HM TREASURY

Transposition of the Alternative Investment Fund Managers Directive

January 2013

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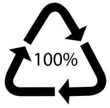

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Subject of this consultation	The transposition of the Alternative Investment Fund Managers Directive in the United Kingdom.
Scope of this consultation	This consultation paper sets out and invites views on the Government's proposed approach towards a number of the key policy decisions that need to be taken as part of the transposition of the Alternative Investment Fund Managers Directive in the United Kingdom.
Who should read this	HM Treasury would like to hear from UK-based fund managers that deem at least part of their regular business as managing AIFs (including UCITS management companies if they manage AIFs as well), discretionary investment managers, operators of unregulated collective investment schemes, investment companies that do not employ an external fund manager, depositaries and custodians holding the assets of AIFs, prime brokerage facilities, investors, trade bodies, and others interested in the Directive and its transposition.
Duration	The consultation will run from 11 January to 27 February 2013.
Enquiries	For general enquiries regarding this discussion paper please contact Jonathan Gee at HM Treasury on 020 7270 6275, or jonathan.gee@hmtreasury.gsi.gov.uk.
How to respond	Please send responses to: AIFMD Transposition Financial Regulation and Markets HM Treasury 1 Horse Guards Road London SW1A 2HQ E-mail: aifmd@hmtreasury.gsi.gov.uk
Additional ways to be involved	Please indicate whether you are willing to discuss these issues with HM Treasury. HM Treasury will consider meeting interested parties to discuss issues raised in this discussion paper. The timing, format and venue of these meetings will be informed by expressions of interest received.
After the consultation	The Treasury will publish a formal response to the views expressed in the consultation once it has closed. A second consultation will also be published in early 2013 covering issues arising from the ongoing Level 2 Regulation.
Getting to this stage	HM Treasury published a discussion paper in March 2012 seeking views on the main transposition decisions and has also consulted informally with industry and other stakeholders.

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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. The Directive also includes new requirements for firms acting as depositary for an AIF.

1.3 Transposition into UK law will require a number of high-level policy decisions, as well as a considerable number of operational ones. The Financial Services Authority is publishing two consultation papers covering a number of policy and operational issues and this Treasury paper highlights some of the key high-level issues that will need consideration. To ensure consistency, the definitions defined in the FSA paper are used in this paper.[2]

1.4 The Government has set out its overall approach to transposing EU legislation, with 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. The Government welcomes views from market participants on how to achieve these objectives.

1.5 This paper has been released at this time in order to inform industry of our proposed approach and allow as much notice for firms to prepare ahead of transposition as possible. However there are a number of issues, including those arising from the Level 2 Regulation, which we cannot consult on at this time. Therefore a second consultation paper will be published shortly. This second paper will include:

- Scope of application of the Directive, including charity funds;
- The European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) Regulations;
- Marketing of EEA retail funds, third country retail funds and sections 270 and 272 of the Financial Services and Markets Act 2000;
- Application of the approved persons regime to internally managed investment companies; and

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

[2] The first FSA consultation has been published and can be found at http://www.fsa.gov.uk/library/policy/cp/2012/12-32.shtml

- Application of the Financial Services Compensation Scheme and Financial Ombudsman Service to AIFM.

1.6 The Directive will be implemented, like other EU financial services directives, by a combination of Treasury Regulations and FSA (FCA) rules. Attached to this paper are draft Regulations.

2 Requirements for sub-threshold fund managers

2.1 The Directive requires AIFMs to be authorised but permits Member States to establish a *de minimis* registration regime for AIFMs managing AIFs with assets under management below certain thresholds[1]. Member states have the option, however, of imposing additional requirements. The Government will need to decide the categories of sub-threshold AIFMs for which it exercises this option and, where it is exercised, the extent to which additional requirements should be applied beyond the Directive minimum requirements for sub-threshold AIFM in Article 3.

2.2 Under current UK regulation, a wide range of sub-threshold AIFMs is already FSA-authorised for regulated activities such as operating a collective investment scheme (CIS), or discretionary portfolio management. Examples include managers of Non-UCITS Retail Schemes (NURS), Qualified Investor Schemes (QIS), and Unregulated Collective Investment Schemes (UCIS) – including many hedge funds and private equity funds.

2.3 The range of options open to the Government for sub-threshold AIFMs include the following:

1. Full application of AIFMD requirements to all sub-threshold AIFMs.
2. Apply a lighter regime selectively, differentiating between AIFMs.
3. Apply no additional requirements above the AIFMD minimum.

2.4 Sub-threshold AIFMs subject to the sub-threshold regime may not benefit from the Directive's marketing and management passports. However, they have the right to opt-in to full authorisation in order to benefit from these AIFMD passports.

Requirements for managers of authorised funds

2.5 AIFs that are authorised funds, whether they take the form of an authorised unit trust, or an OEIC, will belong to one of the following categories:

1. Non-UCITS Retail Scheme (NURS)

   A NURS scheme may be promoted to retail investors but does not fall within the scope of the UCITS Directive.

2. Qualified Investor Scheme (QIS)

   A QIS is open to investment only by "qualified investors" for example corporations, institutions and sophisticated individuals who can reasonably be expected to understand the risks involved in a wider range of investments and investment strategies.

[1] Article 3(2)-(4) provides that Member States may apply a less stringent regulatory regime with opt-in procedures such that smaller AIFMs may benefit from the EU AIF management and/or marketing passport under Chapter VI of the Directive. See also Section III of the Final Report on ESMA's technical advice to the European Commission on possible implementing measures of the AIFMD, 16 November 2011.

2.6 Responses to the previous HM Treasury discussion paper published in March 2012[2] strongly rejected the notion of any de-regulation, particularly for NURS funds, on grounds of investor protection and confidence in the regulatory regime.

2.7 If this is rejected, the options that remain where the manager is a sub-threshold AIFM are to maintain the status quo by requiring the manager to be an authorised person subject to all current applicable rules and guidance but not to apply any new requirements based on the Directive, to apply the full requirements of the Directive to managers of authorised funds, or to apply the Directive requirements selectively.

2.8 Our proposed approach is that for sub-threshold AIFM which manage authorised funds, the full requirements of the Directive will be applied, with the following exceptions where requirements will not be applied:

- the requirements in the Level 2 measures relating to Article 20(3) for the assessment of whether an AIFM has become a 'letterbox entity';
- the remuneration provisions in Article 13 and Annex II, and therefore also the remuneration disclosure requirements in Article 22(2)(e) and (f); and
- the Level 2 provisions relating to the transparency requirements in Articles 22 to 24.

2.9 This approach seeks to create a proportionate level of regulation while maintaining broadly consistent investor protection in authorised funds, particularly for retail investors.

2.10 Although a status quo approach would not remove any existing investor protections, it would create two distinct levels of investor protection depending on the status of the AIFM.

2.11 Consultation with industry has indicated that the transparency requirements of the Directive will be a source of significant ongoing costs for sub-threshold operators. Existing investor disclosure requirements will continue to be applied to sub-threshold AIFMs which manage authorised funds and so it is not anticipated that not applying the final Level 2 measures supplementing Articles 22 to 24 would have any significant investor protection implications.

2.12 In relation to the delegation provisions, this approach also proposes not to apply some of the requirements under delegation for the assessment whether a sub-threshold AIFM of a NURS or QIS has become a letterbox entity.

2.13 In reaching its view, the Government also considered whether to maintain the existing NURS and QIS depositary requirements or whether to level up by adding some or all of the requirements for AIFM authorised under the full scope of the Directive. In reaching its decision to level up, the Government took into account that this would lead to a two-tier system of investor protection in NURS and QIS, which retail investors (in the case of NURS) would be unlikely to recognise.

[2] http://www.hm-treasury.gov.uk/consult_policy_options_implement_aifmd.htm

Box 2.A: Questions 1 to 4

1. Do you agree with the proposed approach? What would the impact of this approach be on competitiveness and investor protection?
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?
3. What would be the impact of applying the full requirements of the Directive to AIFMs of sub-threshold authorised AIFs?
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?

Requirements for managers of non-CIS AIFs

Internally managed investment companies

2.14 Closed ended investment companies (such as investment trusts or venture capital trusts) are the largest category of non-CIS AIF. In the case of internally managed investment companies, where the AIFM is also the company, responses to the Government discussion paper argued overwhelmingly that requirements already imposed on directors by company law and by other legislation such as the Prospectus and Transparency Directives, already provide for a very high standard of investor protection, and that the provisions of the AIFM Directive would add little benefit but incur significant cost.

2.15 The FSA is currently consulting on improvements to Listing Rules to enhance the effectiveness of the regime and on proposed amendments relating to the implementation of the Directive.[3]

2.16 The Government's proposed approach is to only apply a registration regime permitted by the Directive to internally managed companies. In addition to the conditions for registration as a sub-threshold AIFM in the Directive, the Government proposes to give powers to the FCA to refuse registration if an AIFM is subject to a prohibition order, could be subject to a company director's disqualification order, or has been convicted of an offence involving fraud or dishonesty or an indictable offence.

Box 2.B: Questions 5 to 7

5. Do you agree with the proposed approach?
6. What are the costs and benefits of the proposed approach? Are you able to quantify them?
7. Do you believe that the proposed approach could lead to any detriment to investor protection?

External managers of investment companies

2.17 Where an investment company whose portfolio includes securities or contractually based investments currently appoints an external manager, the manager is required to be FSA authorised for the regulated activity of managing investments.

[3] http://www.fsa.gov.uk/library/policy/cp/2012/12-25.shtml

2.18 If external portfolio managers of investment companies restructure themselves to be external AIFM (i.e. carrying out the activity of collective portfolio management rather than individual portfolio management), a registration regime for external managers would lead to a reduction of the current level of regulation.

