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Financial Conduct Authority

12 Endeavour Square

London

E10 1JN

Submitted via email to: dp23-2@fca.org.uk

RE: DP23/2: Updating and improving the UK regime for asset management

BlackRock¹ is pleased to have the opportunity to respond to Discussion Paper 23/2: Updating and improving the UK regime for asset management, issued by the Financial Conduct Authority.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this Discussion Paper and will continue to contribute to the thinking of the FCA on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

Martin Parkes

Managing Director

martin.parkes@blackrock.com

Georgina Uwaifo

Global Public Policy Group

georgina.uwaifo@blackrock.com

¹ BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Executive summary

We believe the UK's objective in this review should be to create a regulatory regime for asset management that allows the sector to better serve end-investors, capture the opportunities stemming from future growth sectors, and take advantage of emerging technologies, rather than attempting to compete for market share with regulated fund sectors which are well-established in other jurisdictions. At the same time, it should recognize the scale and pace of regulatory change the UK's financial services and asset management sector has faced in recent years, and that is currently taking place.

As such, we see almost no benefit in amending regulatory frameworks such as UK UCITS or UK AIFMD which currently function very effectively. UK UCITS in particular is a well-established framework, reflecting the wider global UCITS brand, on account of its simplicity and usability. Accordingly, we believe it is important to maintain the continued access to these funds for UK investors, and we look forward to further progress on the Overseas Fund Regime, in line with this.

Similarly, while we see theoretical benefits to consolidating asset management regulations – UK UCITS, UK AIFMD, UK MiFID – into a single rulebook, in practice this is likely to result in significant operational risk and cost to the asset management sector without yielding any clear benefits to end-investors, competitiveness of the UK sector, or reduction in cost of compliance.

We welcome the views outlined by the Investment Association (IA) in their response to this consultation, and take the opportunity here to provide detailed answers to the FCA's questions below. We have identified three areas we believe the FCA should prioritize, spanning the immediate to longer term:

Securities lending: Securities lending in UK UCITS, which increases return for end-investors, could be made more beneficial to end investors by updating the rules on collateralisation. Traditionally, collateral in respect of these loans is received on a title transfer basis, however, in recent years an alternative method of collateralisation has emerged, whereby lenders take a security interest over (rather than title to) the collateral. Currently, UK UCITS are not permitted to accept collateral by means of security interest (aka 'pledge') and their lendable inventory is underutilised compared to lenders that are not subject to the same limitation. Permitting UK UCITS to also receive collateral by way of security interest ('pledge'), rather than only by transfer of title would increase utilisation of lendable inventory held by these funds, which, in turn, would generate incremental revenue for end-investors, without introducing incremental risk. See our answer to question 24 for more detail.

Share fractionalisation and Retail Service Providers: We have observed an increase in first-time retail investors in recent years, which may be attributed in part to the growth of ETF savings plans that enable investors to start investing in 'fractions' of UCITS ETFs for as little as £2. Fractional investing by means of direct beneficial ownership can provide access to broad diversification and different investment exposures. However, not all models that are currently marketed as 'fractions' actually operate on the principle of allowing direct ownership of the underlying ETFs to end-investors. A small minority of structures deliver performance of an underlying ETF by means of derivative contracts like certificates, and should be differentiated from direct ownership models. It is our understanding that under a derivatives-based model, retail investors become the creditors of the contract issuer and not the actual owners of the underlying instrument. Compared to direct ownership of the underlying, derivative contracts

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can be complex in nature, and many retail investors will not have sufficient understanding of exactly how these instruments work. We encourage the FCA to issue regulatory guidance to distinguish between these two structures. In response to recent ESMA guidance on this issue², we issued a [Policy Spotlight: Fractional Ownership and ETF Savings Plans](#), setting out in further detail our understanding of the two models, and policy recommendations to reinforce investor protection. We encourage the FCA to undertake a similar assessment of different share/ETF ownership models operating in the UK.

