FINANCIAL CONDUCT AUTHORITY

12 Endeavour Square
London
E20 1JN

Call: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

26 February 2025

Dear Chief Executive

Asset Management & Alternatives - Supervisory Strategy

We are writing to firms in this sector to explain our current supervision priorities. This letter helps meet our public commitment to rigorously prioritise resources in line with our approach to supervision and to support firms to understand these priorities.

This year we intend to focus our supervision on the following priorities:

- supporting confident investing in private markets
- building firm and financial system resilience against market disruption, and
- securing positive outcomes for consumers

We will also undertake targeted work to support trust in the market for sustainable investment and to reduce financial crime and market abuse.

Our supervisory work complements our wider policy work, and particularly our work to support growth.

Background

The UK is a leading centre for asset management and is an important sector for the government's growth objectives. It is the largest in Europe and the second largest globally. It plays a central role in the UK economy and in overseeing investments for individuals and institutions from across the globe. By channelling investments into the real economy firms facilitate the delivery of good investment outcomes for investors, efficient functioning of capital markets, and contribute to economic growth.

Firms in the sector manage and advise assets totalling £14.3 trillion. Approximately 2,500 firms operate a range of business models across public and private markets, offering fund management, discretionary investment management, and advisory services. In the last 12 months, we have seen growth in subsectors such as private credit and infrastructure, as well as in products and services such as exchange traded funds (ETFs) and model portfolio services (MPS).

Globally, financial markets continue to be challenging and volatile. The way in which asset managers and alternatives firms manage their responses to geopolitical and market events will continue to be crucial. The increasing interconnectedness of the sector and reliance on third parties underlines the importance of robust operational resilience to the smooth functioning of markets. These changes are likely to affect your business models, products and services, as well as consumer outcomes and the markets.

Supporting the UK's status as an international investment hub and fostering growth and innovation is important for us, in line with our secondary international competitiveness and growth objective. We want to work closely with industry and stakeholders to develop a vision for this priority growth sector. Outside our supervisory work, we will undertake work to strengthen and streamline our regulatory and data frameworks to support investment in areas such as private assets and digital innovation, including tokenisation. We will be engaging with you to discuss initiatives to unlock capital investment and liquidity, accelerate digital innovation to improve productivity, and take forward ideas to reduce the regulatory burden.

Supervisory Approach

Good governance and a healthy firm culture are critical tools to achieve good outcomes during heightened uncertainty and change. We will continue our focus on how effectively firms' governance arrangements are assigning senior accountability for the risks we identify in our priorities below, oversight by governance bodies and ensuring appropriate management information about those risks supports good decision making.

We are continuing to improve how we use data and technology and looking at how this can help reduce regulatory burden. As part of our commitment to reform the regulatory framework, we are reviewing our data collection to make it more efficient and effective. This year we will engage with industry on a review of AIFMD so that we can streamline regulatory requirements and collect data that is proportionate to our supervisory needs and cost-effective for firms.

Our Current Supervisory Priorities

1. Private Markets

Private markets have grown rapidly in recent years, and the UK is the largest centre for private fund management in Europe. Private markets have become an important means for investors to diversify investment and seek new sources of return, and for corporates to obtain long-term capital to finance growth. Increasing numbers of asset managers are investing in private markets capabilities, building organically or via acquisition and joint venture, to meet rising investor demand. Firms seeking growth in this market are investing in capabilities, frameworks, and controls to support their ambitions and deliver good investor outcomes.

Without the frequent trading and regular price discovery present in more liquid public markets, firms must estimate private asset values using judgement-based approaches to meet applicable accounting standards. This introduces a risk that firms could value private assets inappropriately, for example through poorly managed conflicts of interest or insufficient expertise. Investors need fair and appropriate valuations to make informed decisions and understand how their investments perform. Where firms use valuations to price transactions, this may affect fairness between buyers, sellers, and remaining investors. Where firms use valuations to calculate fees, there is a risk of firms inappropriately charging investors.

We have undertaken supervisory work to support confident investing in private assets. We will shortly release our multi-firm review on Private Market Valuation Practices. Firms should consider the report's findings to ensure their valuation processes are robust, with a strong governance framework and audit trail. We also expect boards and valuation committees to be given regular, sufficient information on valuations to ensure effective oversight. We will also continue our leading role in setting global standards and are currently contributing to IOSCO's review of its 2013 Principles for the Valuation of Collective Investment Schemes.

More broadly, poorly managed conflicts of interest increase the likelihood and severity of investor harm. Conflicts may increase where firms operate multiple intersecting business lines, continuation funds, co-investment opportunities or partner with other financial institutions.

This year, we will start a multi-firm review focusing on conflicts of interest at firms managing private assets. We will assess how firms oversee application of their conflict-of-interest framework through governance bodies and reviews by the three lines of defence, to ensure investor outcomes are not compromised. With rapid growth in private markets, we expect to see evolving and updated procedures to identify, manage and mitigate conflicts of interest.

There are currently limited opportunities for retail investors to invest in private assets, but innovative retail product development is underway. Many firms are carefully considering if their product development frameworks remain fit for purpose for the more complex risk landscape in which private assets sit. They are actively addressing the challenges to ensure investors have the right information about private market products. To meet Consumer Duty expectations, many firms are taking additional steps to understand distribution chains to retail clients and taking steps to deliver good outcomes for their products' end-investors. We will continue to supervise these issues to support the sector's transition to retail offers of private market products.