2.19 The Government's proposed approach is to broadly replicate the status quo, so that external AIFMs of companies are subject to a similar level of regulation to external managers carrying out individual portfolio management for those companies. The FSA intends to set out details on this in its second consultation paper.

Box 2.C: Questions 8 to 11

8. Do you agree with the proposed approach?
9. What are the costs and benefits of the proposed approach?
10. There are other categories of non-CIS AIFs, for example, some Enterprise Investment Schemes (EIS). What other categories of non-CIS AIF are there? What regime should apply to sub-threshold AIFMs that manage AIFs in these categories?
11. Under what circumstances should we expect transposition to result in significant restructuring of external AIFM to become internally managed with an internal AIFM?

Requirements for managers of unregulated collective investment schemes

2.20 UCIS are collective investment schemes that are neither authorised by the FSA nor recognised schemes (i.e. non-UK CIS that are recognised by the FSA). UCIS may only be marketed to professional or high net worth or sophisticated investors and, as such, are not subject to the same restrictions as regulated CIS. However persons carrying on regulated activities in the UK in relation to UCIS are subject to FSA regulation, including FSA Handbook requirements.

2.21 The Government's proposed approach for sub-threshold AIFMs which manage UCIS is to maintain a regime broadly equivalent to the status quo by replicating current requirements for UCIS operators. AIFMD requirements that go beyond this will not be applied. In response to the Treasury's previous discussion paper, there was little support for reducing regulatory requirements, on the basis that this could undermine the reputation of the UK regulatory environment. There was no support for increasing regulatory requirements.

2.22 In the case of a sub-threshold AIFM which manages both authorised and unauthorised funds where possible the directive requirements will apply only in respect of the authorised funds.

Box 2.D: Questions 12 to 18

12 Do you agree with the proposed approach?

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

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?

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?

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

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

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

Private equity requirements

2.23 Articles 26 to 30 cover obligations for AIFMs managing AIFs which acquire control of non listed companies and issuers – the so called private equity provisions. The Government proposes that the requirements of these Articles will not apply to sub-threshold AIFMs.

Box 2.E: Questions 19 and 20

19 Do you agree with the proposed approach?

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

Gold plating

2.24 The Government is committed to eliminating unnecessary gold plating. Through earlier consultation with industry, including a discussion paper early in 2012 and ongoing engagement, the Government believes its preferred approach to transposition represents the optimal balance to maintain UK competitiveness, enhance the reputation of UK regulation and protect investors. However, the option to remove any or all gold plating above the AIFMD minimum remains open at this consultation stage.

Box 2.F: Questions 21 and 22

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.

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?

3 Marketing

Marketing to retail

3.1 By default, the Directive prohibits the marketing of AIFs to retail investors but gives Member States the discretion to permit marketing selectively and impose greater restrictions than those for marketing to professional investors. AIFMD defines 'professional investor' as an investor which is considered to be a professional client or may, on request be treated as a professional client within the meaning of Annex II of the MiFID directive. AIFMD defines 'retail investor' as an investor who is not a professional investor. Under the current UK regime, there are two types of UK AIFs that may be offered or promoted to the general public:

1. **Collective Investment Schemes that are authorised by the FSA as Non-UCITS Retail Schemes (NURS)**[1]. The FSA has a number of detailed rules applicable to NURS, including rules that restrict what NURS may invest in; rules that impose maximum limits on certain kinds of investments; and rules that restrict borrowing by NURS.

2. **Companies are exempted from the CIS regime but are subject to the general rules of company law.** In practice, this includes closed ended Investment Companies. If such companies wish to market their shares to the public, they must produce a prospectus which is approved by the FSA and is compliant with the Prospectus Directive[2]. Non-CIS companies which are subject to the listing rules (a category which includes investment trusts and venture capital trusts) are also subject to substantive regulation imposed by the listing rules.

3.2 In addition, QIS and UCIS may currently be offered or promoted to certain categories of investors, some of whom do not fall within AIFMD's definition of 'professional investors'.

3.3 Following responses to the earlier discussion paper, the Government proposes to make no amendments to the range of persons to whom QIS and UCIS may currently be offered, or the range of AIFs that may be marketed to the general public.

Sections 270 and 272 and funds from other jurisdictions

3.4 Sections 270 and 272 of FSMA provide a way for retail funds from designated territories (Jersey, Guernsey and Isle of Man), in the case of 270, and other jurisdictions, in the case of 272, to be marketed to UK investors.

3.5 Under the Directive, the UK will be required to give EU funds managed by EU AIFMs access to the UK retail market on a non-discriminatory basis.

3.6 As part of the second consultation, the Government will be setting out its approach to Section 270 and 272, and incoming EU retail AIFs, in order to provide an updated efficient mechanism by which AIFs from other countries may be marketed to UK investors.

[1] The sale or transfer of units in a Qualified Investor Scheme is restricted to specified categories of eligible investors, some of whom would not automatically be professional investors under AIFMD and MiFID.
2 The exception to this rule is when the company's share offering is less than 5 million euros.

Private placement

3.7 The Directive permits Member States to continue national private placement for at least the first five years of the application of the Directive. It requires that third country (i.e. non-EU) managers of third country AIFs that wish to market their funds in a Member State must comply with the Directive's provisions on transparency and (if applicable) the rules on private equity disclosure.

3.8 The Government is permitted to apply additional Directive requirements for national private placement in the UK. In order to ensure continued investor access to third country AIFs through national private placement in the UK, the Government does not intend to impose additional requirements for third country managers of third country funds above the Directive minimum.

4 Private equity

Competent authority for private equity provisions

4.1 Articles 27 to 29 of the Directive impose obligations on AIFM to provide certain information to the competent authority where an AIF acquires control of a non-listed company or issuer. Article 30 is headed "asset stripping" and imposes restrictions on an AIFM for 24 months from the time that an AIF acquires control of a non-listed company or issuer.

4.2 The competent authority for the purposes of these Articles will be the Financial Conduct Authority. Sufficient legal powers will be conferred on the FCA in order that it is able to fulfil this role.

Depositaries and Article 21(3)

4.3 Article 21(3) permits Member States, by way of derogation, to allow depositaries for certain AIFs with a five year lock up period to be "an entity which carries out depositary functions as part of its professional or business activities in respect of which such entity is subject to mandatory professional registration recognised by law or to legal or regulatory provisions or rules of professional conduct and which can provide sufficient financial and professional guarantees to enable it to perform effectively the relevant depositary functions and meet the commitments inherent in those functions."

4.4 The Government proposes to exercise this derogation in order to support a competitive market for private equity AIFMs. Entities wishing to provide depositary services for relevant AIFs with a five year lock up period will be required hold the permission of "acting as the depositary of an AIF" but will be subject to appropriate depositary requirements. The FSA has provided further details of this regime in its consultation paper.

Box 4.A: Questions 23 and 24

23 Do you agree with the proposed approach?

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)?

5 Other issues

AIF definition

5.1 The category of AIF is simultaneously broader and narrower than the existing category of CIS. For example, it includes bodies corporate such as closed ended investment companies but excludes UCITS.

5.2 This means that amendments to UK legislation to make provision for AIFs must also amend the way in which legislation deals with CIS. While an approach which cut AIFs out of the CIS definition would be simpler from one perspective, there are hundreds of legislative cross references to the CIS definition particularly in tax legislation. Therefore an approach of creating mutually exclusive AIF and CIS definitions would need to have at least part of the AIF definition added to all these cross references. So there are serious practical difficulties in moving the CIS boundaries in legislation.

5.3 FSA permissions outside of firms managing collective investment schemes are also presently tied to the concept of a CIS and these permissions would need to be revisited if the definition was changed.

5.4 The Directive needs to be transposed in an extremely short space of time. It is not realistic that it would be possible to carry out the work needed to overcome these difficulties in the time permitted.

5.5 Therefore the Government proposes that:

1. The definition of CIS in FSMA would remain the same. An entity which is currently a CIS would remain a CIS, and the tax and other legislation which applies to CIS would continue to apply.

2. However, there would be separation in the Regulated Activities Order (RAO). Thus, the RAO would create a new activity of managing an AIF. A person who had the 'managing an AIF' permission would not need the 'establishing etc. a CIS' permission in relation to their management of that AIF, even if the AIF were also a CIS.

3. There would also be a new regulated activity of managing a UCITS. Again a person who had the 'managing UCITS permission' would not need permission to operate a CIS to manage that UCITS. The activity of sole director of an OEIC would be abolished, as the activities of managing an AIF or a UCITS will replace it entirely and the amendments arising from this change will be addressed in the second consultation.

4. There would remain the regulated activity of establishing etc a CIS, which would be required by a person who operated a CIS, and did not have the 'managing AIF' permission, or 'managing UCITS' permission. However, in the event a UCITS or AIF ceased to have a manager (for example because the manager resigned) there would be a transitional period of one month in which a firm would not be carrying on the establishing etc a CIS activity in respect of a scheme without a manager. This is to avoid a circumstance whereby a third party which was providing administration services for a scheme would be immediately caught by the regulated activity by circumstances outside their control.

5 The activities of acting as the trustee of an AUT and acting as the depositary of an OEIC will be replaced by two new activities of acting as depositary of an AIF or acting as depositary of a UCITS.

6 In respect of both the managing and depositary activities exclusions will be included in respect of regulated activities which overlap with those activities. This will avoid the need for firms to apply for multiple, overlapping permissions.

