about unauthorised co-ownership AIFs

  (1) The Treasury may by regulations make provision about unauthorised co-ownership AIFs that corresponds or is similar to, or applies with modifications, any of sections 261M to 261O and section 261P(1) and (2) (rights and liabilities of participants in authorised co-ownership schemes).

  (2) Regulations under subsection (1) may make provision about unauthorised co-ownership AIFs generally, or about unauthorised coownership AIFs of a description specified in the regulations.

(3) In this section "unauthorised co-ownership AIF" means a co-ownership scheme that— (a) is an AIF, and (b) is not authorised for the purposes of this Act by an authorisation order in force under section 261D(1)."

This will enable UK fund managers to launch and operate Reserved Investor Funds, we assume, from April 2024.

Regime for retail funds

Q2: Do you think we should change the boundary of the UK UCITS regime?

If so, do you think we should take any of the three approaches set out here?

Should we consider any alternative approaches?

What timeframe would be needed to allow firms to change their existing product offering or to develop new products?

We consider that changes to the UK UCITS boundary should be considered with caution (although we do not express a view as to any re-branding). We should like to see a much clearer boundary between collective investment schemes and alternative investment funds that may admit retail investors and those which are restricted to professional investors, creating an environment in which both categories of investor can invest with confidence. However, we are wary of unintended consequences in terms of changing the boundary between UCITS and NURS products. For example, many investment products will make reference to one or other of these categories in their own universe of permitted investments. In addition, many different types of financing arrangement will refer to one or other of these categories as permitted collateral. A change to the boundary might lead to significant cost across financial markets of reconsidering these arrangements compared to the potential benefit.

Regime for managers of professional funds

Q3: Do you think we should work with the Treasury to amend the threshold at which AIFMs must apply the full-scope rules? If so, do you have any comments on the options described above?

Are there any other areas we would need to consider if we were to do this?

We very much support increasing the threshold at which the full-scope regime applies to an AIFM, which in our view has significantly impacted access to market entry for start-up managers of real assets. The small AIFM regime is very accommodating for asset managers looking to start up in the UK but there is a very significant increase in cost base to apply the full-scope regime. We note that the regulatory burden is already much greater for a UK based small AIFM than for a small AIFM established in certain key competitor jurisdictions, e.g. Luxembourg (where in many cases only a registration is needed rather than authorisation), so it would be very helpful for small AIFMs to be assisted by the threshold being increased.

We agree with the FCA looking to consider one of these options:

3.48 *"……one option would be to change the size threshold at which firms must apply the full-scope UK AIFM regime. This could for example reflect the growth in markets since the threshold was originally set".*

3.49 *"An alternative option would be to allow firms that meet criteria other than their size to use the small authorised UK AIFM exemption. For example this could relate to the types or strategies of AIF that they manage, or the types of clients they have. This is already a feature of the current regime to an extent. The size threshold is higher for AIFMs who manage AIFs that meet conditions around leverage and redemption rights".*

We would be pleased to engage with you and consider the practicalities of each option.

In keeping with the above, we suggest, at least for fund managers of unauthorised collective investment schemes or alternative investment funds which invest in immovables and are restricted to professional investors, the appropriate threshold for the full-scope regime to apply would be [the point at which a firm manages a single AIF with AUM in excess of [£1 billion] or an aggregate threshold of AUM [£3 billion]]. These managers no longer benefit from the AIFMD marketing passport, so reducing the regulatory burden in this way would help to rebalance the cost/benefit equation to some degree.

As now, it should remain optional for a firm to opt in and seek to change its permissions to comply with the full-scope rules at any point.

Q4: Are there aspects of the current AIFM regime that professional investors do not value? Would there be benefit in us removing any of these?

We welcome a separate regime for fund managers of professional funds and would be pleased to engage with the FCA on the details of this regime and (we suggest) a less-regulated sub-regime applying to AIFMs managing AIFs which are restricted to professional investors.

We, of course, envisage the RIF fund structure (restricted to only professional investors) will be classified like those envisaged in DP paragraph 3.42 *"Many AIFs are operated exclusively for professional investors. Most AIFs are not FCA authorised funds".*

In relation to the RIF and other AIFs operated exclusively for professional investors, we comment on these statements within the DP:

> 3.46 *"…….we have had feedback that, in some areas, the full-scope AIFM standards go beyond what professional investors consider enough to protect their interests".* We very much endorse this feedback.
>
> 3.47 *"We do not plan to significantly change the rules derived from AIFMD".* With one notable exception, we agree with the plan not *to "significantly change the rules derived from AIFMD"*. The exception relates to UK AIFMD 19(10).

