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Dear Chief Executive

Our Asset Management & Alternatives Supervisory Strategy – interim update

We are writing to you to update our portfolio letters issued in August 2022 and February 2023. The update reflects changes in the external risk environment, work that completed since those letters and provides our forward areas of focus for this sector over the next year[1]. The areas of focus that we highlight below are consistent with the multi-year plan we set out previously and are intended to give you clarity on our areas of regulatory focus for the year ahead. Clearly, in the event of unexpected future events we may need to reconsider this plan – if this occurs, we would of course update you.

In writing to a large and diverse group of firms we know that not all issues raised will be relevant to your firm. However, we expect your Board and you to discuss the content of this letter and consider how it applies to your business and, where necessary, take action.

Asset managers faced heightened uncertainty and several market shocks in 2023. As a result, firms have been experiencing challenges in raising and maintaining assets. Responses in the sector to these challenges include cost cutting and consolidation, while evaluating new opportunities present in the environment. While there are some signs of improvement in the outlook, a volatile geopolitical and economic environment continues, and the full impact of challenges faced over previous periods may still be felt over the course of this year. There is a high volume of significant business and regulatory change to be delivered in 2024. This change is likely to impact business models, products and services, as well as customer outcomes and markets. Engagement with your firms and with industry bodies is important to inform any future regulatory change so that we can assess the outcomes that will be delivered.

[1] Since Q4 2022, both the Alternatives portfolio and the Asset Management portfolio are supervised in the Buy-Side Directorate of the FCA. The Buy-Side Directorate also supervises the Custody and Fund Services portfolio (not a focus of this letter)

We remain committed to enabling detailed and constructive engagement through our consultation processes.

As previously communicated, good governance is always important, but especially during periods of heightened uncertainty and change. Failure to effectively manage and oversee these risks and the change impacting firms could result in poor outcomes for investors and customers, as well as reputational and resilience risks crystalising.

Our supervisory approach will continue to focus on assessing the effectiveness of firms' governance arrangements in assigning senior accountability for the risks identified below, oversight by governance bodies, and ensuring appropriate management information about those risks support good decision making.

Setting and testing higher standards

This year we'll continue to work for consumers to make sure that governance bodies of our portfolio firms are looking after investors' interests particularly in periods of market disruption, stressed market conditions and through consolidations occurring in industry.

Assessments of Value and Consumer Duty

In 2023, the Consumer Duty commenced, six years since the release of our Asset Management Market Study, which applied enhanced governance and product value assessment remedies to Authorised Fund Managers (AFMs). Last year we conducted a multi-firm review of AFMs' assessment of value (AoV) that confirmed progress has been made in implementing improved practices and shared examples of the good practice we have observed. Notwithstanding, customer outcomes from these assessments remain variable.

We continue to engage with those firms with significant AoV deficiencies, using our regulatory tools as appropriate. We will maintain our focus on this important area and where we see outliers, we will follow up and take necessary action to ensure AoVs are conducted in line with our rules and expectations.

This year, we will build on this work and will assess, under the Consumer Duty, how asset managers have considered price and value of products and services provided to unit-linked funds[2]. We will undertake a joint multi-firm review with the life insurance portfolio, to understand price and value across the value chain and what actions firms have taken under the Duty to improve outcomes.

From 31 July 2024, the Consumer Duty will also apply to closed products and services. Firms should have started the necessary work to prepare for this deadline and have a clear roadmap in place to comply with the Duty. We will issue a separate communication on Consumer Duty in due course.

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[2] This work has also been referenced in our 'Insurance market priorities 2023-2025' letter of 20 September 2023: https://www.fca.org.uk/publication/correspondence/life-insurance-market-priorities-2023.pdf

Change management

We have previously highlighted harm to consumers and market integrity that can be caused by operational disruption at firms. During 2023, we undertook proactive engagement with several firms to assess their preparedness for complying with Policy Statement 21/3 *Building operational resilience.* We found some weaknesses and gaps in firms' mapping of impact tolerances, risk identification and testing, though we also identified some good practice. We will continue to work with outlier firms identified in 2023 and plan further proactive engagement throughout this year. We remind you that, by no later than 31 March 2025, in-scope firms must have performed mapping and testing showing that you are able to remain within impact tolerances for each important business service. You must also have made the necessary investments to enable your firm to operate consistently within those impact tolerances.