Box 5.A: Question 25

25 Do you agree with the proposed approach?

Ancillary activities

5.6 Annex 1, paragraph 2 of the Directive lists other functions that an AIFM may additionally perform in the course of the collective management of an AIF. The Government proposes that these will be part of the regulated activity of managing an AIF where the firm in question chooses to carry on those activities for an AIF that it manages.

5.7 This approach is being taken because if they were not regulated activities, there would be difficulties in applying the FCA's rule making powers in relation to these activities, to the extent that the FCA wanted to act in pursuance of its competition objective. There could also be technical difficulties in the application of the Financial Ombudsman Service and Financial Services Compensation Scheme. Ensuring that an AIFM's authorisation includes the ancillary activities (where it chooses to carry them on) will also provide clarity and certainty for firms wishing to passport management services to another EEA State.

Box 5.B: Question 26

26 Do you agree with the proposed approach?

Draft Regulations

5.8 Draft Regulations which implement part of the Directive are appended to this paper. The remainder of the Directive will be implemented in FCA rules, and in Regulations accompanying Treasury's second consultation paper. The draft Regulations have been prepared on the basis that the amendments to the Financial Services and Markets Act 2000 made by the Financial Services Bill are in force;[1] and that the Directive will be extended to the EEA.

5.9 The draft has been prepared without the benefit of final Level 2 or Level 3 provisions, and may need to be revised once Level 2 and Level 3 provisions have been adopted. Changes may also be required if the European Venture Capital Fund Regulation and European Social Entrepreneurship Regulation are adopted. Further FCA powers in relation to disciplining registered sub-threshold AIFM may also be required, in line with Article 46 of the Directive. These FCA powers will be considered in the second consultation, together with powers in relation to the European Venture Capital Funds, and European Social Entrepreneurship Funds. While the draft contains some consequential provisions, further consequential amendments will be required. Changes may also be required to update the footnotes.

5.10 The draft Regulations reflect the fact that while there is an overlap between the concept of marketing in the Directive, and the concept of financial promotion in the Financial Services and

[1] A version of the 2000 Act, as amended by the Bill, is available at: http://www.hm-treasury.gov.uk/d/fin_fs_bill_consolidated_fsma_120612.pdf

Markets Act, there may be circumstances in which there is marketing, but no promotion. Thus, if an investment adviser passes on subscription material to a professional investor, asking if the investor wishes to subscribe in an AIF, that might constitute placement of an AIF (and therefore marketing under AIFMD), but it may not constitute financial promotion, if there is no element of persuasion.

5.11 The draft Regulations prohibit marketing of an AIF unless such marketing is permitted under the Regulations. In broad terms, an AIF managed by an AIFM subject to the full requirements of the Directive may be marketed to professional investors if the Directive notification and approval requirements are met. Such marketing will be covered by the exemptions in the Financial Promotions Order (SI 2005/1529, article 29) and the Promotion of Collective Investment Schemes Order (SI 2001/1060, article 16) (exemptions for promotion authorised by or under an enactment other than the Financial Services and Markets Act).

5.12 The Government proposes to allow marketing to professional investors under the third country national private placement regimes permitted under Articles 36 and 42 of the Directive. Sub-threshold AIFMs will be subject to the lighter regime permitted under Article 3. The FCA will need to assess compliance with the Directive requirements under these Articles. The FCA will create a specific regime for these types of AIFMs.

5.13 The draft Regulations permit a person to market an AIF to a retail investor if, in broad terms, (a) the AIFM which manages the AIF could market the AIF to professional investors, in accordance with the Directive requirements, and (b) the person could promote the AIF to that investor, under the existing exemptions to the financial promotions regime. There is no change to the types of investor to whom promotions can be made as a result of the draft Regulations.

5.14 The marketing of AIFs managed by sub-threshold AIFMs (apart from third country AIFMs, authorised AIFs managed by authorised sub-threshold AIFMs, and AIFMs who have opted into the full Directive requirements) is tied to the current financial promotion regime. If a person is able to promote an AIF under the current regime to an investor, the person will be able to market the AIF to that investor.

5.15 The draft Regulations permit a person to market an AIF to an investor if the marketing is not at the initiative of the person and the person can promote to that investor.

5.16 AIFMs which manage AIFs on the Article 42 register must comply with the transparency provisions and articles 26 to 30 of AIFMD. This obligation to comply with the transparency provisions will be imposed using either FCA rules or in further HMT Regulations. This issue will be considered further in the second consultation, together with the future of the section 270 and 272 regimes.

Box 5.C: Questions 27 and 28

27 The Regulations have been prepared consistently with the Government's 'copy out' approach. Do Respondents have comments to that approach?

28 Do the draft Regulations adequately implement the Directive?

6 Transitional provisions

6.1 Article 66(1) & (2) requires that the Directive is transposed by Member States by 22 July 2013. Managers are required to apply for authorisation within one year of the Directive coming into effect.

6.2 AIFM must adhere to the requirements of the Directive that are relevant to them from the point that their application for registration or authorisation is approved.

6.3 As the transitional period provided by the Directive only lasts one year, all AIFM must fully comply with the requirements of the Directive that are relevant to them by 21 July 2014, regardless of whether there has been sufficient time to approve their registration or authorisation.

7 The consultation process

How to respond

7.1 This document provides details on the proposed implementation of the Alternative Investment Fund Managers Directive. Responses to the consultation should be sent by 27 February 2013.

By e-mail to aifmd@hmtreasury.gsi.gov.uk

By post to AIFMD Transposition Consultation, Financial Regulation and Markets, HM Treasury, 1st Floor Red 1, 1 Horse Guards Road, London SW1A 2HQ

Please be aware that all responses may be shared with the Financial Services Authority.

7.2 All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

7.3 When responding please say if you are a business, private individual or representative body. In the case of representative bodies please provide information on the number and nature of people or businesses you represent.

Confidentiality

7.4 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

7.5 If you want the information that you provide to be treated as confidential, please be aware that, under FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury or the Financial Services Authority.

7.6 HM Treasury and the Financial Services Authority will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A Draft Regulations

A.1 This section contains the draft statutory instruments for the Alternative Investment Fund Managers Regulations 2013.

Draft Regulations laid before Parliament under paragraphs 2 and 2A(3)(a) of Schedule 2 to the European Communities Act 1972 for approval by resolution of each House of Parliament.

D R A F T   S T A T U T O R Y   I N S T R U M E N T S

2013 No.

FINANCIAL SERVICES AND MARKETS

The Alternative Investment Fund Managers Regulations 2013

Made - - - -	***
Coming into force - -	***

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The Treasury are a government department designated(**a**) for the purposes of section 2(2) of the European Communities Act 1972(**b**) in relation to financial services.

A draft of these Regulations has been laid before and approved by a resolution of each House of Parliament in accordance with paragraphs 2 and 2A(3)(a) of Schedule 2 to the European Communities Act 1972.

The Treasury make these Regulations in exercise of the powers conferred on them under section 2(2) of the European Communities Act 1972, and (in relation to paragraph 3 of Schedule 2 to these Regulations) paragraphs 13(1)(b)(iii), 14(1)(b), 17(b) and 22(2) of Schedule 3 to the Financial Services and Markets Act 2000(**c**), and section 417 of that Act.

PART 1
INTRODUCTORY PROVISIONS

Citation and commencement

1. These Regulations may be cited as the Alternative Investment Fund Managers Regulations 2013 and come into force on 22nd July 2013.

Interpretation

2.—(1) In these Regulations—

"the Act" means the Financial Services and Markets Act 2000;

"able to promote" has the meaning given in regulation 47(2);

"AIF" has the meaning given in regulation 3;

"AIFM" has the meaning given in regulation 4(1);

"Article 36 custodian" has the meaning given in regulation 58(6);

"Article 36 register" has the meaning given in regulation 58(3);

"Article 42 register" has the meaning given in regulation 60(1);

"authorised AIF" means an AIF that is—

(**a**) S.I. 2012/1759.
(**b**) 1972 c. 68. Section 2(2) was amended by section 27(1)(a) of the Legislative and Regulatory Reform Act 2006 (c. 51) and the European Union (Amendment) Act 2008 (c.7), Schedule, Part 1.
(**c**) 2000 c. 8.

(a) an authorised unit trust scheme, or

(b) an authorised open-ended investment company,

as defined in section 237(3) of the Act (other definitions);

"Commission Delegated Regulation" means the Commission Delegated Regulation (EU) [ ] of [ ], supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision;

"competent authority" means—

(a) the national authority of an EEA State, other than the United Kingdom, responsible for supervising AIFMs; and

(b) in relation to an EEA AIF, the competent authority in the EEA State in which the EEA AIF is registered or authorised, or has its registered office or head office;

"depositary" means a person appointed in accordance with Article 21.1 of the directive;

"the directive" means the alternative investment fund managers directive;

"EEA AIF" means an AIF which—

(a) if it is authorised or registered, is authorised or registered under the applicable national law in an EEA State other than the United Kingdom; and

(b) if it is not authorised or registered, has its registered office or head office in an EEA State other than the United Kingdom;

"EEA AIFM" means an EEA firm falling within paragraph 5(h) of Schedule 3 to the Act, which is exercising in the United Kingdom an EEA right deriving from the directive;

"ESRB" means the European Systemic Risk Board established by Regulation (EU) No 1092/2010 of the European Parliament and the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board(**a**);

"external AIFM" has the meaning given in regulation 4(2);

"external valuer", in relation to an AIF, means a person who performs the valuation function described in article 19 of the directive, and is independent from—

(a) the AIF;

(b) the AIFM which manages the AIF; and

(c) any other person with close links to the AIF or the AIFM;

"full-scope UK AIFM" means a firm which is authorised by the FCA in accordance with Article 6.1 of the alternative investment fund managers directive;

"internal AIFM" has the meaning given in regulation 4(2);

"markets an AIF" has the meaning given in regulation 47(1), and cognate expressions are to be interpreted accordingly;

"professional investor" means an investor which is considered to be a professional client or may, on request, be treated as a professional client within the meaning of Annex II to the markets in financial instruments directive;

"regulator's notice" means a notice of intention referred to in paragraph 14(1)(b) of Schedule 3 to the Act;

"relevant provisions", in relation to a person, means provisions applicable to the person in—

(a) these Regulations;

(b) the Commission Delegated Regulation;

(c) [other directly applicable EU regulations made under the directive]; and

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(**a**) OJ L 332, 24.11.2010, p1.

