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OUT-LAW ANALYSIS

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Regulatory uncertainty persists for listed investment funds in the UK

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Recent papers issued by the UK Treasury and Financial Conduct Authority (FCA) fail to address lingering regulatory uncertainty affecting listed investment funds and it is unclear whether the industry will get all the answers it is looking for before the next UK general election.

The listed investment funds industry in the UK is already grappling with a period of particular uncertainty. Within the market itself, shares are trading at discounts to net asset value at levels not seen since the 2008 financial crisis, there is an elevated amount of consolidation, merger and takeover activity and growing levels of shareholder activism.

On the regulatory front, the UK government and FCA have proposed a number of changes affecting listed investment funds, including changes to the listing regime and costs disclosures. To date, however, there is no clear picture of what the final changes will be or how they will take effect, save for an interim measure affecting the costs disclosure regime announced recently.

Laura Dobie
Legal Director

Details of the government's proposed long-term solution to costs disclosures for listed investment funds are awaited, meaning the industry has no sense yet of how this issue will be fully resolved or when



The costs disclosure requirements which apply to listed investment funds in the UK have come under fire for requiring them to disclose their costs while similar listed commercial companies do not have to do so and because these costs are then aggregated into multi-asset vehicles or funds of funds that invest in listed investment funds. The costs disclosure regime has been a cause for concern in the industry for some time, with the Association of Investment Companies (the AIC), the industry body which represents a broad range of closed-ended investment companies, notably having been critical of the current regime since its introduction in 2018.

The government has begun to take action on the issue. Alongside the chancellor's autumn statement, the Treasury published its [policy note on the UK retail disclosure framework](#) (the policy note) on 22 November 2023. In that policy note, the Treasury stated that it intends to legislate on these matters in 2024, subject to parliamentary time allowing. However, with [the King's speech](#) having already confirmed the

government's legislative priorities and with a general election expected by next autumn and required to take place before the end of January 2025, it is unclear whether there will be sufficient time to deliver in the timeframe.

With a permanent solution seemingly some way off, the government has left it with the FCA to produce an interim solution to mitigate the impact on the investment industry in the short term. The FCA's interim solution, [announced on 30 November 2023](#), allows greater flexibility to explain costs and charges with the intention of providing more transparency to investors. However, while this may give investors more context on costs, it does not solve the wider issues, and the industry will have to wait until the proposals for a more permanent solution are announced.

The costs disclosure regime affecting listed investment funds is derived from a series of EU legislative instruments which continue to apply in the UK post-Brexit. As part of the government's drive to create a smarter regulatory framework for financial services tailored to the UK, it is proposing to overhaul the EU's Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation by way of a statutory instrument. Changes will also be required to the MiFID II regime, which also derives from an EU directive – a separate statutory instrument will be needed to make those relevant changes. The FCA is expected to publish a consultation on draft rules to replace the relevant MiFID provisions related to cost disclosure in due course.

The PRIIPs Regulation introduced a requirement for fund managers to produce a key information document (KID) to enable retail investors to understand and compare the key features and risks of investments. The PRIIPs Regulation and the related regulatory technical standards set out prescriptive requirements in relation to form and content of the KID, including that the costs associated with an investment in the product are set out. Both direct and indirect costs to be borne by the retail investor must be disclosed, including one-off and recurring costs and, to ensure comparability, total aggregate costs must also be displayed to show the compound effects of the total costs on the investment.

The concern with the current requirements is that they are too strict. The FCA has recognised that “the prescriptive methodologies in the PRIIPs framework do not account for potentially relevant nuances in certain product characteristics”, in particular that “concerns have been raised that for listed closed-ended funds ... this has resulted in the inclusion of charges that are more akin to corporate costs than investment costs”.

UCITS funds investing in listed closed-ended funds are also required to produce a key investor information document (KIID). The relevant regulatory regime provides that no other information or statements may be included in that document, thereby allowing no room for costs disclosures to be disaggregated or explained.

In addition, MiFID II requires investment firms recommending or marketing an investment to provide the retail investor with disclosure of aggregated costs and charges. This results in the PRIIPs figures from a listed investment fund being included in such disclosures.

The FCA’s proposed interim fix comes in the form of a “forbearance statement”, relaxing the rules described above on costs disclosures. The FCA will now allow listed closed ended funds and funds that invest in them, or manufacturers of such funds, to “provide additional factual information (as well as the aggregated figure) such as the breakdown of costs to put the aggregate number in context”. As a result, a fund of funds might seek to explain how its own aggregate figure is affected by the investment company’s cost”. This information may also be included in other communications to investors.

