

9 June 2025

Asset Management and Funds Policy Team; Wholesale Buy-side Division
Financial Conduct Authority
12 Endeavour Square
London, E20 1JN
Submitted by Email: AIFMRegimeCFI@fca.org.uk

Re: April 2025, Call for Input: Future regulation of alternative fund managers¹

Dear Sir or Madam,

At the Standards Board for Alternative Investments (SBAI), we welcome the opportunity to respond to the Financial Conduct Authority's ("FCA") Call for Input: Future regulation of alternative fund managers ("Call for Input")².

At the SBAI we are an active alliance of managers and investors dedicated to advancing responsible practices, partnership, and knowledge in the alternatives industry. At our core is a community that is committed to knowledge sharing, informed dialogue, and innovation. We set clear standards and actively promote responsible practice to normalise quality and fairness. Together, our community of allocators and managers create real world solutions – in short, we solve for better.

The SBAI's *Alternative Investment Standards* ("Standards")³ are supported globally by over 150 alternative investment managers representing more than US\$3 trillion in alternative assets under management, and by over 100 institutional investors, overseeing more than US\$8 trillion in assets. The SBAI is an Affiliate Member of the International Organization of Securities Commissions (IOSCO), and we support efforts to facilitate fair and efficient markets, reduce systemic risk, and enable investors to make well-informed investment decisions. For more than 15 years, the SBAI has provided input to UK, EU, and other global authorities to help make regulation fit for purpose, prevent unintended consequences, including in relation to the AIFM-D and the UK implementation thereof.⁴

The SBAI has played a significant role in building trust in the asset management industry through its standards to promote transparency and robust industry practices. At present, the SBAI is consulting on improving practices in the valuation of private market assets⁵ – an area also under FCA focus.

¹ FCA Call for Input: <https://www.fca.org.uk/publication/call-for-input/call-for-input-future-regulation-alternative-fund-managers.pdf>

² <https://www.fca.org.uk/publications/calls-input/future-regulation-alternative-fund-managers>

³ The Alternative Investment Standards ("Standards") address key areas of alternative investment practice including disclosure, valuation, risk management, fund governance, and shareholder conduct. Access here: <https://www.sbai.org/standards.html>

⁴ SBAI Regulatory Engagement: <https://www.sbai.org/regulatory-engagement.html>

⁵ SBAI Consultation on Valuation on Private Market Valuations: <https://www.sbai.org/resource/consultation-paper--5-1---private-market-valuations-2025.html>

We support the FCA's efforts to enhance competitiveness by reducing unnecessary regulatory burdens, enabling alternative investment firms to grow, compete, and innovate. Alternative investments are vital for the economy, and diverse asset managers, including hedge funds, support liquid capital markets and price formation, key to a global financial hub like London.

Given that the EU Alternative Investment Fund Managers Directive⁶ (from which much of the UK's asset management regulation is derived) has been in place for over 10 years, now is an opportune time to assess whether UK regulations are effective and efficient, while recognising the value of remaining aligned with the EU.

We encourage the FCA to consider:

- The role that market-based standard setters like the SBAI in complementing rules with industry-developed standards and guidance
- The use of comply-or-explain mechanisms, which allows needed flexibility for innovation

Striking the Right Balance: Principles, Standards, and Rules

Alternative investment is a diverse and complex field, covering a wide range of investment activities with varying characteristics, such as liquidity, underlying assets, risks, and processes. This makes a rigid blackline rule-based framework difficult to apply effectively.

Overly detailed rules can become complex and costly, requiring precise definitions for legal certainty and enforceability. There is also the risk that they devolve into box-ticking exercises, failing to improve outcomes in investor protection, market integrity, or financial stability.

This is why the SBAI continues to develop its practitioner-led framework of Standards that complement existing rules, focusing on the key concerns of institutional investors. Investment managers formally commit to the Standards, with flexibility through the comply-or-explain mechanism.

The SBAI fosters ongoing dialogue between investors and managers on issues like due diligence, governance, transparency, responsible investment, and alternative credit, offering practical guidance and disclosure templates. This approach focusses on developing a culture of accountability, with an emphasis on outcomes, and requires firms to consider how the Standards apply to their business – striking the right balance between good industry practices, and flexibility and innovation.