(d) rules implementing the directive;

"relevant register" means—

(a) the Article 36 register;

(b) the register mentioned in regulation 59(1); or

(c) the Article 42 register;

"retail investor" means an investor who is not a professional investor;

"small AIFM" has the meaning given in regulation 11;

"small authorised UK AIFM" means a UK AIFM which—

(a) is a small AIFM;

(b) has permission under Part 4A of the Act to manage an AIF; and

(c) has not exercised the option mentioned in Article 3.4 of the directive to meet the full requirements of the directive;

"small registered EEA AIFM" means an AIFM which—

(a) is a small AIFM;

(b) has its registered office in an EEA State other than the United Kingdom; and

(c) has not exercised the option mentioned in Article 3.4 of the directive to meet the full requirements of the directive;

"small registered UK AIFM" means an AIFM entered in the register maintained in accordance with regulation 12(1);

"small third country AIFM" means a third country AIFM which is a small AIFM;

"third country" means a state which is not an EEA State;

"third country AIF" means an AIF which is neither an EEA AIF nor a UK AIF;

"third country AIFM" means an AIFM which has its registered office in a third country;

"UK AIF" means an AIF which—

(a) is an authorised AIF; or

(b) has its registered office or head office in the United Kingdom;

"UK AIFM" means an AIFM which has its registered office in the United Kingdom;

"unauthorised AIF" means an AIF that is not an authorised AIF.

(2) Unless otherwise defined—

(a) any expression used in these Regulations which is used in the directive has the same meaning as in the directive; and

(b) any other expression used in these Regulations which is defined for the purposes of the Act has the meaning given by the Act.

Meaning of "AIF"

3.—(1) "AIF" means a collective investment undertaking, including investment compartments of such an undertaking, which—

(a) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of these investors; and

(b) does not require authorisation pursuant to Article 5 of the UCITS directive.

(2) An AIF may be open-ended or closed-ended, and constituted in any legal form, including under a contract, by means of a trust or under statute.

(3) The following entities are not AIFs—

(a) an institution for occupational retirement provision which falls within the scope of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision(**a**);

(b) a holding company;

(c) an employee participation scheme or employee savings scheme;

(d) a securitisation special purpose entity.

Meaning of "AIFM", "external AIFM" and "internal AIFM"

4.—(1) "AIFM" means a legal person that performs risk management or portfolio management for an AIF.

(2) An AIFM may be either—

(a) an external AIFM appointed by or on behalf of the AIF to manage the AIF ("external AIFM"); or

(b) where the legal form of the AIF permits internal management and where the AIF's governing body chooses not to appoint an external AIFM, the AIF itself ("internal AIFM").

PART 2

AUTHORISATION OF AIFMS

General restriction on giving permission to manage an AIF

5.—(1) In this regulation, and regulation 6, "applicant" means a person who—

(a) applies for permission under Part 4A of the Act, or for the variation of an existing permission, to manage an AIF; and

(b) upon being granted such permission, would become—

(i) a full-scope UK AIFM, or

(ii) a small authorised UK AIFM managing an authorised AIF.

(2) The FCA must not give permission under Part 4A of the Act to an applicant unless—

(a) the applicant is a legal person;

(b) the applicant would be the only AIFM of each AIF it managed;

(c) it is satisfied that the applicant will comply with the relevant provisions;

(d) the applicant has sufficient initial capital and own funds in accordance with relevant provisions relating to Article 9 of the directive;

(e) there are at least two persons conducting the business of the applicant who are of good repute and are experienced in relation to the investment strategies pursued by the AIFs managed by the applicant; and

(f) the names of the persons mentioned in sub-paragraph (e) have been communicated to the FCA.

Consultation requirements for certain authorisations

6.—(1) The FCA must consult the relevant competent authority before it grants permission under Part 4A of the Act to an applicant if the applicant is—

(a) a subsidiary of X,

(**a**) OJ L 235, 23.9.2003, p10.

(b) a subsidiary of a parent undertaking of X, or

(c) a company controlled by the same persons that control X.

(2) For the purposes of paragraph (1), "X" is—

(a) a UCITS management company authorised in accordance with Article 6.1 of the UCITS directive,

(b) an investment firm authorised in accordance with Article 5 of the markets in financial instruments directive,

(c) a credit institution authorised in accordance with Article 6 of the banking consolidation directive, or

(d) an insurance undertaking authorised in accordance with Article 4 of the life assurance consolidation directive or Article 6 of the first non-life insurance directive,

in an EEA State other than the United Kingdom.

(3) In this regulation, "the relevant competent authority" means the competent authority (within the meaning of the relevant single market directive) in relation to X.

Supplementary provisions about AIFMs

7.—(1) This regulation applies to—

(a) a full-scope UK AIFM, in relation to AIFs managed by it, and

(b) a small authorised UK AIFM, in relation to authorised AIFs managed by it,

if the AIFM concerned is an external AIFM.

(2) If the AIFM is unable to ensure compliance by an AIF it manages, or by another entity on the AIF's behalf, with relevant provisions for which the AIF is responsible, the AIFM must immediately inform—

(a) the FCA, and

(b) where the AIF concerned is an EEA AIF, the competent authority of the AIF,

about the non-compliance.

(3) The FCA must require the AIFM to take steps to remedy the situation.

(4) If the non-compliance persists despite the steps mentioned in paragraph (3) being taken—

(a) the FCA must require the AIFM to cease acting as manager of that AIF; and

(b) the FCA must immediately inform—

(i) the competent authorities of the EEA States in which the AIF is marketed, and

(ii) if the AIF is an EEA AIF, the competent authority of the AIF,

of its requirement.

(5) Without prejudice to other powers available to the FCA, the FCA may use its power under section 55J of the Act (variation or cancellation on initiative of regulator) to impose the requirements mentioned in paragraphs (3) and (4)(a).

Changes in the scope of authorisation

8.—(1) This regulation applies where a full-scope UK AIFM, or a small authorised UK AIFM managing an authorised AIF, has notified the FCA of any material changes to the conditions for initial authorisation in accordance with relevant provisions relating to Article 10.1 of the directive.

(2) If the FCA decides to impose restrictions in relation to the proposed changes, or to reject the proposed changes, it must inform the AIFM within one month of receiving the notification mentioned in paragraph (1).

(3) The FCA may prolong the period of one month referred to in paragraph (2) by up to another month, if it considers this to be necessary because of the specific circumstances of the case, and after having notified the AIFM accordingly.

Notification to ESMA

9. The FCA must, on a quarterly basis, inform ESMA of—

(a) the authorisations granted to full-scope UK AIFMs, or withdrawn from such AIFMs, in accordance with Chapter 2 of the directive; and

(b) the AIFs managed or marketed in EEA States by such AIFMs.

PART 3

AMENDMENTS TO THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES) ORDER 2001

Amendments to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

10.—(1) The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(**a**) is amended as follows.

(2) In article 3(1)—

(a) in the definition of "overseas person" for "51" substitute "51ZA, 51ZB, 51ZC, 51ZD, 51ZE"; and

(b) insert the following definitions at the appropriate places—

""AIF" has the meaning given in regulation 3 of the Alternative Investment Fund Managers Regulations 2013(**b**);

"AIFM" has the meaning given in regulation 4 of the Alternative Investment Fund Managers Regulations 2013;

"authorised AIF" has the meaning given in regulation 2(1) of the Alternative Investment Fund Managers Regulations 2013;

"authorised unit trust scheme" has the meaning given in section 237(3) of the Act (other definitions);

"EEA AIF" has the meaning given in regulation 2(1) of the Alternative Investment Fund Managers Regulations 2013;

"small authorised UK AIFM" has the meaning given in regulation 2(1) of the Alternative Investment Fund Managers Regulations 2013;

"small registered UK AIFM" has the meaning given in regulation 2(1) of the Alternative Investment Fund Managers Regulations 2013;

"UCITS" has the meaning given in Article 1.2 of the UCITS directive;".

(3) In articles 4(2), 8(c), 15(2)(g), 16(1)(b) and 33(b)(iii), for "51" substitute "51ZA, 51ZB, 51ZC, 51ZD, 51ZE".

(4) After article 42, insert—

"Depositaries of UCITS and AIFs

42A. A person does not carry on an activity of the kind specified by article 40 if the person carries on the activity in relation to—

(a) a UCITS, and the person has permission under Part 4A of the Act to carry on the activity specified in article 51ZB in respect of that UCITS; or

---

(**a**) S.I. 2001/544.
(**b**) S.I. 2013/[].

(b) an AIF, and the person has permission under Part 4A of the Act to carry on the activity specified in article 51ZD in respect of that AIF.”.

(5) In the heading of Chapter X, omit ‘schemes’.

(6) For article 51 and the cross-heading following it, substitute—

“Managing a UCITS

51ZA.—(1) Managing a UCITS is a specified kind of activity.

(2) A person manages a UCITS when the person carries on collective portfolio management of the UCITS, which includes the functions in Annex 2 to the UCITS directive (the text of which is set out in Schedule 5) in relation to a UCITS.