Relatedly, we have previously expressed our agreement with the FCA's assessment that the Retail Service Provider (RSP) execution model lacks transparency, competition, protection against sub-optimal execution, and choice of execution venue, potentially unfairly disadvantaging retail investors in comparison with institutional investors.³ In this context, we welcome the FCA's efforts to develop a consolidated tape, which we feel would allow executions via the RSP process to be benchmarked against the wider market, driving best execution and better outcomes for retail investors.

Tokenisation of fund units: We see both fund and security tokenisation as a medium-to-long-term opportunity, which could significantly enhance efficiency of transfer and settlement processes, ultimately delivering savings to end-investors. The three major use cases for tokenisation currently would be tokenising existing securities for specific purposes i.e. collateral management, issuing assets directly on a blockchain, and tokenising fund units such as the closed-circuit tokenization of money market funds. We feel that a clear regulatory framework is needed for the industry to operate within; collaboration across market participants in these early stages to tackle the operational challenges posed; and eventually, the development of an ecosystem based on tokenisation. See our answer to questions 15-18 for more detail.

Additional commentary: While much of the focus of this DP relates to improving the functioning of the UK asset management regime by means of changes to the UK UCITS, UK AIFMD and UK MiFID frameworks, there are some significant and targeted improvements that exist outside of these structures, such as reform to the Financial Services Compensation Scheme (FSCS) levy. A change to the structure of the levy could help to reduce the cost of doing business in the UK for firms.

Responses to questions

The structure of the asset management regulatory regime

Question 1: 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?

These frameworks are well-established and are embedded into firms' operations with little issue. We therefore do not believe that creating a common consolidated rulebook should be an immediate priority. While there may be some upside to having a single rulebook over the longer

² See ESMA, [Public Statement on derivatives on fractions of shares](#), March 2023

³ See BlackRock's response to the [FCA CP 22/12: Improving equity secondary markets](#).

term, we believe a more targeted approach to address specific complications would be more effective at this stage. Conversely the immediate downside of this exercise would be operational risk and significant cost for firms in the sector, particularly given the scale and pace of ongoing regulatory reform.

A more impactful way of meeting the aim – set out in the DP – of simplifying the compliance burden or accommodating future financial product innovations would be to directly lower the cost of doing business in the UK asset management sector. We therefore welcome the FCA's commitment to undertaking a review of the funding mechanism for the Financial Services Compensation Scheme (FSCS) levy. We believe this can be done in a way that is consistent with the regulatory objectives set out in the Financial Services and Markets Bill to promote international competitiveness that is aligned with robust consumer protection. We provide a detailed overview of our recommendations for reforming the FSCS in our [response to the FCA's DP21/5: Compensation Framework Review](#).

Question 2: 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?

In general, we believe the UK should seek to establish advantage in future growth industries, and avoid seeking to compete for market share with the regulated fund sectors that are well established in other jurisdictions.⁴

UCITS is a well-established and internationally recognised brand that provides simple, transparent access to liquid investments. It is unclear what benefit the introduction of a 'basic' fund would bring to investors, and we therefore see little benefit in changing the boundary of the UK UCITS regime. A fund with restricted investment capabilities would typically be more appropriate where it offers access to a unique investment opportunity for a suitable specialised investor type. The LTAF is one example of this, and we welcome the FCA's recent proposals to permit retail investor access to these funds, with suitable guardrails.⁵

Question 3: 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?

Question 4: Are there aspects of the current AIFM regime that professional investors do not value? Would there be benefit in us removing any of these?

Answering questions 3 and 4 together: as with UCITS, we believe AIFMD is a well-established and well-functioning framework and do not see particular need to amend it.

⁴ See BlackRock's [response to HM Treasury's Review of the UK funds regime](#).

⁵ See BlackRock's [response to FCA CP22/14: Broadening retail access to the long-term asset fund](#).