In 2023, we assessed how well firms had embedded the Guiding Principles for ESG and sustainable investment funds. We found that while much progress has been made, many firms still have further work to do, particularly around the disclosure and clarity of information being given to retail investors and consumers.

This year, firms will implement the Sustainability Disclosure Requirements (SDR) and investment labels. Where firms promote their ESG credentials, their boards and other governance bodies should be appropriately structured to oversee and review management information about those activities, the third-party ESG information providers used, and the claims made by their firms. We will be concerned if firms make exaggerated or misleading sustainability-related claims, including about their investment products.

We recognise that a considerable amount of current and planned regulatory change impacts this sector, presenting challenges for firms. These changes come at a time when many firms are struggling to attract and/or maintain assets under management, leading some firms to implement cost cutting programmes. There is a risk that firms may not be adequately resourced to handle this change at the same time as transformation programmes and any strategic developments, such as mergers/acquisitions. Therefore, this year we will work to establish firms' preparedness by assessing how firms' governance and resourcing of change programmes has considered and mitigated this risk (particularly firms' implementation of SDR, and preparedness for complying with PS21/3) to ensure that potential harms to investors and markets are being appropriately addressed.

Valuation practices for private assets

A higher interest rate and tighter credit environment has placed pressure on the valuations of some assets. A higher proportion of fund assets globally are now held in private assets where valuation practices are not as transparent as those for publicly traded assets. As more investors seek access to private markets, it is vital that they can trust that valuations are robust and reliable in all market conditions.

Building on the work we completed in 2023 on liquidity management, we will be conducting a multi-firm review examining valuation practices for private assets, including examining the personal accountabilities for valuation practices in firms, governance of valuation committees, the information reported to boards about valuations and the oversight by relevant boards of those practices. Again, as with other multi firm reviews, we will communicate the outcomes of this work for the benefit of all firms.

Reducing and preventing serious harm

We will be building on work done over the last year to strengthen horizon scanning for emerging risk, making sure firms in our portfolio meet threshold conditions, closely monitoring those firms with significant market impact, that present idiosyncratic risks to the system or are identified as outliers. We expect firms to have systems and controls in place to counter the risk that they might be used to further financial crime. This includes compliance with the UK sanctions regime, where a failure to be compliant could result in breaching threshold conditions and relevant Handbook rules.

Market integrity and disruption

The Buy-Side sector are important participants in financial markets and, alongside routine surveillance, we will continue our work diagnosing and addressing elements of the system that have shown vulnerability to market stress. This includes work with other domestic agencies and internationally to strengthen resilience of money market funds, funds with significant liquidity mismatches, and transmission of risk from the non-bank financial sector to the wider market. We will have particular focus where we see large, concentrated positions in markets, and highly leveraged positions. We expect to see robust risk management practices which address these issues and that appropriately account for potential market impact.

We will continue our work with the Bank of England on the ongoing System-Wide Exploratory Scenario being conducted to improve understanding of the behaviours of banks and non-bank financial institutions during stressed financial market conditions and how those behaviours might interact to amplify shocks in UK financial markets that are core to UK financial stability.

Supporting Innovation

Technological and digital innovation is occurring across the value chain. This offers opportunities to positively transform business models and improve outcomes. Firms need to consider how technological innovation can be safely and effectively implemented in the sector so that potential benefits are realised whilst risks are managed.

In supporting innovation, we have been working with the Technology Working Group, which sits under the Treasury's Asset Management Taskforce, on the recently published blueprint for fund tokenisation. We will continue to support the Asset Management Taskforce to identify and harness potential innovative new technologies for the UK asset management industry. With Project Guardian, we are collaborating with regulators across the world to explore fund and asset tokenisation use cases. We intend to work closely with other regulators globally and international standard setters to encourage convergence of global standards in this important area.