(3) If a person manages a UCITS and also carries on other activities in connection with or for the purposes of the management of that UCITS, such other activities are also included in the activity specified in paragraph (1).

Acting as trustee or depositary of a UCITS

51ZB.—(1) Acting as—

(a) the trustee of an authorised unit trust scheme, or

(b) the depositary of an open-ended investment company,

where the scheme or company is a UCITS, is a specified kind of activity.

(2) In paragraph (1), “authorised unit trust scheme”, “trustee” and “depositary” have the meanings given in section 237 of the Act.

Managing an AIF

51ZC.—(1) Managing an AIF is a specified kind of activity.

(2) A person manages an AIF when the person performs risk management or portfolio management for the AIF.

(3) If a person manages an AIF, and also carries on—

(a) one or more of the additional activities listed in paragraph 2 of Annex 1 to the alternative investment fund managers directive (the text of which is set out in Schedule 6) for that AIF; or

(b) one or more other activities in connection with or for the purposes of the management of that AIF,

those activities are included in the activity specified in paragraph (1).

Acting as trustee or depositary of an AIF

51ZD.—(1) Acting as—

(a) the trustee of a unit trust scheme, or

(b) the depositary of an open-ended investment company, or of another undertaking,

where the scheme, company or other undertaking is an AIF falling within paragraph (3), is a specified kind of activity.

(2) In paragraph (1)—

(a) “depositary” means—

(i) a person appointed in accordance with Article 21.1 of the alternative investment fund managers directive (whether or not the appointment is required by that Article); or

(ii) an Article 36 custodian as defined in regulation 3(1) of the Alternative Investment Fund Managers Regulations 2013;

(b) "trustee" in relation to a unit trust scheme means a person holding the property of the scheme on trust for the participants and appointed in accordance with Article 21.1 of the alternative investment fund managers directive (whether or not the appointment is required by that Article); and

(c) "unit trust scheme" has the meaning given in section 237(1) of the Act.

(3) An AIF falls within this paragraph if it is—

(a) an AIF managed by a full-scope UK AIFM;

(b) a UK AIF managed by an EEA AIFM; or

(c) an authorised AIF managed by a small authorised UK AIFM.

Establishing etc. a collective investment scheme

51ZE. Establishing, operating or winding up a collective investment scheme is a specified kind of activity.

Exclusions

Persons excluded from managing an AIF

51ZF. There is excluded from article 51ZC the activity of managing an AIF if the person carrying on the activity is listed or described in Schedule 7(**a**).

Operating a collective investment scheme in relation to a UCITS or an AIF

51ZG. A person does not carry on the activity specified in article 51ZE if the person carries on the activity—

(a) in relation to a UCITS, and—

(i) at the time the person carries on the activity, the UCITS is managed by a person with permission under Part 4A of the Act to manage a UCITS; or

(ii) no more than 30 days have passed since the UCITS was managed by a person with that permission; or

(b) in relation to an AIF, and—

(i) at the time the person carries on the activity, the AIF is managed by a person with permission under Part 4A of the Act to manage an AIF; or

(ii) no more than 30 days have passed since the AIF was managed by a person with that permission.

(7) In article 51A, for "Article 51 is" substitute "Articles 51ZA, 51ZB, 51ZC, 51ZD, and 51ZE are".

(8) In articles 64, 68(1) and (3)(b)(ii) and 69(2)(b)(ii), for "51", substitute "51ZA, 51ZB, 51ZC, 51ZD, 51ZE".

(9) In regulation 72E(5), for "51(1)(a) substitute "51ZE".

(10) After article 72F, insert—

"Managers of UCITS and AIFs

72G.—(1) This article applies to a person with permission under Part 4A of the Act to manage a UCITS, or to manage an AIF.

(**a**) General exemptions for certain persons are also provided for in the Financial Services and Markets Act 2000 (Exemption) Order 2001 (S.I. 2001/1201).

(2) Activities carried on by the person in connection with or for the purposes of managing a UCITS or, as the case may be, managing an AIF, are excluded from the activities specified in this Part, other than the activities mentioned in paragraph (1).”

(11) After Schedule 4, insert—

“SCHEDULE 5

Article 51ZA

FUNCTIONS INCLUDED IN THE ACTIVITY OF MANAGING A UCITS: ANNEX II TO THE UCITS DIRECTIVE

1. Investment management.

2. Administration—

(a) legal and fund management accounting services;

(b) customer inquiries;

(c) valuation and pricing (including tax returns);

(d) regulatory compliance monitoring;

(e) maintenance of unit-holder register;

(f) distribution of income;

(g) unit issues and redemptions;

(h) contract settlements, including certificate dispatch;

(i) record keeping.

3. Marketing.

SCHEDULE 6

Article 51ZC

ADDITIONAL ACTIVITIES INCLUDED IN THE ACTIVITY OF MANAGING AN AIF LISTED IN PARAGRAPH 2 OF ANNEX 1 TO THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE

(a) Administration—

(i) legal and fund management accounting services;

(ii) customer inquiries;

(iii) valuation and pricing, including tax returns;

(iv) regulatory compliance monitoring;

(v) maintenance of unit-/shareholder register;

(vi) distribution of income;

(vii) units/shares issues and redemptions;

(viii) contract settlements, including certificate dispatch;

(ix) record keeping:

(b) Marketing;

(c) Activities related to the assets of AIFs, namely services necessary to meet the fiduciary duties of the AIFM, facilities management, real estate administration activities, advice to undertakings on capital structure, industrial strategy and related matters, advice and services related to mergers and the purchase of

undertakings and other services connected to the management of the AIF and the companies and other assets in which it has invested.

SCHEDULE 7

Article 51ZF

PERSONS EXCLUDED FROM REGULATED ACTIVITY OF MANAGING AN AIF

Interpretation of this Schedule

1. Any expression used in this Schedule which is used in the alternative investment fund managers directive has the same meaning as in that directive.

Persons excluded

2. A small registered UK AIFM.

3. An AIFM which manages one or more AIFs whose only investors are—

(a) the AIFM,

(b) the parent undertakings of the AIFM,

(c) the subsidiaries of the AIFM, or

(d) other subsidiaries of those parent undertakings,

provided that none of the investors is an AIF.

4. An institution for occupational retirement provision which falls within the scope of Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision(**a**), including, where applicable, the authorised entities responsible for managing such institutions and acting on their behalf referred to in Article 2.1 of that directive, or the investment managers appointed pursuant to Article 19.1 of that directive, in so far as they do not manage AIFs.

5. The European Investment Fund, the European Development Finance institutions and bilateral development banks, the World Bank, and other supranational institutions and similar international organisations, in the event that such institutions or organisations manage AIFs and in so far as those AIFs act in the public interest.

6. National, regional and local governments and bodies or other institutions which manage funds supporting social security and pension systems.

7. A holding company.

8. An employee participation scheme or employee savings scheme.

9. A securitisation special purpose entity.”.

(**a**) OJ L 235, 23.9.2003, p10.

PART 4

SMALL AIFMs

Meaning of "small AIFM"

11. "Small AIFM" means an AIFM which directly, or indirectly through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manages portfolios of AIFs whose assets under management—

(a) do not exceed 500 million euros in total in cases where the portfolios of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF; or

(b) do not exceed 100 million euros in total in other cases, including any assets acquired through the use of leverage.

Small registered UK AIFM

12.—(1) The FCA must keep a register of small registered UK AIFMs, and may refuse to enter an AIFM on the register only if any of the conditions in paragraph (2) to (5) is not met.

(2) The AIFM is—

(a) a UK AIFM;

(b) a small AIFM; and

(c) is not the AIFM of any other AIF.

(3) The AIFM is —

(a) an internal AIFM; and

(b) a body corporate that is not a collective investment scheme.

(4) None of the individuals responsible for the management or operation of the AIFM—

(a) has been convicted of any offence involving fraud or dishonesty, or any indictable offence, and for this purpose "offence" includes any act or omission which would have been an offence if it had taken place in the United Kingdom; or

(b) is subject to a prohibition order.

(5) Grounds do not exist which would permit or require a court to make a disqualification order within the meaning of section 1(1) of the Company Directors Disqualification Act 1986(**a**) against an individual responsible for the management or operation of the AIFM.

(6) The FCA may—

(a) keep the register of small registered UK AIFMs in any form it thinks fit;

(b) include on the register such information as the FCA considers appropriate; and

(c) exploit commercially the information contained in the register, or any part of that information.

(7) The FCA must—

(a) publish the register on a regular basis; and

(b) provide a certified copy of the register, or any part of it, to any person who asks for it—

(i) on payment of the fee (if any) fixed by the FCA; and

(ii) in a form in which it is legible to the person asking for it.

(**a**) 1986 c. 46. Section 1(1) was amended by the Enterprise Act 2002 (c. 40), s. 204(1), (3), and the Insolvency Act 2000 (c. 39), s. 5(1).

Applications for entry on register of small registered UK AIFMs

13.—(1) An application for entry on the register of small registered UK AIFMs must—

(a) be made in such manner as the FCA may direct; and

(b) contain or be accompanied by such information as the FCA may reasonably require for the purpose of determining the application.

(2) At any time after receiving an application and before determining it, the FCA may require the applicant to provide it with such further information as it reasonably considers necessary to enable it to determine the application.

(3) Different directions may be given, and different requirements imposed, in relation to different applications or categories of applications.

(4) The FCA may require an applicant to provide information which it is required to give under this regulation in such form, or to verify it in such manner, as the FCA may specify.

Determination of applications

14.—(1) The FCA must determine an application for entry on the register of small registered UK AIFMs before the end of the period of three months beginning with the date on which it receives the completed application.

