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By email: AIFMRegimeCFI@fca.org.uk

Dear Asset Management and Funds Policy Team,

Financial Services Consumer Panel response to FCA Call for Input - Future regulation of alternative fund managers

The Financial Services Consumer Panel (the Panel) welcomes the opportunity to respond to the FCA's call for input on the future regulation of alternative fund managers. Please also refer to our previous response to the FCA Consultation Updating and improving the UK regime for asset management – DP23/2.¹ In addition, we have also submitted a separate response to the HM Treasury consultation - Regulations for Alternative Investment Fund Managers.

The Panel supports the FCA's review of the regulation of alternative fund managers; however, we do have the following comments:

- The FCA should establish a set of high minimum standards as a baseline for all firms. For example, they should be expected to adhere to the FCA principles and standards, including the Consumer Duty and the Senior Managers and Certification Regime.
- The rules and regulations relating to alternative fund managers should give greater consideration to investors as key stakeholders than is currently contemplated in this call for input.
- The FCA should categorise firms based on a holistic risk assessment approach that also considers all risks that may lead to consumer harm; the Panel believes that the current emphasis on size of firm and use of leverage is largely intended to address market integrity.
- Firms must have documented evidence that an investor is an accredited / professional investor; self-certification is not sufficient. The FCA must hold the distributor responsible for ensuring that this evidence is obtained prior to investment.

¹ [20230522_final_fscp_response_fca - asset management regime - dp23-2.pdf](#)

- Firms must provide information to investors that helps them to make decisions that are in their best interest. This should include information about all of the material risks that are posed by the firm structure, as well as the assets in the fund. This must be complete, clear, understandable, and timely. Firms should be expected to test their communications with their target market. The FCA should ensure that there is consistency of information across the various types of funds so that investors and potential investors can make comparisons.
- Consumer protections, including access to the Financial Ombudsman Service (FOS) and coverage by Financial Services Compensation Scheme (FSCS) should be safeguarded. Further, consumers should benefit from the same protections as they would receive for similar products or services.

In addition to these comments, we have responded to the questions in the attached Annex.

Yours sincerely,

Chris Pond
Chair of the Financial Services Consumer Panel

Annex:

Question 1: Do you agree that the areas outlined above are issues with the current regime? If not, please explain why. Are there any issues beyond those that we have identified that we should consider when amending the regime?

The Panel agrees that the issues described by the FCA may be problematic, particularly from the perspective of potential consumer harm. We are particularly concerned with firms that may take advantage of the structure of the rules to avoid higher expectations and those firms where the FCA has identified poor conduct and valuation practices, inappropriate and incorrectly classified products, and weak risk management controls.

The Panel believes that there should be a greater emphasis on a broader risk assessment of the risks posed by AIFs / AIFMs as part of the regime, including those risks that are related to consumer / investor harm. The Panel believes that, while important, the focus on the size of the firm and the degree of leverage to categorise firms primarily address market integrity / stability and are only part of the picture.

Question 2: Do you have any comments on structuring the presentation of our rules thematically based on the product cycle and business activities?

The Panel agrees that the FCA's proposed structuring of the rules is a practical and user-friendly approach which should improve the ability to navigate and understand them and will help to ensure good outcomes for investors at the various stages of the investment journey. We would also like to see consideration of post-investment issues, including enforcement and redress, especially in the event that something goes wrong.

Question 3: Do you agree with the principle of creating three levels of firms based on their size to achieve proportionality? If not, what alternative approach would you suggest?

We believe that, with the availability of technology today, sophisticated risk assessments should guide regulatory priorities for authorisation, supervision, and enforcement. Whilst size is one characteristic that will create risk, there are many others, financial and non-financial, that should be considered. The Panel would expect that this risk assessment would capture risks to consumers, as well as risks to market integrity. This will serve to incentivise firms to follow good business practice, to instil the proper culture, and to deliver products and services that consumers need and want.