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We note that the European Commission conducted a detailed review of the operation of the AIFMD framework and concluded that only minor changes were required to the regime, particularly in the area of delegation reporting and liquidity management.

Improving the way the regime works

Question 5: 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?

BlackRock is not a user of third-party AFMs, therefore, we do not have substantive comments on this question. However, the FCA may wish to consider how this regime balances facilitating innovation and ensuring investor protection: namely, how it enables new, smaller managers who may be less able to conduct their governance in-house to enter the market. It may be that as managers grow in size and scope, they are encouraged to take more responsibility for their own governance, rather than remaining within the third-party AFM model.

Question 6: Do you have any comments on us potentially amending the rules and guidance around liquidity stress testing?

We note that this issue and a broader set of liquidity risk management considerations for open-ended funds are currently being discussed at the international level by the Financial Stability Board (FSB) and International Organization of Securities Commissions (IOSCO), and recommend that any approach taken in the UK is consistent with the outcome of this work.

As part of their liquidity risk management processes, asset managers already employ ex-ante measures including ongoing stress testing of portfolio assets and liabilities. We believe all managers should do so and therefore support the FCA removing the ‘where appropriate’ qualification in ESMA’s stress testing guidance when transposing it into the UK rulebook.

To further enhance the quality of managers’ stress testing, we encourage the FCA to consider two other areas. Firstly, a consolidated tape for both fixed income and equity will provide managers with access to timely and reliable market data, which is critical to properly assess market depth and transaction costs, and can in turn enhance assessments of asset liquidity and calibration of swing pricing models.

Secondly, liquidity stress testing also requires understanding how the underlying investors of a fund may behave, and while it is possible to achieve this through dialogue with institutional investors, retail funds – which are often intermediated through distribution networks – can be more complicated to assess due to the aggregation of flows in omnibus accounts. Better visibility of these flows would allow managers to conduct more robust modelling of fund liability profiled. The FCA could consider convening working groups of all actors involved in the fund distribution chain, to explore how to improve the flow of critical information on underlying investor types.

Question 7: Do you have any comments on whether we should make our rules on liquidity management and anti-dilution clearer?

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We support efforts to improve the availability and uptake of swing pricing, or alternative anti-dilution mechanisms. For swing pricing in particular, we recommend raising standards and best practises in its use, while, crucially, maintaining its primary use as an investor protection tool. The standards that are set for swing pricing should cover the principles and operations that underpin the setting of swing factors and thresholds, model management, operations, governance, and escalation procedures. They should not take an overly prescriptive approach such as recommending when swing pricing should occur and what swing factors should be applied, as this could unfairly distort the cost of trading for fund investors versus other market participants. An overly prescriptive approach would also undermine the fiduciary duty fund managers hold towards their investors. We discuss our recommendations on how swing pricing can be further encouraged in our [Policy Spotlight: Swing pricing – Raising the bar](#).

It will again be important to ensure the UK is consistent with FSB-IOSCO work on this issue.

Question 8: Do you have any comments on the benefits or costs associated with public disclosure of fund liquidity?

Public disclosure of fund liquidity could increase market timing risks, and may risk incentivising behaviours that are detrimental to fund investors both individually and collectively, if investors were to inaccurately interpret the data presented.

Indeed, identifying a liquidity classification framework that is appropriate to the structure of open-ended funds and gives an accurate picture of fund liquidity, is a critical pre-requisite of public disclosure of fund liquidity. Assessments of open-ended funds' liquidity positions should reflect how redemptions are managed in practice, and recognise that liquidity of individual securities is relative to trade size and market capacity – which will vary over time. Moreover, investors in mutual funds have an equity stake valued according to the pro-rata share of underlying fund assets, and funds will sell a range of securities and not just rely on cash, cash equivalents, or government bonds in portfolios to weather a market shock or manage large outflows.