(2) The FCA may determine an incomplete application if it considers it appropriate to do so; and it must in any event determine such an application within six months beginning with the date on which it first receives the application.

(3) If the FCA determines to enter an AIFM on the register, it must give written notice of its determination to the applicant.

Procedure when refusing an application

15.—(1) If the FCA proposes to refuse an application made under regulation 13(1) it must give the applicant a warning notice.

(2) If the FCA decides to refuse an application—

(a) it must give the applicant a decision notice; and

(b) the applicant may refer the matter to the Tribunal.

Revocation of registration

16.—(1) If a small registered AIFM ceases to meet any of the conditions in regulation 12(2)(a), 12(2)(c), 12(3), or 12(4)(a), it must inform the FCA immediately.

(2) If proceedings begin against an individual responsible for the operation or management of a small registered UK AFIM for a disqualification order or disqualification undertaking under the Company Directors Disqualification Act 1986, the AIFM must inform the FCA immediately.

(3) If a small registered UK AIFM exceeds the applicable threshold for assets under management in regulation 11, within the meaning of Chapter 1 of the Commission Delegated Regulation, it must—

(a) inform the FCA; and

(b) within 30 days of exceeding the threshold, either—

(i) apply to the FCA for permission under Part 4A of the Act to manage an AIF (or for variation of an existing permission so as to carry on a regulated activity of that kind); or

(ii) appoint a person with such permission to act as AIFM of the AIF.

(4) In an application under paragraph (3)(b)(i), a small registered UK AIFM may request to become—

(a) a small authorised UK AIFM; or

(b) a full-scope UK AIFM, in accordance with relevant provisions relating to Article 3.4 of the directive.

(5) If an AIFM fails to—

(a) apply for permission under Part 4A of the Act to manage an AIF, or

(b) appoint a person with that permission,

within 30 days as required by paragraph (3)(b), its registration is treated as revoked upon the expiry of the 30 day period.

Applications for revocation of registration

17.—(1) A small registered UK AIFM may apply to the FCA for its registration to be revoked, and for permission under Part 4A of the Act to manage an AIF (or for variation of an existing permission so as to carry on a regulated activity of that kind).

(2) In its application, a small registered UK AIFM may request to become—

(a) a small authorised UK AIFM; or

(b) a full-scope UK AIFM, in accordance with relevant provisions relating to Article 3.5 of the directive.

Grounds for revocation of registration

18.—(1) Subject to paragraph (2), the FCA may revoke the registration of a small registered UK AIFM if—

(a) the AIFM does not meet any condition in regulation 12(2) to (5);

(b) the AIFM has contravened the relevant provisions;

(c) the AIFM applies for or consents to the revocation of its registration; or

(d) the AIFM is wound up.

(2) If an AIFM applies to the FCA for permission in accordance with regulation 16(3), the FCA may not revoke the registration of the AIFM on the ground that the AIFM is not a small AIFM until the FCA has determined the AIFM's application.

Procedure on revocation

19.—(1) If the FCA proposes to revoke the registration of a small registered UK AIFM on the grounds mentioned in regulation 18(1)(a) or (b), the FCA must give the AIFM a warning notice.

(2) If the FCA decides to revoke the registration of a small registered UK AIFM on the grounds mentioned in regulation 18(1)(a) or (b)—

(a) the FCA must give the AIFM a decision notice, and

(b) the AIFM may refer the matter to the Tribunal.

Disclosure obligations of small registered UK AIFMs

20.—(1) A small registered UK AIFM must provide the FCA with such information that the FCA may direct on—

(a) the main instruments in which the AIFM trades, and

(b) the principal exposures and most important concentrations of the AIFs that it manages,

in order to enable the FCA to monitor systemic risk effectively.

(2) Information provided under paragraph (1) must be given at such times, and verified in such manner, as the FCA may direct.

Application of FCA rules to small authorised UK AIFMs managing an authorised AIFs

21.—(1) Subject to paragraph (4), a rule of a kind specified for the purposes of this paragraph made by the FCA under the Act does not apply to a small authorised UK AIFM in respect of its management of an authorised AIF.

(2) Subject to paragraph (3), a rule is specified for the purposes of paragraph (1) if it—

(a) has the same effect as a provision in the Commission Delegated Regulation—

(i) specifying the conditions under which the AIFM shall be deemed to have delegated its functions to the extent that it becomes a letter-box entity and can no longer be considered to be the manager of an AIF as set out in Article 20.3 of the directive; or

(ii) supplementing articles 22 to 24 (transparency provisions); or

(b) is made by the FCA for the purposes of implementing Articles 13 and 22.2.e and f of, and Annex II to, the directive.

(3) A rule is not specified for the purposes of paragraph (1) if—

(a) immediately before 22nd July 2013 it applies to the operator of—

(i) an authorised unit trust scheme;

(ii) a scheme constituted by an authorised open-ended investment company; or

(iii) a recognised scheme; or

(b) it imposes the same requirement as a rule which falls within sub-paragraph (a).

(4) This regulation ceases to have effect [on 22nd July 2015].

Application of FCA rules to small authorised UK AIFMs managing unauthorised AIFs

22.—(1) Subject to paragraph (4), a rule of a kind specified for the purposes of this paragraph made by the FCA under the Act does not apply to a small authorised UK AIFM in respect of its management of an unauthorised AIF.

(2) Subject to paragraph (3), a rule is specified for the purposes of paragraph (1) if it is imposed by the FCA for the purposes of implementing the directive.

(3) A rule is not specified for the purposes of paragraph (2)—

(a) to the extent that it is a relevant provision relating to article 3 of the directive

(b) if immediately before 22nd July 2013 it applies to the operator of a collective investment scheme other than—

(i) an authorised unit trust scheme;

(ii) a scheme constituted by an authorised open-ended investment company; or

(iii) a recognised scheme; or

(c) if it imposes the same requirement as a rule which falls within sub-paragraph (a).

(4) This regulation ceases to have effect [on 22nd July 2015].

PART 5

OPERATING CONDITIONS FOR FULL-SCOPE UK AIFMS AND SMALL AUTHORISED UK AIFMS

Valuation

23.—(1) An AIF falls within this paragraph if—

(a) it is managed by a full-scope UK AIFM; or

(b) it is an authorised AIF managed by a small authorised UK AIFM.

(2) Where an external valuer is appointed to value—

(a) the assets of an AIF falling within paragraph (1); or

(b) the net asset value per unit or share of such an AIF,

the external valuer must carry out the valuation impartially, and with all due skill, care and diligence.

(3) An external valuer may not delegate such valuation to a third party.

(4) If the FCA considers the appointment of an external valuer does not comply with relevant provisions relating to Article 19.5 of the directive, the FCA may require that another external valuer be appointed instead.

(5) Irrespective of any contractual arrangements that provide otherwise, an external valuer is liable to the AIFM for any losses suffered by the AIFM as a result of the external valuer's negligence or intentional failure to perform its tasks.

Disqualification

24.—(1) If it appears to the FCA that an external valuer appointed in relation to an AIF falling within regulation 23(1) has failed to comply with the relevant provisions, it may disqualify the valuer from acting as the valuer for—

(a) AIFs managed by full-scope UK AIFMs, and

(b) authorised AIFs managed by small authorised UK AIFMs,

or any particular class of such AIFs.

(2) If the FCA proposes to disqualify a valuer under this section, it must give the valuer a warning notice.

(3) If the FCA decides to disqualify a valuer, it must give the valuer a decision notice.

(4) The FCA may remove any disqualification imposed under this regulation if satisfied the disqualified person will in future comply with the relevant provisions.

(5) A person who has been disqualified under this regulation may refer the matter to the Tribunal.

Approval for delegation of functions to certain undertakings

25.—(1) This regulation applies to—

(a) a full-scope UK AIFM in relation to the AIFs it manages; and

(b) a small authorised UK AIFM in relation to authorised AIFs it manages.

(2) An AIFM may delegate its functions of portfolio management or risk management for an AIF to an undertaking if—

(a) the undertaking falls within paragraph (3); or

(b) the AIFM has obtained the prior approval of the FCA for such delegation in accordance with paragraphs (4) to (7).

(3) An undertaking falls within this paragraph if it is—

(a) authorised or registered for the purpose of asset management; and

(b) subject to supervision in relation to its asset management function.

(4) An application by an AIFM for approval—

(a) must be made in such manner as the FCA may direct; and

(b) must contain or be accompanied by such information as the FCA may reasonably require for the purposes of determining the application.

(5) At any time after receiving an application and before determining it, the FCA may require the applicant to provide it with such further information as it reasonably considers necessary to enable it to determine the application.

(6) An application under paragraph (4) must be determined by the FCA within one month of receiving the completed application.

(7) The FCA may determine an incomplete application if it considers it appropriate to do so; and it must in any event determine such an application within two months of receiving the application.

Revocation of approval

26.—(1) The FCA may revoke its approval granted under regulation 25.

(2) If the FCA decides to revoke its approval—

(a) it must give the applicant a decision notice; and

(b) the applicant may refer the matter to the Tribunal.

Liability following delegation under Article 20 of the directive

27.—(1) This regulation applies to—

(a) a full-scope UK AIFM in relation to the AIFs it manages; and

(b) a small authorised UK AIFM in relation to the authorised AIFs it manages.

(2) Irrespective of any contractual arrangements that provide otherwise, the liability of an AIFM to an AIF it manages, or to an investor of such an AIF, is not affected by—

(a) the delegation of the AIFM's functions to a third party ("a delegate"); or

(b) any sub-delegation by the delegate to another person ("a sub-delegate"); or

(c) any further sub-delegation by a sub-delegate.