Question 4: Do you agree with our approach to rule-making for each level? If not, what alternative approach would you suggest?

The Panel agrees with the proposed rule structure shown in Table 2 of paragraph 2.12. However, the Panel would prefer to see high minimum standards that apply across all firms, regardless of risk. In addition to these standards, the FCA should then implement additional layers of specific rules applied on the basis of the identified risks of the firm rather than the size of the firm.

Question 5: Are there any benefits or costs associated with opting up to a higher threshold regime that we should consider when we draft rules? If you are an AIFM, would you consider opting up to a higher regulatory threshold?

The Panel notes the comment in paragraph 2.20 that “professional clients sometimes require their investment managers to exceed regulatory minimum standards”. This speaks volumes, as it clearly states that investors with expertise have a voice. The FCA should be ensuring that all investors have a voice; therefore, the FCA should set an acceptable standard that is applicable to any firm that has investors that are not professional investors. All AIFMs should be achieving the standards that are expected by professional investors.

Question 6: Do you agree with the proposed levels of the thresholds? Do you have any other comments on the proposed levels and the metrics used for the thresholds?

No, the Panel does not agree with thresholds. One of the key issues identified by the FCA in paragraph 2.5 was the issue that cliff edges associated with thresholds pose and the fact that firms will act to avoid thresholds. This will still exist in this proposal. As noted in our response to question 3, we believe that the FCA should use a risk-based methodology to establish regulation and to authorise, monitor, and supervise firms. Whilst the size of the firm and the degree of leverage used are both relevant, they are largely associated with market integrity rather than consumer protection, so are just two of the metrics that should be utilised. The Panel expects that appropriate metrics will also capture any materials risks the firm poses to consumers. Under this approach, each firm will be different and there is no obvious benefit to regulatory arbitrage. In fact, firms that engage in this kind of behaviour should see an increase in their risk profile.

The FCA will need to monitor risks in the sector and to publish information as to its risk-assessment methodology, and it will generally need to give firms sufficient notice when their risk profile changes. Firms should then have time to challenge and / or adapt to the required changes.

The Panel recognises that firms may argue that it makes their business model and regulation more complex, but if they are managing their firm properly, these should already be part of their own internal risk assessment approach.

Question 7: Do you agree that we should make our expectations of risk management by highly leveraged firms clearer? Do you have any comments on the best way to achieve this?

Yes, highly leveraged firms should understand all of the associated risks, and the FCA should make it clear that is the expectation. Because the FCA has access to the information of all firms, as well as other regulators, it is uniquely positioned to identify risks that firms would not, so should share information with those firms to which the risks are relevant. It would also be helpful if the FCA and the firms would share information in a structured and collaborative manner, so that all are alerted to any emerging risks. In the current environment, there are many ways that this can be done; it does not need to be in formal letters.

However, this approach should not be limited only to leverage but should include other risks, especially those that will impact investors, as well.

Question 8: Do you see a need for a separate regime for venture capital and growth capital funds? Are there any other areas where we should consider setting up tailored regimes?

The Panel takes the view that all funds should adhere to a high minimum standard, regardless of the type of fund. As noted previously, rules and expectations may differ depending on the risks associated with the firm. Therefore, the FCA should assess the additional layer(s) of expectations that would be imposed on these types of firms, based on the risks they present. Given the government's intention to increase the level of investment by non-professionals into productive assets, these funds must be subject to increased regulation rather than less.

Question 9: Do you have any comments on our planned approach to set different rules for managers of LCICs?

The Panel agrees that all Listed Closed-Ended Investment Companies (LCICs) should be authorised and supervised by the FCA. This will protect investors who may not have the expertise and / or the time to follow and analyse the assets and transactions of the firm.

The FCA should subject all firms to a set of high minimum standards, which are designed to ensure compliance with FCA principles, Code of Conduct, Consumer Duty, the Senior Managers regime, etc. Beyond that, the FCA should assess the risks posed by the firm, potentially adding a

layer of rules to address risks to consumer protection and market integrity and ensuring that those risks are appropriately managed. This assessment can and should include mitigations derived from other regulation, such as the Listing Rules.