Principles vs. Rules vs. Standards

- **Principles** are high-level guidelines typically embedded within legislation. They outline the broad behaviours firms should exhibit. A good example are *The Principles*⁷ which govern the behaviour of firms regulated by the Financial Conduct Authority in the UK.
- **Rules**, at the other end of the spectrum, are precise directives detailing exactly how firms must act. Failure to comply results in sanctions or legal action. Rules need to be clearly defined for legal certainty, and while they can change over time, they tend to be extensive and slow to evolve. Consequently, rules work best in stable areas where clarity is paramount, such as firm authorisation.
- **Standards** fall between principles and rules, providing more detailed guidance on required behaviours than legislation or principles alone. They are often applied to specific areas, like governance, where detailed rules would be impractical. In fast-evolving business areas, standards help ensure behaviours remain aligned with the intent of legislation while allowing flexibility. They can allow for flexibility whilst still aiming at the same behavioural outcome intended by the legislation and the principles, which otherwise in the case of prescriptive rules can lead to unnecessary

⁶ The AIFMD entered into force on July 21, 2011. EU member states had until July 22, 2013, to transpose the AIFMD into their national law.

⁷ The FCA Principles (PRIN 2.1): <https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html>

complexity and rigidity – which may prompt parties to circumvent the spirit of the rules by adapting new definitions, technical business models, or escaping to jurisdictions where the rules do not apply.

Should you wish to discuss any elements of our response we would be more than happy to oblige.

Yours sincerely

Thomas Deinet
Executive Director
Standards Board for Alternative Investments (SBAI)

Responses to Specific Questions⁸

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?

We agree in principle with the desire to introduce more proportionality, and to avoid cliff-edge-effects which disincentivise firms to grow, while achieving similar regulatory outcomes. As set out in the introduction above, we encourage the FCA to also consider

- The role that market-based standard setters like the SBAI in complementing rules with industry-developed standards and guidance
- The use of comply-or-explain mechanisms, which allows needed flexibility for innovation

However, we would like to point out the following:

Under 2.8, the Call for Input suggest that large firms have more market presence and pose more risks, but it is not clear what exactly is meant by “market presence” and “risk”:⁹

- Market presence could relate to AUM, gross AUM, or trading volume, but needs to be put into the context of the size of the respective market to provide any meaningful insight about market presence (for example, global FX markets trade 7.5tn USD per day, at what size would an individual manager have “market presence”?)
- Risk could relate to the risk taking within the fund, or systemic risk, but it is unclear how risk should be measured and how non-bank finance causes any systemic concerns

In addition, it is important to note that large investment firms usually manage many segregated, non-interconnected funds with potentially different underlying asset classes and strategies. It would not be appropriate to treat these separate asset pools as one consolidated balance sheet (as one would in the context of a bank or insurance) for the purposes of assessing “market presence” or “risk”.

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

The SBAI agrees that structuring the rules along the phases of the product cycle could make them easier to understand and navigate, however, some market participants have cautioned us not to make *superficial* changes that will require firms to spend resources to adapt to the newly organised rule. Also, the

⁸ Where we have chosen not to answer a question, this should not be considered an endorsement of any or all the suggestions contained in that question.

⁹ Also, under 2.24, there is a reference to “firms with broad reach and potential for harm”)

interconnection with the origins of the relevant rules needs to remain clear. Hence, these more cosmetic aspects should be a more gradual and are not a high priority.

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?

The SBAI is generally supportive of a more proportionate approach by size of firm. However, sub-threshold authorised investment firms will be captured by the full scope regime, which would not be proportionate.

The FCA might also consider comply-or-explain mechanisms to soften cliff-edge effects, or incorporate some grace period, where firms only need to fulfil enhanced obligations if their AUM is consistently above a certain size threshold.

The FCA should also consider adjusting the existing thresholds to account for inflation since the rules have been introduced.

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?

We welcome the use of AUM for the purposes of the calculation of the size of a firm.

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?

