HM Treasury

Transposition of the Alternative Investment Fund Managers Directive:

response to consultation

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1 Introduction

1.1 The Alternative Investment Fund Managers Directive[1] (AIFMD) is due to be transposed into national law by 22 July 2013.

1.2 The Directive establishes an EU-wide harmonised framework for monitoring and supervising risks posed by Alternative Investment Fund Managers (AIFMs) and the funds they manage (AIFs); and for strengthening the internal market in alternative funds. The Directive requires the authorisation of AIFM. There are provisions relating to how AIFMs conduct their business, transparency and marketing. The Directive covers the investment managers of hedge funds, private equity funds, retail investment funds, investment companies, and real estate funds among others and is therefore relevant to many different types of asset manager.

1.3 Transposition into UK law requires a number of high-level policy decisions, as well as a considerable number of operational ones. On 11 January 2013, HM Treasury published a consultation setting out the Government's proposed approach with regard to a number of these decisions.

1.4 The Government welcomes the responses received and is grateful to all interested parties for their contributions to date.

1.5 Decisions set out here have been informed by responses to the consultation and discussions with stakeholders. All decisions have been made with regard to the guiding principles set out in the consultation document, namely that the expectation that a "copy-out" approach will be adopted wherever possible in order to minimise the regulatory burden on firms. Gold-plating must be supported by strong justification. The Government's proposed approach is consistent with this and is intended to maintain and enhance the UK's competitiveness as a centre from which to manage and domicile funds. The approach is also intended to ensure strong consumer protection and to maintain and enhance confidence in the regulatory system.

[1] Directive 2011/61/EU on Alternative Investment Fund Managers

2 Summary of responses

2.1 This section summarises responses to all the questions in the consultation and sets out the Government's response.

Requirements for sub-threshold managers

Requirements for managers of authorised funds

Question 1: Do you agree with the proposed approach? What would the impact of this approach be on competitiveness and investor protection?

Question 2: What would be the costs and benefits of the proposed approach against an alternative of maintaining the status quo for AIFMs of sub-threshold authorised AIFs?

Question 3: What would be the impact of applying the full requirements of the Directive to AIFMs of sub-threshold authorised AIFs?

Question 4: Are there any further provisions of the Directive that you consider should not be applied without creating significant inconsistencies in the level of investor protection of funds operated by managers above and below the threshold?

2.2 The Government approach sought to avoid a two tiered system of investor protection in NURS and QIS depending on the size of the operator. To this effect, the approach proposed was to apply full Directive requirements to sub-threshold NURS and QIS managers save for certain exceptions that were deemed excessively burdensome and that were not essential to maintaining the consistency of investor protection.

2.3 Despite these exceptions, respondents argued that the new regime would be excessively difficult and costly for small firms to comply with and that existing requirements for NURS and QIS managers provided a sufficiently robust regime of investor protection. All respondents who commented on these issues called for the *status quo* to be maintained.

2.4 It was nevertheless argued that the Government's approach should not impede the FCA's ability to make amendments to rules for NURS and QIS where necessary outside the context of implementing the Directive.

Government response

2.5 The Government recognises concerns around increasing regulatory burden on small firms. We also recognise that existing FCA COLL rules for NURS and QIS provide sufficient, yet proportionate, protection for the categories of investors they may be marketed to. Given this, and the Government's commitment to avoid gold-plating unless there is strong justification, we propose to amend our approach and not impose any new requirements on sub-threshold managers of authorised funds as part of our implementation of the Directive.

Requirements for managers of non-CIS AIFs

Internally managed investment companies

Question 5: Do you agree with the proposed approach?

Question 6: What are the costs and benefits? Are you able to quantify them?

Question 7: Do you believe that the proposed approach could lead to any detriment to investor protection?

2.6 Internally managed investment companies are currently subject to regulatory requirements arising from company law, the Listing Rules, the Prospectus Directive, and the Transparency Directive rather than FCA authorisation. While the requirements do not completely match FCA authorisation, they do ensure that sufficient enforcement and investor protection safeguards are in place. The Government therefore proposed to apply the *de minimis* registration regime permitted by the Directive to sub-threshold internally managed investment companies.

2.7 This approach was endorsed by respondents who answered these questions and no objections were raised.

Government response

2.8 As no further concerns have been raised, and the approach has been broadly endorsed, the Government does not intend to amend the proposed requirements for internally managed investment companies.

External managers of investment companies

Question 8: Do you agree with the proposed approach?

Question 9: What are the costs and benefits of the proposed approach?