Question 10: Do you have any comments on our proposed approach to applying the thresholds in the same way to LCICs as to other types of AIF?

As we have described previously, the Panel does not agree that thresholds should be the basic starting point for the regulatory framework for AIFs. Thresholds are designed to ensure market integrity. Although thresholds protect consumers from market-wide issues, they are not sufficient to ensure consumer protection. And the issues noted by the FCA relating to cliff edges will still exist.

Question 11: Given the role of an LCIC's board of directors, are there any areas that would benefit from us clarifying our expectations of AIFMs and/ or any requirements that should not be retained in so far as they apply to the AIFMs of LCICs?

The Panel believes that good governance is the underpinning of any successful firm, regardless of industry, and the board of directors is responsible for ensuring and demonstrating this. In addition, for any firm subject to financial services regulation, the board of directors must demonstrate that they are aware of and that the firm has implemented the minimum standards noted in our response to Question 9. The board of directors must also ensure that the risks posed by the firm, including risks that expose consumers to harm and any risks specific to AIFMs, are assessed and appropriately mitigated.

Question 12: Do you have any comments on our proposed areas of reform for LCICs? Are there any further areas of the regime where different requirements should apply to the AIFMs of LCICs? If so, please explain how the requirements should apply differently and why this is the case.

The Panel notes the comment in paragraph 2.49 relating to the perceived lack of value of information provided to investors over and above that provided in the annual report. Before discontinuing this requirement, the FCA should conduct research (or expect firms to do so) to identify why this information is not valued and / or what could make it more valuable.

The degree of leverage used by an AIFM is a risk which the Panel believes is important to capture in a thorough risk assessment; however, leverage is just one of the risks that should be considered.

If the FCA rules that are in place relating to AIFMs are not practical, e.g., the delegation rules, then the Panel supports either changing or removing those rules, as long as sufficient provisions to protect consumers and market integrity remain. The FCA should analyse and document the fact-based reasons for any proposed changes, including any potential for harm to consumers.

Question 13: Do you see a need for changes to the regime’s depositary requirements? Should these requirements apply only to specific levels of firm or certain types of fund, such as authorised funds? Should our regime seek to align its depositary rules with those of another jurisdiction or jurisdictions?

The Panel does not see a need to change the regime’s depositary requirements. Again, we note that some investors, which are presumably professional investors, expect a fund to appoint a depositary; therefore, this should be a baseline expectation. A depositary provides a means to ensure that a fund is following good business practices, and as the FCA notes, provides consumer protection. The Panel accepts that funds that have only professional investors may not value this, but the Panel expects that these funds must have evidence demonstrating that these investors are truly qualified as such; the fund cannot accept self-certification alone.

Question 14: Could any of the ideas in this Call for Input adversely impact any of the groups with protected characteristics i.e. age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment?

The Panel has not identified any ideas within the call for input that may adversely impact any group with protected characteristics. However, we do very much appreciate that the FCA is considering this possibility.

Question 15: Are there other steps we could take to improve outcomes for fund investors or potential investors with any of these protected characteristics?

In compliance with UK law and the Consumer Duty, we expect firms to consider investors with protected characteristics or investors who are, or might be, vulnerable in all aspects of their business model, including product design, pre- and post-sales, monitoring, reporting, etc.

Question 16: Do you have any comments on the approach to the risk management rules outlined in annex 1?

The Panel agrees with the approach where there are general requirements that apply to all AIFs with an extra layer of requirements depending on

the risks posed by the firm. However, the Panel would expect that the risks are expanded to include risks over and above the size of the firm, liquidity, and leverage. These address risks to market integrity. The FCA must also identify the risks of harm to consumers and implement appropriate standards and rules to mitigate those risks.