There is a particular issue relating to the rules on external valuers that causes an issue for real estate funds and which the FCA is aware from previous discussions with the industry. This issue is set out again below.

In addition, we should like to see further rationalisation of the rules, particularly in relation to rules that have been designed for open-ended funds and which really have no relevance for closed-ended funds, such as the requirement to calculate and disclose leverage on a periodic basis and following both the gross and commitment methods.

We should also like the FCA to comment on whether it perceives any value in the ongoing obligation of AIFMs to provide it with periodic reporting and, if so, which items and their relevance to which strategies. This reporting remains a significant burden and cost for AIFMs and the benefits should be justified if it is to be retained. We believe at the bare minimum the frequency of reporting should be reduced.

<u>UK AIFMD 19(10) – External Valuers</u>

UK AIFMD 19(10) states:

> *"AIFMs [alternative investment fund managers] are responsible for the proper valuation of AIF assets, the calculation of the net asset value and the publication of that net asset value. The AIFM's liability towards the AIF and its investors shall, therefore, not be affected by the fact that the AIFM has appointed an external valuer.*
>
> *Notwithstanding the first subparagraph and irrespective of any contractual arrangements providing otherwise, the external valuer shall be liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks."*

Many valuers, including RICS-regulated firms, are required to hold professional indemnity insurance (**PII**). However, such cover is not available with unlimited liability. Even where PII is not mandatory, many reputable valuation providers will not accept unlimited liability. If they do, they demand a significantly higher fee to compensate for the risk. A consequence is that many fund managers are unable to find external valuers to provide the required independent valuations or can only do so at a significant additional cost.

We suggest the removal of the second paragraph of UK AIFMD 19(10) altogether.

Contractual liability limits are commonplace in the legal and auditing professions. A prudent fund manager will ensure that the limit agreed with any professional adviser is proportionate to the risk of receiving incorrect advice. This will protect the positions of fund investors, fund managers and professional advisers. It makes little sense to restrict a fund manager's discretion to make appropriate arrangements with an external professional.

We note that FCA PS 21/14 stated:

> *"2.35 Several respondents noted that, although AIFMD provides for external valuers, in practice few firms are prepared to act as an external valuer because they are subject to unlimited liability if they are found to be negligent in their valuation. Respondents reported that this is widely interpreted as 'simple' negligence, which could be the result of an error made in good faith. Several respondents suggested that we should change the AIFMD wording to state that liability would only be in cases of gross negligence, covering serious errors or an intentional failure to perform the valuation appropriately. Respondents noted that valuers need professional indemnity insurance, but it would not be possible to get this to cover simple negligence…….*
>
> ***Our [FCA] response***
>
> ***We note the points raised around the potential liability for external valuers. We consider independent valuation of illiquid and hard-to-value assets to be an important control to protect consumers. We would like the market for external valuers to work better, so that all managers of LTAFs can access their services on reasonable terms. The liability standard comes from the AIFMD and was transposed through the Treasury's secondary legislation as part of implementing the Directive. We are unable to change the requirement at this stage, but are considering the function of external valuer together with the Treasury.***"

We suggest that the DP is an opportunity for the FCA to

- continue to consider the function of external valuer together with the Treasury; and
- explore legislative options like the removal of the second paragraph of UK AIFMD 19(10).

Chapter 4: Improving the way the regime works

Rules for authorised fund managers (AFMs)

Responsibilities of host AFMs

Q5: Do you think that we should amend our fund rules or add guidance either to make clearer the requirements on portfolio managers of funds, or to set minimum contractual requirements between host AFMs and portfolio managers?

Do you think this would lead to any other consequences that we need to consider?

As stated in our response to question 1, we do not think there should be specific rules that govern how a firm with permission to "manage investments" should have to carry out that activity differently under a contract from a fund management firm than it would for any other type of client.

To the extent that the FCA continues to have concerns about "hosted" fund platforms, we suggest that any such rules should focus on delegation of the portfolio management function by the fund management firm and should be constrained to arrangements where the end investors might be retail clients (rather than professional only products).

Enhancing liquidity management

Q6: Do you have any comments on us potentially amending the rules and guidance around liquidity stress testing?

Q7: Do you have any comments on whether we should make our rules on liquidity management and anti-dilution clearer?

