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The five key takeaways for fund managers and sponsors from the UK's "Mansion House reforms"

By James Tinworth

In his annual Mansion House speech on 10 July 2023[1], the UK's Chancellor of the Exchequer, Jeremy Hunt, set out a series of proposed changes to UK financial services law and regulation. These proposals have been named the "Mansion House reforms" and are a continuation of the process that was kicked off by the "Edinburgh reforms" that were announced by the Chancellor on 9 December 2022[2].

The overall framework for the reforms (and for the reforms to come) is to improve aspects of the regulation of financial services in the UK now that the UK has left the European Union. Divergence between the regimes in the UK and the EU will accelerate at each stage.

Of the many reforms that were announced, we would highlight the following for our fund manager and sponsor clients and contacts: (1) improvements to the UK version of the short selling regulation, (2) the replacement of the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation with a new tailored UK retail disclosure regime, (3) permitting asset managers to pay for research on a bundled basis (i.e. where a broker who is executing a transaction for a buy-side firm adds an additional amount above the actual cost of executing the trade, and uses the additional amount to pay for research which it would provide to the buy-side firm), (4) the continuation of the theme to increase pension fund investments in less liquid assets (unlisted equities, in this case), and (5) the reiteration of the desire to establish a new "intermittent trading venue" (a half-way house between being a private and a publicly listed company?).

(1) Improvements to the UK version of the short selling regulation

The government launched a consultation seeking views on its proposal to delete the aspects of the UK's retained version of the Short Selling Regulation (SSR) related to sovereign debt and credit default swaps as part of the government's work to replace the SSR with a UK-tailored regulatory regime[3].

The government also announced[4] two key changes to improve the SSR in the UK:

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[1] https://www.gov.uk/government/collections/mansion-house-2023

[2] https://www.gov.uk/government/collections/financial-services-the-edinburgh-reforms

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1168851/Short_Selling_Regulation_Review_-_sovereign_debt_and_CDS_consultation_document__1_.pdf

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1169119/Short_Selling_Regulation_Review_-_Government_response__1.pdf

I. The government will replace the current public disclosure regime based on individual net short positions with an aggregated net short position disclosure regime.

The main concerns with the current SSR were that it negatively impacted the price discovery process; that individual position disclosures revealed proprietary trading strategies, that it created risks around copycat behaviour and short squeezes when individual positions were disclosed publicly, and that, ultimately, the SSR discouraged short selling activity above the 0.5% disclosure threshold.

This change means that, instead of individual net short positions in shares above 0.5% being published, the government will implement an aggregated net short positions disclosure model.

The government will also give the FCA the ability to make any rules on the functioning of public disclosure arrangements that it believes are necessary to administer this aggregated net short position disclosure model. The FCA will take the outcome of the Call for Evidence into account when considering and consulting on any public disclosure rules.

II. The government will increase the current disclosure threshold for net short position reporting to the FCA from 0.1% to 0.2% (which was the threshold before the pandemic).

In addition:

- The government plans to enable the FCA to make rules about the SSR. The FCA will take the outcome of the Call for Evidence into account, including feedback on the current report submission deadline, the lack of information on total issued capital, and the FCA's operational arrangements for position reporting, when considering and consulting on the net short position reporting regime.

- The government agrees that the current market maker exemption could be streamlined to lower administrative burdens for firms[5]. The government envisages that the detail of the market maker exemption requirements will be in FCA rules. The FCA will take the outcome of the Call for Evidence into account, including streamlining arrangements, when considering and consulting on rules relating to the market maker exemption.

- Under the current regime, the FCA is required to maintain a list of shares which are exempt from key obligations in the SSR where the principal venue for trading of the share is in an overseas country. This list is a 'negative' list of exempt overseas shares rather than a 'positive' list of shares in scope of these SSR obligations. The government recognises the feedback provided on the issues with the current 'negative' list of exempt overseas shares and the benefits of moving to a 'positive' list of in scope shares. The government plans to enable the FCA to make rules about exempt share arrangements.

  The FCA will retain its current role of determining where shares are principally traded and will take the outcome of the Call for Evidence into account, including the feedback on moving to a positive list, when considering and consulting on rules on arrangements for overseas shares.

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[5] To allow market makers to effectively carry out their function without undue burden, they are exempt from covering and disclosure requirements under the SSR. To receive an exemption, market makers are required to notify the FCA at least 30 calendar days before they intend to make use of the exemption.

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Over to you, FCA.

The SSR is a good example of administratively onerous EU legislation. It is encouraging that the UK government is being so pragmatic here and we hope that comparable pieces of retained EU legislation are revised in a similar way.