Question 10: There are other categories of non-CIS AIFs, for example some Enterprise Investment Schemes (EIS). What other categories of non-CIS AIFs are there? What regime should apply to sub-threshold AIFMs that manage AIFs in these categories?

Question 11: Under what circumstances should we expect transposition to result in significant restructuring of external AIFM to become internally managed with an internal AIFM?

2.9 The Government proposed to maintain a *status quo* of requirements where an investment company has an external manager.

2.10 Respondents noted the need to make provision for EIS and certain types of property fund.

Government response

2.11 The Government will maintain a *status quo* of requirements for sub-threshold managers externally managed investment companies.

2.12 Currently managers of EIS schemes that are structured as funds either manage UCIS funds or they manage funds subject to the CIS exemption. EIS managers managing funds under the CIS exemption are in theory not required to hold FCA Part 4A permissions but in practice we believe they do hold at least some permissions. Under our current drafting, EIS funds operating under the CIS exemption would by default fall into the same category as authorised and unauthorised funds. This means that no further requirements would be imposed on them as part of AIFMD implementation and, again, a *status quo* would be maintained.

2.13 Certain property fund managers operate a model whereby they are advisors to a CIS operator with Part 4A permission. In order to maintain a regime as close as possible to the *status quo* for these operators, the Government will apply a registration-only regime to sub-threshold managers of property funds, but in addition we will retain the requirement for an operator with Part 4A permission. From an investor protection perspective, the justification is that this mirrors as closely as possible current arrangements, and the funds do not contain financial instruments other than shares in any companies through which the property is held.

Requirements for managers of unregulated collective investment schemes

Question 12: Do you agree with the proposed approach?

Question 13: What are the costs and benefits of the proposed approach? Are you able to quantify them?

Question 14: Do you believe there would be merit in implementing the minimum registration regime permitted by the Directive for managers of unregulated collective investment schemes? If so, under what circumstances?

Question 15: Are there any specific features of the current regime that you believe should no longer be applied to managers of unregulated collective investment schemes?

Question 16: Are there any additional requirements you believe need to be put in place for managers of unregulated collective investment schemes?

Question 17: What are the most significant additional costs for sub-threshold managers of UCITS in order to comply with the Directive? Are you able to quantify them?

Question 18: Do you agree with the assumptions underpinning the impact assessment for the costs of compliance for sub-threshold managers of UCIS?

2.14 The Government's proposed approach for sub-threshold AIFMs which manage unregulated collective investment schemes (UCIS) was to maintain a regime equivalent to the *status quo* that replicated current requirements. It was felt that there was no justification to add any further regulation and there was little appetite for the Government to adopt a de-regulatory approach – in fact a number of firms had previously expressed concern about this possibility as it might undermine confidence in the UK regulatory system.

2.15 This approach was broadly supported by respondents to the consultation. No parties argued for enhanced regulation in this area, though there was limited support for deregulation for UCIS solely marketed to professional investors.

Government response

2.16 No case has been advanced for the Government to impose further regulatory requirements in this area as part of AIFMD implementation.

2.17 While there have been certain calls for some deregulation, the broad consensus is that existing requirements are important to maintain confidence in the UK regulatory system. As such the Government does not intend to amend its proposals for sub-threshold managers of UCIS.

Private equity requirements

Question 19: Do you agree with the proposed approach?

Question 20: What are the costs and benefits of the proposed approach? Are you able to quantify them?

2.18 The Government proposed not to require any sub-threshold AIFM to comply with the provisions of Directive Articles 26 to 30.

2.19 No concerns were raised about this approach. All respondents who answered these questions endorsed the Government's view that there are already suitable safeguards in place and that application of these provisions would create an unnecessary administrative burden.

Government response

2.20 In light of the responses we have received, the Government will not amend its approach to sub-threshold AIFMs and Directive Articles 26 to 30.

Gold plating

Question 21: Please provide details of any further gold plating above the Directive minimum that you consider the Government should remove for:

A The managers of authorised funds;

B The managers of non-CIS AIFs; and

C The managers of UCIS funds

Question 22: Is there any other aspect of the Directive not covered explicitly in this consultation document or the follow up document in which you consider the Government is imposing significant unnecessary costs on the industry or consumers?

2.21 There were a few responses in respect of these two questions. The views expressed and Government response have been incorporated into other sections of this document.

Private equity

Depositaries and Article 21(3)

Question 23: Do you agree with the proposed approach?

Question 24: What types of institution do you believe would be interested in acting as a depositary for private equity and other AIFs under Article 21(3)?