Q8: Do you have any comments on the benefits or costs associated with public disclosure of fund liquidity?

Institutional investors have long recognised the illiquidity of real estate as an asset class. Following the global financial crisis, real estate industry bodies, such as the Association of Real Estate Funds AREF and INREV undertook considerable work to ensure that lessons from the crisis were learnt. Industry guidance to member funds is already in line with the 2018 IOSCO Recommendations and there is considerable disclosure to investors. We do not believe that further regulation is necessary, and we believe that industry trade bodies are well-placed to set best practice for funds for professional investors.

Given the importance of allowing UK firms to remain broadly equivalent for the purposes of wider market access and operating efficiencies, we would want to recognise the AIFMD liquidity management provisions being proposed under the current EU legislative review. A pragmatic approach for the FCA could be as follows:

- Require fund managers of open-ended funds that admit retail investors to make available at least two liquidity management tools (LMTs) (and implement detailed policies and procedures to operate, administer, activate and deactivate such tools) from a specified list (in addition to any other liquidity management provisions set out in the fund rules/constitutional documents). Please see further comments below on funds for retail investors;
- Fund managers of open-ended funds that admit only professional investors to retain the discretion and flexibility to choose what is most appropriate for their specific investment strategy, but should be expected to make available at least one LMT from the specified list;
- The LMTs to be chosen from could include redemption and subscription suspensions, redemption gates, notice periods, redemption fees, swing pricing, anti-dilution levies, redemptions in kind, and side pockets.

Funds for retail investors that invest in real estate need to be either a QIS or NURS. For a NURS investing in real estate, specific rules already exist as such a fund would now be regarded as a fund investing in inherently illiquid assets (FIIA). Proposals for addressing liquidity arrangements for such funds were set out in FCA Consultation Paper CP20/15 *Liquidity mismatch in authorised open-ended property funds.* The outcome of this is still outstanding. Our comments are as follows:

- We continue to express serious concerns regarding the introduction of mandatory notice periods as this adversely impacts investor choice and has the potential to cause poor customer outcomes. The daily dealt open ended property funds continue to provide investors with much needed income and capital diversification and are easily understood by the investor base. We believe that different liquidity tools are appropriate in different circumstances, and a “one-size-fits-all” approach does not deliver the best outcome for retail investors. This is also more consistent with the 2018 IOSCO Recommendations. If change is considered necessary, although notice periods may be appropriate for some funds and investors, a deferral mechanism will be more appropriate for others. Both are valid liquidity management tools.
- Prior to any new regulations being proposed, as an absolute minimum, there needs to be a corresponding change to the ISA rules to permit longer term notice periods and additionally widespread platform development ensuring any notice periods can be operationally supported by an evolved platform ecosystem. Only at that stage, and not prior, should any new regulation be considered post a review of the success of the embryonic LTAF regime and its take up by wealth managers. This considered approach aligns and is consistent with the ‘call to action’ recently made by the PFWG in their publication ‘Investing in Less Liquid Assets – Key considerations’ and provides a consistent and joined up approach.
- We do not believe that a grandfathering provision for existing ISA investors will be sufficient to prevent poor customer outcomes. This will be made considerably worse for funds with a high proportion of ISA investors if the ISA rules are not amended to allow investment in such funds.

We have not commented on the specific proposal on COLL 6.12.11R(2) as this only applies to UCITS funds and real estate is not an eligible asset for such funds. This does not therefore apply to real estate funds.

In respect of dilution adjustments, UK funds for professional and for retail investors investing in real estate as an asset class generally use dual pricing with a bid/offer spread to reflect the cost of transacting in the underlying property, particularly Stamp Duty Land Tax. In Europe, capitalisation and amortisation is more common. AREF and INREV have recently updated and coordinated their guidance in this area. We do not believe that further regulation is necessary. In the past, additional dilution adjustments have been used to reflect the additional discount for forced sale of real estate assets in stressed situations. In practice, fund managers would generally seek to use other LMTs to avoid this scenario arising.

We have not commented on the proposal for public disclosure of liquidity “buckets” as separate and specific rules already apply to funds investing in commercial and residential real estate, as outlined above.

Investment due diligence

Q9: Do you have any comments on us making our expectations on investment due diligence clearer for all asset managers?

We wish not to respond to this question.

Clarifying rules for depositaries

Q10: Do you agree that we should make our expectations of depositaries clearer?

Do you have any comments on the areas where greater clarification would be desirable?