This means assessments of funds' liquidity profile based on static ex-ante classifications of individuals securities in the portfolio – for example the High-Quality Liquid Assets (HQLA) metric used for banks – will not be appropriate.⁶

We again note that the way fund liquidity is measured and classified is subject to ongoing FSB-IOSCO discussions, and we encourage that the UK is consistent with recommendations and guidance put forward.

Question 9: Do you have any comments on us making our expectations on investment due diligence clearer for all asset managers?

We believe the current regime on investment due diligence is functioning well, but it is important not to conflate investment due diligence with portfolio risk management – including liquidity risk. Both elements are important to ensuring the best possible outcomes for investors in the fund. Due diligence is security-specific and should also take into account the differences in process inherent in investing in listed securities as opposed to private assets, which do not have the benefit of public listing documents. We also believe that liquidity should always be

⁶ For further discussion, see [BlackRock \(2021\) Liquidity Risk Management is Central to Open-Ended Funds – Addendum](#).

considered at the level of the portfolio, and not purely at an individual asset level (see question 8).

Question 10: 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?

No specific concerns.

Question 11: 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?

The FCA may want to consider re-emphasising the underlying principle of the eligible assets rules for UCITS, namely that they should be readily transferable securities.

Question 12: 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 agree with the FCA's preferred approach as described in the paper, and further would not support any modifications of the rules. No comment.

Question 13: Are there any other areas where you think we should consider removing or modifying prescriptive requirements in the retail fund rules?

No comment.

Technology and innovation

Question 14: Do respondents agree that we should work towards consulting on rules to implement the 'Direct2Fund' model?

Yes. BlackRock has worked with the Investment Association on this proposal, and we support their recommendations.

Question 15: 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?

Question 16: 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?

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Question 17: How important do you think the different kinds of ‘fund tokenization’ discussed above are for the future of the industry? Are there examples from other jurisdictions that could be models for UK fund regulation?

Question 18: 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?

Questions 15-18 are answered together here.

Tokenisation of securities and fund units could significantly enhance efficiency of transfer and settlement processes, ultimately delivering savings to end-investors. At present, we note three major use cases for tokenization:

1. Tokenising existing securities for specific purposes, i.e. collateral management: the development of industry wide network that allows participants to more quickly mobilise assets for collateral could ease operational friction
2. Issuance of assets directly on a blockchain – where we have seen recent activity with debt issuance.
3. Tokenisation of fund units, for example closed circuit tokenisation of money market funds, which if adopted more widely would bring both operational benefits to fund investors, but also market-wide benefits by facilitating transfer of funds between market participants without requiring activity in underlying secondary markets.

We see both fund and security tokenisation as a medium-to-long-term opportunity. Particular challenges at present include the emergence of multiple private blockchains, which could lead to trapped liquidity; the establishment of custody in instances where the owner does not have an existing relationship with the security issuer; and the form of payment that should be used. We see the need for a clear regulatory framework for the industry to operate in e.g. concerning KYC; continued collaboration across all market participants to explore the operational challenges posed; and the development, over time, of an ecosystem based on tokenization – rather than a range of standalone solutions.

Improving investor engagement through technology

Question 19: Do you agree that improving the content and readability of the prospectus will improve investor engagement? What specific changes would you like to see?

As the FCA points out, the prospectus and constituting instrument are effectively the terms and conditions of the contract between the AFM and the investor. Their primary function as legal documents necessarily limits how simple and engaging they can be. We are supportive of efforts to make these documents clearer and more accessible, and believe the FCA are best placed to specify the types of information that would be most relevant for firms to provide to investors, particularly in the context of new Consumer Duty considerations.

It could be beneficial to have a means of centralising the common sets of information that applies across almost all funds an investment manager may provide, such as the relevant FCA

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rules that apply, details about the fund manager, and the legal structures of the firm. This would in essence split the prospectus into a) a single, central, online document detailing all of the common pieces of information that are repeated across a firm's prospectuses; and b) a product-specific prospectus with information specifically relevant to the individual fund.

Question 20: 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?

As with the prospectus, the reports and accounts are a legal requirement of fund managers, and as such, will have limitations on how engaging they will be to investors.