2.22 The Government proposed to exercise the Member State derogation provided under Article 21(3) in order to ensure that as proportionate a depositary requirement is put in place as possible for managers of relevant funds. Respondents who answered these questions stressed the importance of making full use of Article 21(3).

Government response

2.23 Given the endorsement of this approach and as no concerns were raised, the Government will not amend its proposed approach in this regard.

Other issues

AIF definition

Question 25: Do you agree with the proposed approach?

2.24 The Government proposed that there would be overlapping definitions of AIFs and CIS. The Regulated Activities Order would be amended creating new activities of "managing an AIF" and "managing a UCITS".

2.25 Respondents welcomed that the approach would mean that firms would not have to apply for multiple overlapping permissions. However some responses did argue that it would have been preferable and simpler to have separate and mutually exclusive definitions of AIF and CIS.

Government response

2.26 While we sympathise with concerns raised, our assessment remains that, given the practicalities involved, it would not be possible to amend legislation to create separate and exclusive definitions of AIF and CIS in the timescale of AIFMD implementation. However it would remain possible to review this issue at a later date.

Ancillary activities

Question 26: Do you agree with the proposed approach?

2.27 The Government proposed that functions listed in Annex 1, paragraph 2 of the Directive should be part of the regulated activity of managing an AIF to ensure that the FCA is able to apply its rule making powers with respect of competition and to prevent any technical difficulties in the application of the Financial Ombudsman Service and Financial Services Compensation Scheme.

2.28 Respondents were divided on this issue. Some felt that the reasons set out for including ancillary activities within the regulated activity of managing an AIF were not compelling. There were also concerns that this could cause confusion.

2.29 However a majority of responses approved of the universal nature of the permission and said that it would simplify firms' FCA permissions.

Government response

2.30 The Government will include the functions listed in Annex 1, paragraph 2 within the regulated activity of managing an AIF.

Draft regulations

Question 27: The regulations have been prepared consistently with the Government's 'copy out' approach. Do respondents have comments to that approach?

Question 28: Do the draft regulations adequately implement the Directive?

2.31 Issues raised in response to these questions have been incorporated into the following chapter and Annex A.

3 Further issues raised by respondents

3.1 A number of related policy concerns were raised by respondents to the consultation. Those on which the Government is able to provide a response are set out below.

Transitional arrangements

Territorial scope of application

3.2 The Government sought to use the full flexibility provided by Article 61 to give firms a realistic timetable in which to become compliant with the requirements of the Directive and to keep disruption to business as a minimum.

3.3 Many respondents queried were concerned that the transitional arrangements, set out in regulation 68, only apply to UK AIFMs. It was repeatedly cited that this would be very damaging for a number of firms.

3.4 The Government's view is that Article 61 does permit extension of the transitional arrangements to non-UK AIFM. Therefore the regulations will be amended to provide an equivalent transitional period for both EEA and third country AIFMs.

UK AIFMs ceasing to operate during the transitional period

3.5 Some respondents queried whether an AIFM that would cease to operate by the end of the transitional period would have to apply for authorisation.

3.6 As it stands, the obligation at regulation 68(2) applies to all UK AIFMs which do not benefit from the grandfathering provisions at regulations 70 and 71, but it is important to note that the obligation is to make an application by 22 July 2014. In the case of an AIFM which ceases to manage AIFs before that obligation crystallises in July 2014, the failure to comply with the obligation would be academic.

3.7 However to provide greater legal certainty, the Government intends to apply the obligation to make an application for permission or registration only to UK AIFMs that continue managing an AIF after 21 July 2014.

Closed-ended AIFs that make no additional investments or whose subscription period has closed

3.8 Respondents have asked whether regulations 70 and 71 permit an AIFM to make use of the grandfathering provisions with respect of AIFs to which those regulations apply, even where the AIFM manages other AIFs.

3.9 As the regulations stand, the AIFM must be exclusively managing AIFs within the scope of regulation 70 or 71 in order to benefit from the grandfathering. However, the Government recognises that this is a less flexible approach than permitted by the Directive. Therefore the Government will amend the regulations to permit an AIFM to also manage other AIFs.

Depositary transitional

3.10 In the draft regulations, once an AIFM becomes authorised, the AIFMD depositary regime applied from that point including the requirement that the depositary has the new Part 4A permission.

3.11 Following various feedback, and to ensure maximum flexibility this has been amended so that during the transitional year, the depositary of an authorised AIFM need not have the new Part 4A permission. The depositary will, however, need to comply with the other relevant Directive requirements with respect of the AIFs of that AIFM.