Are there any areas where we should consider removing oversight functions from depositaries? Are there areas where the contribution of depositaries is particularly valuable for the interests of investors?

We wish not to respond to this question. We believe the Depositary and Trustee Association (DATA) are best placed to answer this question.

Improving the fund rules

Q11: Do you have comments on the analysis of the eligible assets rules for UCITS set out here? Do you think we should update or provide guidance on these rules?

If we did so, what impact would this have for managers of UCITS funds?

We wish not to respond to this question. Real estate is not an eligible asset class for a UCITS fund.

Q12: Do you have any comments on whether we should consider removing or modifying detailed or prescriptive requirements in the rules on prudent spread of risk?

We believe that two aspects of the prudent spread of risk impede the development of investment funds, particularly for investment in illiquid assets:

- The limit of 35% invested in another collective investment scheme under COLL 5.6.7 (6). We envisage situations, particularly for immovable property as an asset class, in which a NURS may wish to pool its direct property holdings with another NURS, LTAF or institution through a pooling vehicle such as a CoACS NURS. The first NURS may hold other investments outside the pooling vehicle such that it is not a feeder NURS, but never-the-less wishes this to be more than 35% of its property.
- The restriction under COLL 5.6.10 (3) that prohibits a second scheme having more than 15% of its assets in other collective investment schemes. We envisage situations in which a NURS, for example a multi-asset fund, invests for its property allocation in a property fund NURS and that NURS wishes to pool some or all of its portfolio another NURS, LTAF or institution through a pooling vehicle such as a CoACS NURS.

Both of these points have been recognised in the development of rules for the LTAF. We believe that the current provisions are unnecessarily restrictive and that they impede rather than enhance risk mitigation.

Q13: Are there any other areas where you think we should consider removing or modifying prescriptive requirements in the retail fund rules?

We wish not to respond to this question.

Chapter 5: Technology and innovation

Technology in fund operations

Q14: Do respondents agree that we should work towards consulting on rules to implement the 'Direct2Fund' model?

We wish not to respond to this question.

Fund tokenisation

Q15: What benefits would tokenised units in authorised funds provide for investors? What regulatory changes would be needed to enable tokenised units to be issued?

How much of a priority should we put on enabling tokenisation of units?

As a starting point, we propose there should be policy review of the nature of the token and the extent to which the token will be transparent as well as the policy expectation for transparency.

In the context of such a review, we suggest:

- tokenisation of UK real estate funds or other indirect vehicles should be acceptable; but
- there may be challenges with tokenisation of direct UK real estate assets.

Industry may be advocating the token functioning more as a method of ownership rather than a token be a securitised or consolidated version of an asset or collection of assets, and for the tokenisation sector to benefit from economies of scale.

In this scenario:

- The issues to be addressed for real estate assets include those issued relating to ongoing maintenance/custody/management.
- If a real estate asset were tokenised a token holder would then own a fractional share of that asset and hence in principle should be liable for Stamp Duty, other taxes and liabilities arising from partial ownership of the asset. In addition, each fractional share would need to be registered with the Land Registry.

It may be tokenisation for equities, bonds or fund/indirect vehicle units are quite easy to conceptualise but for assets like real estate, the real estate tokens would be challenging to create and manage and give rise to legal and tax considerations which need to be better understood.

Subject to this starting point (and in the case of equities and bonds), we welcome the fact that the FCA is open to examining the rules how units are created, transferred, registered, and ultimately cancelled to ensure that they are flexible enough to allow firms to operate a digital register. We note, however, that managers already operate digital registers, albeit that these are not distributed registers or registers that otherwise use blockchain or distributed ledger technology. The key consideration and priority for any regulatory rules connected with tokenisation is that the rules should not discriminate on the basis of technology, either to the disadvantage or advantage of those using blockchain or distributed ledger technology to operate and/or market funds. In particular, a firm using blockchain or distributed ledger technology to give investors access to investments in property, should not have burdens placed on it that would not apply if it were giving investors via a non-blockchain or distributed ledger structure. That firm should also not be given an advantage through reduced regulatory requirements that would otherwise apply if the firm used a non-blockchain or distributed ledger structure.

Tokenised portfolio assets

Q16: Are there specific rules that could impact firms' ability to invest in tokenised assets, where the underlying instrument is itself an eligible asset?

How much of a priority should we put on enabling investment in tokenised assets?

As indicated in our response to question 15, we suggest tokenisation of UK real estate funds or other indirect vehicles should be acceptable; but there may be challenges with tokenisation of direct UK real estate assets.