(3) A delegate or sub-delegate which has delegated its functions must review on an ongoing basis the services provided by the person to whom functions have been delegated.

Depositary liability: general provisions

28.—(1) Regulations 28 to 31 apply in relation to the depositary of—

(a) a UK AIF managed by a full-scope UK AIFM; and

(b) an authorised AIF, managed by a small authorised UK AIFM.

(2) Irrespective of any contractual arrangements that provide otherwise, but subject to regulations 29(4) and 31(2), the obligation of the depositary under regulation 29(2) is not affected by any delegation of the depositary's functions referred to in Article 21.8 of the directive.

(3) Irrespective of any contractual arrangements that provide otherwise, the liability of the depositary to the AIF, or to investors of the AIF, in regulation 30 is not affected by any delegation of the depositary's functions referred to in Article 21.8 of the directive.

(4) The depositary's liability to the investors of the AIF may be invoked directly or indirectly through the AIFM, depending on the nature of the legal relationship between the depositary, the AIFM and the investors.

Depositary liability for loss of financial instruments held in custody

29.—(1) This regulation applies where there is a loss by the depositary or a third party to whom the custody of financial instruments held in custody in accordance with Article 21.8.a of the directive has been delegated or sub-delegated.

(2) Subject to paragraphs (3) and (4), the depositary must return financial instruments of the identical type or the corresponding amount to the AIF, or the AIFM acting on behalf of the AIF, without undue delay.

(3) The depositary is not required to comply with the obligation in paragraph (2) if it can prove that the loss arose as a result of an external event beyond the depositary's reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

(4) The depositary is not required to comply with the obligation in paragraph (2) if it can prove that—

(a) the lost financial instruments were held in custody by a third party;

(b) the depositary had delegated its functions to the third party in accordance with relevant provisions relating to the second paragraph of Article 21.11 of the directive;

(c) a written contract between the depositary and the third party—

(i) expressly transfers the obligation in paragraph (2) to the third party; and

(ii) enables the AIF, or the AIFM acting on behalf of the AIF, to make a claim against the third party in respect of the loss of financial instruments, or for the depositary to make such a claim on their behalf; and

(d) a written contract between the depositary and the AIF, or the AIFM acting on behalf of the AIF, expressly allows a transfer of the depositary's obligation in paragraph (2) and establishes an objective reason for the transfer.

(5) A third party ("A") to which custody of financial instruments has been delegated and to which the obligation in paragraph (2) has been transferred in accordance with paragraph (4) is not required to return financial instruments of the identical type or corresponding amount to the AIF, or the investors of the AIF, if it can prove that—

(a) the lost financial instruments were held in custody by another third party ("B");

(b) A had sub-delegated its functions to B in accordance with relevant provisions relating to the second paragraph of Article 21.11 of the directive;

(c) a written contract between A and B—

(i) expressly transfers from A to B the obligation to return financial instruments of the identical type or corresponding amount to the AIF, or the investors of the AIF; and

(ii) enables the AIF, or the AIFM acting on behalf of the AIF, to make a claim against B in respect of the loss of financial instruments, or for the depositary to make such a claim on their behalf; and

(d) a written contract between A and the AIF, or the AIFM acting on behalf of the AIF, expressly allows a transfer of A's obligation to return financial instruments of the identical type or corresponding amount to the AIF, or the investors of the AIF, and establishes an objective reason for the transfer.

Depositary liability for other losses

30. If an AIF, or investors of an AIF, have suffered losses other than the loss by the depositary or a third party to which custody has been delegated or sub-delegated of financial instruments held in custody in accordance with Article 21.8.a of the directive, the depositary is liable to the AIF, or investors of the AIF, if the losses are a result of the depositary's negligent or intentional failure to comply with the relevant provisions.

Depositary liability and third country custodians

31.—(1) This regulation applies where—

(a) the law of a third country requires certain financial instruments to be held in custody by a local entity; and

(b) there is no local entity that satisfies the delegation requirements in relevant provisions relating to Article 21.11.d.ii of the directive.

(2) The depositary is not required to comply with the obligation in regulation 29(2) in relation to the financial instruments mentioned in paragraph (1)(a) if—

(a) the rules or instruments of incorporation of the AIF concerned expressly allow for a discharge of the obligation;

(b) the investors of the AIF were informed of the discharge and of the circumstances justifying the discharge prior to their investment;

(c) the AIF, or the AIFM on behalf of the AIF, instructed the depositary to delegate the custody of the financial instruments to a local entity;

(d) a written contract between the depositary and the AIF, or the AIFM acting on behalf of the AIF, expressly allows for such a discharge; and

(e) a written contract between the depositary and the local entity expressly transfers the obligation of the depositary to the local entity and enables the AIF, or the AIFM acting on behalf of the AIF, to make a claim against the local entity in respect of the loss of financial instruments or for the depositary to make such a claim on their behalf.

PART 6

FCA DUTIES

ESMA notification requirements

32. If the FCA requires additional information from a full-scope UK AIFM in accordance with Article 24.5 of the directive, the FCA must inform ESMA about this requirement.

Use of information by FCA and supervisory cooperation

33.—(1) The FCA must use the information it gathers under relevant provisions relating to Article 24 of the directive in respect of AIFMs it supervises for the purposes of identifying the extent to which the use of leverage contributes to—

(a) the build up of systemic risk in the financial system;

(b) the risk of disorderly markets; or

(c) the risks to the long-term growth of the economy.

(2) The FCA must ensure that—

(a) the information mentioned in paragraph (1), and

(b) the information it gathers under relevant provisions relating to Article 7 of the directive,

is made available to ESMA, the ESRB, and competent authorities of other relevant EEA States.

(3) The FCA must, without delay, provide information to the competent authorities of other relevant EEA States, if an AIFM under its responsibility, or an AIF managed by such an AIFM, could potentially constitute an important source of counterparty risk to a credit institution or other systemically relevant institutions in those EEA States.

(4) In this regulation, "credit institution" means a credit institution authorised under the banking consolidation directive.

Limits on leverage

34.—(1) This regulation applies in relation to—

(a) a full-scope UK AIFM; and

(b) a small authorised UK AIFM.

(2) The FCA must use the measures in paragraph (3) if they are necessary in order to ensure the stability and integrity of the financial system, for the purpose of limiting the extent to which the use of leverage by an AIFM with respect to the AIFs it manages contributes to—

(a) the build up of systemic risk in the financial system; or

(b) the risks of disorderly markets.

(3) The measures are—

(a) limits on the level of leverage an AIFM may employ; or

(b) other restrictions on the management of an AIF.

(4) Before taking the measures in paragraph (3) in relation to a full-scope UK AIFM, the FCA must notify ESMA, the ESRB and, where the measures concern an EEA AIF, the competent authority of the EEA AIF.

(5) A notification mentioned in paragraph (4) must contain details of—

(a) the proposed measures;

(b) the reasons for the measures; and

(c) when the measures are intended to take effect.

(6) Unless there are exceptional circumstances, such notifications must be given at least 10 working days before the proposed measures take effect.

(7) If the FCA proposes to take action contrary to ESMA's advice mentioned in Article 25.6 or 25.7 of the directive, it must inform ESMA, stating its reasons.

(8) Without prejudice to other powers available to the FCA, the FCA may use its power under section 55J of the Act (variation or cancellation on initiative of regulator) to impose limits on leverage or other restrictions on the management of an AIF.

Exchange of information relating to potential systemic consequences of AIFM activity

35. The FCA must communicate information to—

(a) competent authorities,

(b) ESMA, and

(c) the ESRB,

where the information is relevant for monitoring and responding to the potential implications of the activities of individual AIFMs or AIFMs collectively for the stability of systemically relevant financial institutions and the orderly functioning of markets on which AIFMs are active.

PART 7

PRIVATE EQUITY

Introductory provisions

36. This Part applies to—

(a) a full-scope UK AIFM; and

(b) a third country AIFM managing an AIF on the Article 42 register, with respect to AIFs on that register.

Ways of acquiring control or shares

37.—(1) This Part applies where control is acquired of a non-listed company or issuer in the following ways—

(a) one AIF acquires control individually;

(b) two or more AIFs, managed by the same AIFM, acquire control jointly on the basis of an agreement aimed at acquiring such control; or

(c) two or more AIFs, managed by two or more AIFMs, acquire control jointly on the basis of an agreement aimed at acquiring such control.

(2) This Part also applies where shares of a non-listed company are acquired, held or disposed (but control is not acquired) in one of the following ways—

(a) one AIF acquires, holds or disposes the shares individually;

(b) two or more AIFs, managed by the same AIFM, acquire, hold or dispose of the shares jointly on the basis of an agreement aimed at so doing; or

(c) two or more AIFs, managed by two or more AIFMs, acquire, hold or dispose of the shares jointly on the basis of an agreement aimed at so doing.

(3) This Part does not apply where the non-listed company or issuer is—

(a) a small or medium-sized enterprise within the meaning of Article 2(1) of the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises(**a**); or

(b) a special purpose vehicle with the purpose of purchasing, holding or administering real estate.

Meaning of "control"

38.—(1) For the purposes of this Part, "control" means—

(a) for a non-listed company, holding more than 50% of the voting rights of the company; and

(b) for an issuer, holding the percentage of voting rights which confers control in the EEA State in which the issuer has its registered office, determined by rules or other provisions adopted in that EEA State implementing Article 5.1 and 5.3 of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids(**b**).

(2) When calculating the percentage of voting rights for the purposes of paragraph (1), in addition to the voting rights held directly by the AIF, the voting rights of the following are included—

(a) an undertaking controlled by the AIF; and

(b) a person acting in its own name but on behalf of the AIF or on behalf of an undertaking controlled by the AIF.