Promoting competition and positive change

The asset management and alternatives sector in the UK is an international, globally competitive sector. High standards have contributed to the trust and confidence enjoyed in the UK market, which has in turn facilitated international competitiveness and growth.

Policy priorities

There are several regulatory enhancements planned for this sector over 2024[3].

We will undertake work to implement the government's Smarter Regulatory Framework (SRF) with a focus on MiFID, AIFMD and UCITS. While the timeframe for migration of these regulations into the FCA Handbook is yet to be determined, we expect to make significant progress this year.

Informed by the feedback we received to DP23/2 *Updating and improving the UK's regime for asset management,* we will ensure any changes made:

- better meet the needs of investors, both domestic and international, retail and professional
- enable technological development, innovation and better use of data
- are consistent with international standards and take account of rules in other jurisdictions, so that firms can continue to operate efficiently on a global basis
- are effective and proportionate, simplifying and standardising requirements where possible.

We expect to 'lift and drop' significant parts of existing regulation but will take the opportunity to make changes to progress the three main priorities for reform identified through feedback: making the regime for alternative fund managers more proportionate; updating the regime for retail funds and supporting technological innovation[4].

Some important reforms will affect disclosure for retail distribution of asset management products. We intend to consult about a replacement regime to PRIIPs and are seeking industry views on how support to consumers can be enhanced under the Advice Guidance Boundary Review.

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[3] Please our regulatory initiatives grid for further information on planned regulatory initiatives in the next two years: https://www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid

[4] https://www.fca.org.uk/news/speeches/updating-and-improving-uk-regime-asset-management-our-priorities

For a few in sector it will be of interest that we are currently in the process of transferring EU requirements for Money Market Funds into our Handbook, and at the same time consulting on standards to enhance resilience of such funds.

Modernising our Fund Authorisation process and enabling operation cross border

This year, firms will begin to access our enhanced Fund Gateway. This system will initially be used to recognise new Offshore Funds from equivalent jurisdictions to be marketed into the UK, some transitioning from the Temporary Marketing Permissions Regime that has been in place since Brexit. Facilitating continuing access for EEA funds supports a wide and deep fund universe for UK retail and other investors. For all users of the Fund Gateway the new system will support an enhanced experience.

International engagement

As regulator of a leading investment management financial centre, the FCA will continue to be involved in the development of international standards relating to the sector, such as provision of thought leadership to IOSCO and FSB. IOSCO's FSEG is considering NBFI systemic risk issues, including bond market liquidity and margining practices. Our Executive Director, Sarah Pritchard, is co-leading an FSB workstream on leverage in the non-bank sector together with the ECB. Our Buyside Head of Policy, Nike Trost, is Deputy Chair of IOSCO Committee 5 (Asset Management) with files developing global standards on liquidity, benchmarks and short-term corporate bonds. Our Director Matthew Long is Chair of the Digital Products Taskforce considering global standards for digital assets.

We expect our firms to meet high standards consistent with the important role they play in global markets and within one of the largest investment management ecosystems globally.

Next steps

You should discuss this letter with your Board and Executive Committee and consider whether the risks of harm above are present in your firm and adopt strategies for mitigating them. As CEO, you are responsible for ensuring that your firm meets FCA requirements, including the relevant obligations and expectations set out above. You should take all necessary actions to ensure these are met and reinforce accountabilities with your Senior Managers for these risks. In any future supervisory engagement with you, we will consider whether your governing bodies and Senior Managers have taken appropriate action to ensure that consumers and markets are adequately protected from harms.

Contacts

Should you have any queries please contact your usual FCA supervisor or use the channels on our contact page if you do not have a named supervisor. For those of you with dedicated supervisors, this letter is an addition to your Firm Evaluation letter.

In the event your firm faces urgent issues of strategic importance, please contact Christopher Davis, the Head of Department for Market Interventions – Asset Management & Funds at Christopher.Davis@fca.org.uk.

Yours sincerely

Camille Blackburn

Director – Wholesale Buy-Side