Ominously, however, the paper included the following statement:

"Other suggestions, such as greater transparency on derivative trading and greater scrutiny of hedge funds will be considered where appropriate as part of the government's wider work to Build a Smarter Regulatory Framework in the UK".

(2) Replacement of the PRIIPs Regulation with a new tailored UK retail disclosure regime

The government confirmed its intention to entirely remove from legislation all firm-facing retail disclosure requirements currently in the PRIIPs Regulation and ensure that the FCA can deliver a new UK retail disclosure regime which is tailored and proportionate to the UK market.

The UK Retail Disclosure Consultation Response[6] sets out the government's vision for the new retail disclosure framework and further details on next steps to deliver this reform.

The government will publish a draft Statutory Instrument by 2024 to enable the FCA to deliver the new retail disclosure regime, following the repeal of the PRIIPs Regulation (and related secondary legislation). The FCA will also publish a consultation paper seeking industry feedback on their draft rules for the new retail disclosure regime.

The main issue with the PRIIPs Regulation was that its application was very wide and its heavy-handed disclosure requirements were triggered when a fund was made available to just one "retail investor" (whether that retail investor was an employee of the fund's manager or an ultra- high net worth investor). We hope that the FCA is truly proportionate when it comes to framing the application of the UK's new retail disclosure regime with respect to alternative investment funds aimed at professional investors. Potentially its application may be similar to that of the recent Consumer Duty.

(3) Re-bundling of payments for research

In the Edinburgh reforms, the Chancellor announced that he would be launching an independent review of financial services investment research and its contribution to UK capital markets competitiveness. On 9 March 2023, the Economic Secretary to the Treasury announced that Rachel Kent had been appointed to lead this work.

6 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1168713/UK_Retail_Disclosure_Consultation_Response.pdf

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Rachel Kent published the outcome of her review on 10 July 2023[7], making a series of recommendations. Her key recommendations are to: (i) introduce a Research Platform to help generate research; (ii) allow additional optionality for paying for investment research; (iii) allow greater access to investment research for retail investors; (iv) involve academic institutions in supporting investment research initiatives; (v) support issuer-sponsored research by implementing a code of conduct; (vi) clarify aspects of the UK regulatory regime for investment research and consider introducing a bespoke regime; and (vii) review the rules relating to investment research in the context of IPOs.

For several years, UK asset managers have not been permitted to pay for research on a bundled basis. This is now changing.

The government accepted all the recommendations made to it. The FCA has committed to start immediate engagement with the market to inform any rule changes on removing the requirement to unbundle research costs by the first half of 2024.

US law provides that broker-dealers are not permitted to accept discrete payments for research (so-called "hard dollar" payments) unless they are willing to be registered as investment advisers (which most broker-dealers would prefer to avoid). However, UK asset managers have been prevented from making bundled payments.

Hopefully, the SEC "no action" relief, which allowed US broker dealers to accept “hard dollar” payments for research from UK asset managers, but which expired on 3 July 2023, will be renewed shortly. Hopefully, UK buy-side firms will not experience a reduction in their ability to access US investment research between now and the effective date of the change to the UK rules.

(4) Increasing pension fund investments in unlisted equities

The UK has the largest pension market in Europe, worth over £2.5 trillion.

First there was the introduction of the Long-Term Asset Fund, the UK’s new hybrid[8] authorised investment fund vehicle (LTAF). The primary intention behind the LTAF was to make it easier for Direct Contribution (DC) pension schemes to get exposure to longer-term assets. Recent changes have also made it easier for self-select DC pension schemes and Self-Invested Personal Pensions (SIPPs) to invest in LTAFs.

Continuing this theme of linking the huge pool of pension capital to less liquid assets, the Mansion House reforms announced an industry led compact[9] committing many of the UK’s largest DC pension providers to the objective of allocating at least 5% of their default funds to unlisted equities by 2030.

(5) Intermittent trading venue

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[7] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1168719/UK_INVESTMENT_RESEARCH_REVIEW_-_RACHEL_KENT_10.7.23.pdf

[8] A technically open-ended fund which can invest in long-term/illiquid assets.

[9] A much fancier word for a formal agreement or contract between two or more parties.

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“And, in a highly innovative step which represents a global first, we will establish a pioneering new “intermittent trading venue” that will improve private companies access to capital markets before they publicly list. This will be up and running before the end of 2024, and put the UK at the forefront of capital market innovation.”

The intermittent trading venue was first mooted in the Edinburgh reforms:

“Working with the regulators and market participants to trial a new class of wholesale market venue which would operate on an intermittent trading basis.”

Seven months later, however, there are no details. The proposal, however, has piqued the interest of businesses in search of capital. The main point to clarify is whether being on an intermittent trading venue is a temporary stage on the route to being publicly listed or whether it could be an attractive alternative.

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