Marketing

3.12 Following various observations made regarding how the Government proposes to implement requirements around marketing units or shares of AIFs, the Government will make certain amendments to the regulations to improve clarity and to ensure that activities outside the scope of the Directive are not inadvertently captured.

Article 36 and 42 registers

3.13 A number of respondents were concerned that the registration process for AIFMs seeking to market in the UK under Article 36 or 42 was too onerous, particularly for AIFMs only undertaking exploratory work. This process has therefore been replaced with a process whereby an AIFM need only notify the FCA and it may then market AIFs in the UK. It will not be necessary to await approval from the FCA before marketing may take place.

A Questions and answers

A.1 Certain technical questions that do not relate to policy have also been raised by respondents in the course of the consultation process. Where the Government is to provide an answer, responses are set out below.

Q – Would a UK or EEA AIFM managing a third country AIF or a third country AIFM that is making use of the transitional provisions in regulation 68 need to wait for cooperation agreements in line with Article 36(1)(b) or Article 42(1)(b) of the Directive to be in place between the home Member State of the AIFM and the relevant supervisory authorities before marketing to UK investors?

A – Not while the transitional provisions apply to the AIFM. However once the Directive regime applies, even while the transitional period is still running, the cooperation agreement would need to be in place to continue marketing.

Q – Could an AIFM operating under the transitional arrangements launch and market new AIFs?

A – Yes. The transitional arrangements attach to the AIFM.

Q – Could an existing manager that does not meet requirements for authorisation under the Directive, such as a credit institution, continue to manage under the transitional arrangements?

A – Yes, provided that the manager meets the definition of "AIFM" and is replaced by an authorised or registered AIFM by the end of the transitional period.

Q – What activities must a firm be carrying out before 22 July 2013 to be able to benefit from the transitional arrangements?

A – To make use of the transitional arrangements, before 22 July a firm must be managing an AIF (as defined in the regulations) and, in the case of a third country manager, marketing the AIF in the EEA. Such firms do not need to make any specific application or go through any procedure to benefit from the transitional provisions.

Q – Will the assets of AIFs covered by regulations 70 and 71 be used for the purposes of calculating an AIFM's total assets under management under the Directive?

A – No

Q – If an AIFM is authorised under the Directive, do Directive provisions apply with respect of AIFs covered by regulations 70 and 71?

A – No

Q – Why is there a requirement for a "single AIFM" where a third country AIFM is seeking permission to market?

A – This requirement was intended to ensure that a single entity is identified which is responsible for complying with the requirements accompanying permission for such funds to be marketed, and not to require that there be no other entity which could be considered an AIFM. The Treasury will be amending the regulations to clarify this.

Q – Does the transitional period apply to marketing?

A – Yes it applies to the marketing of AIFs managed by transitional AIFMs.

Q – Why does regulation 58(6) require a single depositary for Article 36 AIFs?

A – Arguably regulation 58(6) can be interpreted as allowing one or more entities to act as depositary, but the Treasury will be amending regulation 58(6) to make this clear.

Q – Some of the language in the draft regulations is European language that could be taken to mean something different under UK law (for example "domicile" and "best efforts"). Will copying this language into the UK regulations produce the wrong result?

A – Regulation 2(2)(a) of the draft regulations provides that expressions used in the Directive have the same meaning when used in the draft implementing regulations. This, as well as the general rule of interpretation of UK legislation which implements a Directive, means that even if an expression may be used differently in the UK in other situations, within the regulations the expression will have the same meaning as it has in the Directive.

B List of respondents

B.1 The following organisations submitted responses to the consultation:

AEW Europe LLP

Alternative Investment Management Association Limited

Association of Investment Companies

Association of Real Estate Funds

Augentius

Berwin Leighton Paisner LLP

BlackRock

British Private Equity and Venture Capital Association

Campbell Lutyens & Co Limited

CDC Group Plc

City of London Law Society

Depositaries and Trustees Association

Euroclear SA / NV

Eversheds LLP

Guernsey Financial Services Commission

Harbottle & Lewis LLP

Hollyport Capital LLP

Investment Adviser Association

Investment Management Association

ipes Private Equity Fund Services

Kingfisher Property Partnerships Limited

Langham Hall UK LLP

Law Society of England and Wales

Morgan Stanley & Co. International Plc

NCM Fund Services Limited

Sidley Austin LLP

State Street Bank and Trust Company

UBS Limited

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