The FCA further confirmed that “if entities provide further factual information such as a breakdown of the costs to put the aggregate number in context, or include this information in their wider communication documentation, we confirm that we will not take enforcement action to the extent that the firm contravenes the restriction on adding further information to the UCITS KIID or the prescriptive requirements of the PRIIPs KID” and that that position “also extends to materials issued by MiFID firms that distribute PRIIPs or UCITS”. Firms must continue to comply with other relevant rules and requirements, including [the consumer duty](#).

In response to the FCA's announcement, the Investment Association has removed guidance which required funds to report the underlying costs of investment companies as part of their own charges.

In the long run, the government intends to replace the PRIIPs Regulation with a new UK retail disclosure framework for consumer composite investments (CCIs). In its policy note, the Treasury said that "the government has also noted some stakeholders' concerns with current cost disclosure requirements, and in particular their potential impact on the investment company sector".

The Treasury also announced that the proposed legislation would provide the FCA with rule making powers to reform the PRIIPs Regulation cost disclosure requirements so as to provide a solution to the industry's concerns. It said that UCITS funds are also to be brought within the same costs disclosure regime, which has been welcomed as a way of further levelling the playing field for listed investment funds. For its part, the FCA has stated that it will issue feedback on responses to [its December 2022 discussion paper on the future disclosure framework](#) and consult on new disclosure rules in the first half of 2024. It said that any future changes will be informed by consumer research, so as to deliver a regime that meets the needs of consumers.

Laura Dobie
Legal Director

This continuing regulatory uncertainty makes it difficult to ascertain what the overall impact will be on the listed investment funds industry



Given their status as alternative investment funds (AIFs) under the Alternative Investment Fund Managers Regulations 2013, listed investment funds fall within the PRIIPs and MiFID regimes and are obliged to disclose aggregated fees. One UK lawmaker, however, is

leading a campaign to change that.

Baroness Ros Altmann, on 22 November 2023, introduced a private members bill into parliament to remove investment companies from the AIFMD regime in the UK. No date has been set yet for the second reading of the bill and there is no clear timescale for how it might progress into law. The reality is, as noted by the AIC, that few private members bills succeed and, in any event given wider regulatory and market expectations around product cost disclosures, the bill alone may not be enough to take investment companies outside of the costs disclosure regime. Accordingly, [the AIC has set out its own proposed framework for investment company cost disclosures](#), although it is not clear whether the government will adopt all or even any of the proposals in the new CCI regime it plans.

In addition, the listed investment funds industry is awaiting details of the FCA's proposed changes to the listing rules which have been pending since May 2023.

In May 2023, [the FCA announced](#) significant reform proposals to the listing regime for equity shares with the aim of strengthening the UK's position in global wholesale markets. The FCA focused on the new framework for commercial companies and noted in respect of closed-ended investment funds (CEIFs), to which Chapter 15 of the Listing Rules applies, it expected its approach to "remain largely unchanged". It added that it would "consider if similar changes [to those proposed for premium listed commercial companies] are also needed for CEIFs to ensure consistency and proportionality" but expects to retain "existing bespoke rules, or carveouts and modifications" currently applicable to CEIFs with a premium listing, unless tailored adjustments are deemed necessary.

The FCA expected to publish further information related to these proposals in autumn 2023, aiming for an accelerated timetable, but to date there has been no update on the revisions to the listing regime generally or specifically in relation to CEIFs.

Details of the government's proposed long-term solution to costs disclosures for listed investment funds are awaited, meaning the industry has no sense yet of how this issue will be fully resolved or

when. The FCA has noted that without legislative reform its ability to disapply the current rules or make changes is limited. With a general election looming in 2024 or early 2025, there is a risk that this could fall off the legislative agenda, increasing the uncertainty.

With a two-stage process of an interim and then permanent fix, investment companies and other stakeholders in the sector will need to tackle two sets of modifications as and when they come into place, meaning continued changes for the industry and that the issues will not be settled immediately. Even the FCA's interim solution is at risk of being revised further, with the FCA noting that it may be changed and/or withdrawn and the interim measures "should not be read as providing an indication about the outcome of the wider analysis and what the future regime may require".

This continuing regulatory uncertainty makes it difficult to ascertain what the overall impact will be on the listed investment funds industry and, with political change predicted following the next general election the answers should not be expected soon.