There are though, several areas of divergence in the COLL handbook regarding the reporting requirements across regulated funds, so would encourage the FCA to assess where consistency of these criteria could be enhanced. We again feel the FCA would be best placed to determine the most appropriate types of information that should be included, particularly in the context of new Consumer Duty considerations.

Question 21: 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 are supportive of the FCA permitting a virtual format for unitholder meetings.

We would also encourage the FCA to reconsider which issues require a unitholder vote, and how these votes are expressed. As the DP notes, distribution of funds through platforms can mean that there is no channel for direct engagement between the unitholder and fund manager. This can mean funds' operational and governance processes, such as IOP changes, fail due to a lack of attendance or interaction from unitholders. The FCA could also consider modifying the COLL guidelines to allow for written resolutions where unitholders would need to express unanimous consent, which could be more time and cost efficient where there are fewer unitholders.

Question 22: 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 are committed to a future where every investor can participate in shareholder voting.. At BlackRock, since launch in January 2021, we have expanded our own Voting Choice offering – a proxy voting mechanism.⁷ We welcome the FCA's consideration of ways to support the trend towards shareholder participation. However, we caution against the suggestion in the DP of

⁷ <https://www.blackrock.com/corporate/about-us/investment-stewardship/blackrock-voting-choice>

requiring fund managers to provide such services – particularly given the variety of approaches currently being adopted across the market. In our view, ‘expression of wish’ mechanisms, which offer end-investors a way to simply express a preference, are not a solution to the challenge of enhancing client voice, given there is no direct mechanism to attribute end-investors wishes to the share of securities they hold – and therefore risk conflict with managers’ fiduciary duty. Indeed the Department for Work and Pensions in guidance issued last year has recognised ‘expression of wish’ as “distinct from client-directed voting”.⁸

Concluding questions

Question 23: 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? (The response form for this question provides a tool for ranking the 10 major topics set out in Table 1 on p.14).

See executive summary.

Question 24: 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?

One area the FCA could consider is the ability of UK UCITS to engage in securities lending. Securities lending is undertaken by UK UCITS as part of their efficient portfolio management strategies, and generates incremental revenues from their asset holding, thereby increasing returns for end-investors.

Traditionally, collateral in respect of these loans is received on a title transfer basis, however, in recent years an alternative method of collateralisation has emerged, whereby lenders take a security interest over (rather than title to) the collateral. COLL 5.4.6R(1)(aa) states that collateral is adequate for a UK UCITS scheme only if it is received under a title transfer arrangement. As such, UK UCITS are not currently able to receive collateral by way of security interest (aka ‘pledge’) and their lendable inventory is underutilized compared to lenders that are not subject to the same limitation. This competitive disadvantage will likely be further exacerbated by the forthcoming changes to capital rules applicable to bank borrowers which, as things stand, could see borrowing from UK UCITS become prohibitively expensive.

We therefore recommend the FCA permit UK UCITS to also receive collateral by way of security interest (‘pledge’), rather than only by transfer of title. This will likely increase utilisation of the lendable inventory held by UK UCITS, which in turn will generate incremental revenue for end-investors.

We believe this could be done without introducing incremental risk to UK UCITS: Security interest collateral arrangements have been structured such that they are legally akin to title transfer arrangements so that collateral is “sufficiently immediate” for the purposes of COLL

⁸ See Department for Work and Pensions: [Consultation outcome - Reporting on Stewardship and Other Topics through the Statement of Investment Principles and the Implementation Statement: Statutory and Non-Statutory Guidance.](#)

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5.4.6 (2) and can be appropriated and liquidated as quickly following a borrower default. To this end, the International Securities Lending Association (ISLA) has produced market standard documentation as well as supporting legal opinions which talk to the enforceability of these arrangements and the extent to which they constitute security financial arrangements for the purposes of the Financial Collateral Arrangements (No 2) Regulations 2003.