2. Market Integrity and Disruption

Disruptive market events are becoming more frequent. Since 2020, the sector has demonstrated resilience in navigating volatility, with significant episodes of market stress and disruption including the LDI crisis, dash for cash, Crowdstrike outage, basis and carry trade volatility and recent geopolitical events.

Recently, the Bank of England (BoE), in collaboration with the FCA, published findings from the System Wide Exploratory Scenario (SWES). The report noted enhanced resilience in a number of sectors, including in the asset management sector. However, it also found some persistent risks and vulnerabilities in the system. Actions by non-bank financial institutions (NBFIs), like rapid asset sales, amplified the impact of the initial scenario shock.

The SWES report provides valuable insights for firms to help improve their risk management practices. This includes consideration of system wide dynamics for stress testing and contingency planning. Informed by the vulnerabilities identified in the SWES report, we will focus surveillance on prudent risk management, liquidity management and operational resilience. We will continue to improve our supervisory processes to strengthen oversight of these market vulnerabilities.

We will also continue to monitor liquidity risk and ensure that the recommendations in IOSCO's consultation paper on Liquidity Management for Collective Investment Schemes are in place across our systems. Similarly, we will consider findings on margin preparedness from both the SWES and the FSB's final report on Liquidity Preparedness for Margin and Collateral Calls and discuss actions with relevant firms. Finally, we will continue our data-led approach to identifying outlier firms and funds to seek assurances about risk management. We will focus particularly on those with high leverage, illiquidity, or concentrated investment strategies.

Operational frictions can limit firms' abilities to react to market disruption. Firms should consider the resilience and effectiveness of their operational processes and collateral management practices, including their oversight of third parties where services are outsourced.

3. Consumer Outcomes

Asset managers play an important role in providing suitable products and services that support consumers' financial goals. Retail products and services like ETFs and MPS, have seen innovative development giving consumers greater investment choice and diversity.

Under the Consumer Duty (the Duty), firms must act to deliver good outcomes for retail consumers. Since the Duty came into force, firms have made significant efforts to implement and embed it into their business practices. Firms should continue to develop their monitoring capabilities to assure themselves they are delivering good consumer outcomes.

In our 2024 interim portfolio letter we discussed a multi-firm review of unit-linked funds. This work is ongoing. The review is assessing price and value across the value chain for unit-linked funds to ensure good outcomes are being delivered for investors. We plan to publish our findings, including good practices, later this year.

MPS have been growing at pace. Though MPS sit outside traditional fund wrappers, these portfolios generally invest in investment funds and asset managers are active in constructing and distributing these services. This year, we will start a multi-firm review of MPS looking at how firms are applying the Duty, to provide confidence that investors are receiving good outcomes from MPS and share good practice on how firms are doing this.

We will also engage with firms affected by key policy proposals to make our disclosure regime more flexible to support smooth implementation of these proposals. Our Advice-Guidance Boundary Review (AGBR) proposals aim to help consumers get the support they need to make informed financial decisions. We see the potential for firms to use targeted support to better engage consumers and help them achieve better outcomes with their savings and investments. Our Consumer Composite Investments consultation to transform product disclosures will prioritise good consumer outcomes through a more flexible regime.

4. Targeted Work - Sustainable Finance

To maintain and grow the UK's position as a global investment hub, the sector needs to keep pace with change and meet appetite for sustainable investment. The introduction of our Sustainability Disclosure Requirements (SDR) and Investment Labels regime, with the anti-greenwashing rule, aims to build trust in the market and ensure that products that are marketed as sustainable do as they claim, with the evidence to back up these claims.

We will engage with firms with sustainability-related products, to understand how they are implementing the labelling, naming, and marketing rules. This will allow us to identify any outliers and engage with them.

We encourage firms to use the further information we have published since our SDR Policy Statement, including the SDR webpage for firms and good practice disclosure examples for investment labels.

5. Targeted Work - Financial Crime and Market Abuse

The increasing trend towards investment in private assets requires commensurate risk management to tackle financial crime risks related to complex ownership structures.

Firms should be alert to the risk they could be used to facilitate financial crime, including fraud, money laundering, terrorist financing and bribery and corruption. Appropriate and proportionate systems and controls are key mitigants to this risk, and effective oversight is crucial where controls are outsourced. Proportionate and risk-based due diligence on investors and robust Know Your Client (KYC) checks are particularly important to identify ultimate beneficial owners.

Where we identify weaknesses, we will review the effectiveness of firms' financial crime systems and controls, with a supervisory focus on anti-money laundering (AML) controls in private markets funds.

Market abuse undermines confidence in, and the integrity of, financial markets. Established, robust systems and controls are crucial in mitigating this risk, with firms providing a vital first line of defence. We expect firms to ensure their market abuse controls enable them to discharge obligations under the Market Abuse Regulation (MAR).

Next Steps

We are writing to a large and diverse group of firms and know not all the issues raised here will be relevant to your firm. You should discuss this letter with your Board, Executive Committee, and accountable Senior Managers to consider whether the risks of harm discussed here exist in your firm and implement strategies for managing them.

Contacts

This letter complements our wider policy work, and particularly in the current cycle, our work to support growth. The priorities identified here will help you and us to prioritise resources to those areas of most significance.

If you have any questions or feedback about these supervisory priorities, please contact your usual FCA supervisor or via our contact page if you do not have a named supervisor. For firms with dedicated supervisors, this letter is an addition to your Firm Evaluation letter and ongoing supervisory programme.

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

Yours faithfully

Camille Blackburn
Director, Wholesale Buy-Side
Financial Conduct Authority