We understand that the main rules associated with underlying assets, e.g. property laws; and the implications in terms of Stamp Taxes and otherwise protecting the Exchequer are outside the jurisdiction of the FCA.

In terms of Stamp Taxes and otherwise protecting the Exchequer, we assume that the FCA will be consulting with HM Treasury and HMRC.

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Investment in cryptoassets

Q17: How important do you think the different kinds of 'fund tokenisation' discussed above are for the future of the industry?

Are there examples from other jurisdictions that could be models for UK fund regulation?

Please see our comments in response to question 15 above.

Q18: What other regulatory changes, if any, would you like to see to enable fund managers to make wider use of advances in technology without weakening investor protection?

We wish not to respond to this question.

Chapter 6: Improving investor engagement through Technology

Ongoing information needs of investors

The fund prospectus

Q19: Do you agree that improving the content and readability of the prospectus will improve investor engagement?

What specific changes would you like to see?

We wish not to respond to this question.

Managers' reports and accounts

Q20: What changes to the rules for managers' reports and accounts could enable firms to make best use of technology to meet investors' information needs?

How else could disclosure of ongoing information to fund investors be improved?

For example would there be benefit in us consolidating ongoing annual disclosure reports for funds?

We wish not to respond to this question.

Investor engagement

Q21: Do you agree we should review the rules for unitholder meetings? What changes should we make so that these meetings maximise the participation of fund investors?

We wish not to respond to this question.

Q22: How could the relationships between fund manager, intermediary and investor be better reflected in rules for authorised funds?

Should the FCA do more to enable investors to engage with the manager of their fund?

We wish not to respond to this question.

Chapter 7: Conclusion

Q23: Do you have any comments on the relative benefits of the topics raised in this paper which you think we should consider as part of prioritising our work?

How would you rank the areas covered in this paper in terms of priority?

We are mindful that any changes should, as a priority, have clear benefits and be proportional and not unduly burdensome. Our members' businesses are cross-border in nature and competitive internationally. It is vital that the UK asset management regime supports and complements the global frameworks in which our members operate and provides a robust but flexible environment which protects investors and encourages innovation. We would be very happy to discuss any aspects of our response with the FCA.

Q24: Do you have any comments on potential reform of the UK regulatory regime for asset managers and funds in areas that are in scope of this paper but have not been discussed in detail?

While this DP is a useful occasion to consider opportunities for the future UK asset management framework, we note some key issues are excluded from the scope which are of significant importance to our members. For example, what approach will the UK take to future alignment with EU AIFMD? Is there any intention to maintain a framework which aligns with EU rules (with a view to benefitting from any potential future third country passport in AIFMD, for example) alongside any separate UK regimes which might be more appropriate for those firms which do not operate in the EU? We appreciate this is not just an FCA decision, but we would welcome the opportunity to discuss this with both the FCA and the Government. You will note we have highlighted, in response to question 1, the importance to UK asset managers being able to be considered for "equivalence" for the purposes of access to professional investors in EEA member states under both AIFMD and MiFIR. However, there are some managers who would:

- prefer to operate outside the fully compliant AIFMD regime;
- access EU investors via national private placement regimes; and
- not want to be forced into full AIFMD compliance as the *quid pro quo* for accessing a third country pan-EU marketing passport (which they may feel they do not need in order to operate their business successfully).

We also highlight, as indicated in our response to question 4, that the DP is an opportunity for the FCA to:

- continue to consider with the function of external valuer together with the Treasury; and
- explore legislative options like the removal of the second paragraph of UK AIFMD 19(10).

We would also like to comment on the practical experience of some of our members when using FCA Connect to make applications and notifications, including notifying to market non-UK funds in the UK under NPPR. For those firms, who do not need to frequently use FCA Connect, it would be valuable to be able to have a soft copy form of all of the documents, so that they can obtain relevant advice on what is required to complete the process in advance. In addition, the lack of an adviser-only access level to FCA Connect is a hindrance to this process. It would be very useful if some simple but practical changes could be made to the application process and FCA Connect itself to address these challenges. We would be happy to discuss in more detail.

Finally, in our response to the UK Funds Review Call for Input and in our response to CP21/12 in respect of the LTAF, we indicated our strong support for the introduction of the RIF unauthorised contractual scheme. We continue to see the need for the RIF and strongly advocate for its introduction as indicated above in our responses to questions 1 and 4.