Further guidance on leverage is expected from the Financial Stability Board (FSB), and we understand that the FCA intends to evaluate the effectiveness of the AIFMD provisions in this context. The SBAI would like to reiterate some of the point made in prior SBAI consultation responses to the FSB, FCA, and ESMA:¹⁰

- High leverage does not necessarily equal high risk in the underlying portfolio. Leverage is therefore not useful as a stand-alone risk measure (at the fund or systemic level) and is in fact often not correlated with risk (leverage often arises when placing hedging transactions, which reduce the portfolio risk, but can increase regulatory leverage measures)
- Current regulatory leverage measures do not contain information on the type and directionality of underlying exposures and thereby provide no information on the impact at times of distressed selling.
- More generally, a prudential approach to regulating asset management can lead to unintended consequences, including situations where “hard-wired” regulatory leverage limits could trigger fire sales/forced unwinding of portfolios when these limits are breached (potentially inflicting losses on investors) in situations when funds would otherwise be prepared to hold on to these positions.

The SBAI acknowledges the potential for leverage to transmit stress in ways that could impact systemically relevant entities, such as banks. Therefore, it is important to better understand the risk taking of such systemically relevant entities in markets, as well as making full use of existing data collected by authorities from asset managers, banks and other intermediaries, to assess the potential for such systemic risk.

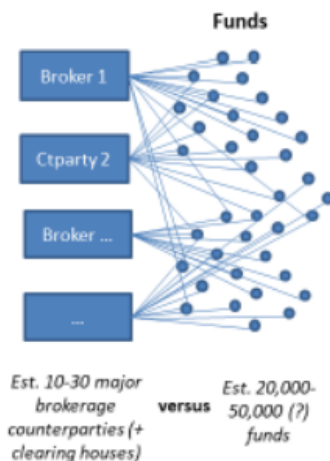
Usually, a small number of banks and other intermediaries will have great overview of leverage provided to by such entities to other financial actors, such as hedge fund managers and others.

This was also pointed out in our consultation response ESMA Consultation on Guidelines to address leverage in Alternative Investment Funds (AIF) – 21 August 2020 (Appendix A: Illustrative Systemic Risk Dashboard):

¹⁰ For example: SBAI response to ESMA CP on Leverage Risk (2020) <https://www.sbai.org/resource/sbai-responds-to-esma-cp-leverage-risks.html>

Understanding the counterparty risk transmission channel:

Counterparty risk channel



- (Banking) counterparties have to assess their risk taking vis-à-vis their fund counterparties (as part of capital frameworks etc.)
- A small number (~10-30) entities will hold bulk of risk

For discussion:

- Would it be easier to collect counterparty risk information from these regulated entities, which ...
 - are regulated in major financial jurisdiction
 - have existing capital frameworks in place
- ... versus trying to collect the data from possibly 10,000s of funds across all types of jurisdictions?

In addition to the above, we agree with the FCA that differentiated approaches might be needed for different types of activities and investments.

In this context, the SBAI would like to highlight the Open Protocol (OP) risk reporting framework in the SBAI Toolbox¹¹, which provides a detailed perspective on netted and non-netted long and short exposure of a fund by exposure class (Equity, Sovereign, & Interest Rate, Credit (excluding corporate bonds), Convertible Bonds, Currency, Real Asset & Commodities). The data allows to calculate aggregate leverage measures, but importantly, allows to analyse exposures in specific underlying markets on a per fund level. The OP methodology provides this data broken down further, e.g. by sectors, regions, etc. This exposure data is complemented by various other risk measures such as VaR, Sensitivity, Stress Test and Counterparty Exposure. This data facilitates meaningful analyses by exposure type across funds as well as consistent aggregation.

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 SBAI had been critical of the AIFM-D depositary requirements (which originated from the retail-oriented UCITS Directive) since their initial proposal in 2009, given AIFs primary target audience are sophisticated institutional investors who conduct extensive due diligence on their managers, not retail investors, who require a much high level of protection. The SBAI would welcome further consultation about introducing more flexibility and choice around the depositary requirements, without compromising the safeguards of independent custody and fund administration.

¹¹ Open Protocol: <https://www.sbai.org/toolbox-resources/open-protocol.html>