(3) For the purposes of this regulation, voting rights are calculated on the basis of all the shares to which voting rights are attached even if the exercise of those rights is suspended.

Confidential information

39.—(1) This regulation applies to—

(a) employees of a non-listed company or issuer,

(b) representatives of the employees, and

(c) experts who assist the employees or representatives,

who receive information in accordance with this Part, or corresponding provisions adopted in an EEA State other than the United Kingdom implementing Articles 26 to 30 of the directive (obligations for AIFMs managing AIFs which acquire control of non-listed companies and issuers).

(2) If the information mentioned in paragraph (1) is provided in confidence—

(a) regulation 25 of the Information and Consultation of Employees Regulations 2004(**c**), or

(b) regulation 25 of the Information and Consultation of Employees Regulations (Northern Ireland) 2005(**d**),

apply to the information as they apply to information or documents given in confidence by an employer pursuant to the employer's obligations under those Regulations.

(**a**) OJ L 124, 20.5.2003, p. 36.
(**b**) OJ L 142, 30.4.2004, p. 12. In the United Kingdom, the Panel on Takeovers and Mergers is required under section 943(1) of the Companies Act 2006 (c. 46) to make rules implementing Article 5 of Directive 2004/25/EEC.
(**c**) S.I. 2004/3426.
(**d**) S.R. (NI) 2005 No. 47.

Notification of the acquisition or disposal of major holdings and control of non-listed companies

40.—(1) When an AIF acquires, disposes of, or holds shares of a non-listed company, the AIFM managing the AIF must notify the FCA of the proportion of voting rights of the non-listed company held by the AIF any time when that proportion reaches, exceeds or falls below the thresholds of 10%, 20%, 30%, 50% and 75%.

(2) When an AIF acquires control of a non-listed company, the AIFM managing the AIF must notify the following persons of such control—

(a) the non-listed company;

(b) the company's shareholders of which the identities and addresses are available to the AIFM or can be made available by the company or through a register to which the AIFM has or can obtain access; and

(c) the FCA.

(3) The notification required under paragraph (3) must contain the following additional information—

(a) the resulting situation in terms of voting rights in the company;

(b) the conditions subject to which control was acquired, including information about the identity of the different shareholders involved, any person entitled to exercise voting rights on their behalf and, if applicable, the chain of undertakings through which voting rights are effectively held; and

(c) the date on which control was acquired.

(4) The AIFM must, subject to regulation 43—

(a) in its notification to the non-listed company, request the board of directors of the company to inform the employees' representatives or, where there are none, the employees themselves, without undue delay of the acquisition of control by the AIF and of the information in paragraph (4); and

(b) use its best efforts to ensure the board of directors complies with its request.

(5) The notifications required under this regulation by an AIFM must be made as soon as possible, and in any event no later than ten working days after the date on which the AIF reaches, exceeds or falls below the relevant threshold or acquires control over the non-listed company.

Disclosure in case of acquisition of control

41.—(1) When an AIF acquires control of a non-listed company or an issuer, the AIFM managing the AIF must provide the information in paragraph (2) to—

(a) the company;

(b) the company's shareholders of which the identities and addresses are available to the AIFM or can be made available by the company or through a register to which the AIFM has or can obtain access; and

(c) the FCA.

(2) The information is—

(a) the identity of the AIFM which either individually or in agreement with other AIFMs manage the AIF or AIFs that have acquired control;

(b) the policy for preventing and managing conflicts of interest, in particular between—

(i) the AIFMs or the AIFs, and

(ii) the company;

(c) the specific safeguards to ensure that any agreement between—

(i) the AIFMs or the AIFs, and

(ii) the company,

is concluded at arm's length; and

(d) the policy for external and internal communication relating to the company, in particular as regards employees of the company.

(3) The AIFM must, subject to regulation 43—

(a) in its notification to the company, request the board of directors of the company to give the employees' representatives or, where there are none, the employees themselves, without undue delay the information in paragraph (2); and

(b) use its best efforts to ensure that the board of directors complies with its request.

Additional disclosure when control is acquired of non-listed companies

42.—(1) When an AIF acquires control of a non-listed company, the AIFM managing the AIF must ensure that the AIF, or the AIFM acting on behalf of the AIF, discloses their intentions with regard to the matters in paragraph (2) to—

(a) the non-listed company; and

(b) the shareholders of the non-listed company of which the identities and addresses are available to the AIFM or can be made available by the non-listed company or through a register to which the AIFM has or can obtain access.

(2) The matters are the future business of the non-listed company and the likely repercussions on employment by the company, including any material change in the conditions of employment.

(3) The AIFM must, subject to regulation 43—

(a) request that the board of directors of the non-listed company notifies the employees' representatives or, where there are none, the employees themselves, about the AIF's intentions with regard to the matters in paragraph (2); and

(b) use its best efforts to ensure the board of directors complies with its request.

(4) When an AIF acquires control of a non-listed company, the AIFM managing the AIF must provide the FCA and the AIF's investors with information on the financing of the acquisition.

Sensitive information

43. The duties in regulations 40(5), 41(3), and 42(3) do not arise if the communication of information by the board of directors to employees' representatives, or where there are none, the employees themselves, would seriously harm the functioning of the non-listed company, or would be seriously prejudicial to it.

Annual report of AIFs exercising control of non-listed companies

44.—(1) When an AIF acquires control of a non-listed company, the AIFM managing the AIF must include in the AIF's annual report, prepared in accordance with relevant provisions relating to Article 22 of the directive, the information in paragraph (3) relating to the non-listed company.

(2) The duty in paragraph (1) does not arise if the non-listed company is required to draw up an annual report under the law applicable in the EEA State in which the company has its registered office and the AIFM ensures that—

(a) the annual report of the non-listed company contains the information in paragraph (3); and

(b) the report is made available by the board of directors of the company to the employees' representatives or, where there are none, to the employees themselves within the period in which the annual report must be drawn up.

(3) The information is—

(a) a fair review of the development of the company's business representing the situation at the end of the period covered by the annual report;

(b) any important events that have occurred since the end of the financial year;

(c) the company's likely future development; and

(d) in relation to the company's acquisition or disposal of its own shares—

(i) the reasons for acquisitions made during the financial year;

(ii) the number and nominal value or, in the absence of a nominal value, the accountable par of the shares acquired and disposed of during the financial year and the proportion of the subscribed capital which they represent;

(iii) in the case of acquisition or disposal for a value, the consideration for the shares; and

(iv) the number and nominal value or, in the absence of a nominal value, the accountable par of all the shares acquired and held by the company and the proportion of the subscribed capital which they represent.

(4) If the information in paragraph (3) is included in the company's annual report, the AIFM must make the information available to the investors of the AIF in so far as already available within six months following the end of the financial year of the AIF, and in any event, no later than the date on which the annual report of the company must be drawn up in accordance with the law applicable in the EEA State in which the company has its registered office(**a**).

(5) If the information in paragraph (3) is included in the AIF's annual report, the AIFM must request and use its best efforts to ensure that the board of directors of the non-listed company makes that information available to employees' representatives of the company or, where there are none, to the employees themselves, no later than six months following the end of the financial year of the AIF.

Asset stripping

45.—(1) When an AIF acquires control of a non-listed company or an issuer, for a period of 24 months following the acquisition of control, the AIFM managing the AIF—

(a) must not facilitate, support or instruct any distribution, capital reduction, share redemption or acquisition by the company of its own shares;

(b) in so far as the AIFM is authorised to vote on behalf of the AIF at the meetings of the governing bodies of the company, must not vote in favour of a distribution, capital reduction, share redemption or acquisition by the company of its own shares; and

(c) in any event must use its best efforts to prevent distributions, capital reductions, share redemptions or the acquisition by the company of its own shares.

(2) A distribution to shareholders falls within paragraph (1) if—

(a) it would be made when on the closing date of the last financial year the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may be not distributed under the law or the statutes, on the understanding that where the uncalled part of the subscribed capital is not included in the assets shown in the balance sheet, this amount must be deducted from the amount of subscribed capital;

(b) the amount of the distribution would exceed the amount of the profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed to reserve in accordance with the law or the statutes.

(3) An acquisition by a company of its own shares falls within paragraph (1) if, to the extent that acquisitions of own shares are permitted, the acquisitions by the company, including shares previously acquired by the company and held by it, and shares acquired by a person acting in that person's own name but on the company's behalf, would have the effect of reducing the net assets below the amount mentioned in paragraph (2)(a).

(4) For the purposes of this regulation—

(**a**) For companies registered under the Companies Act 2006 (c. 46), provisions about annual reports are contained in Part 15 of that Act.

(a) “distribution” includes the payment of dividends and of interest relating to shares;

(b) the provisions on capital reductions do not apply on a reduction in the subscribed capital, the purpose of which is to—

(i) offset losses incurred; or

(ii) to include sums of money in a non-distributable reserve provided that, following that operation, the amount of such reserve is not more than 10 % of the reduced subscribed capital; and

(c) the restriction on acquisition by a company of its own shares does not apply to shares acquired in the circumstances described in Article 20.1.b to 20.1.h of the second company law directive.

(5) In this regulation—

“law” means the law applicable to the company in the EEA State in which it is registered;

“second company law directive” means the second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards in respect of the formation of public limited liability companies and the maintenance and alteration of their capital(**a**);

“statutes” means the instruments of incorporation of the company.

FCA functions in relation to this Part

46.—(1) The FCA must supervise compliance by the AIFM with the AIFM’s duties under this Part.

(2) A full-scope UK AIFM that contravenes any provision of this Part is to be treated as having contravened rules made under section 137A of the Act (FCA’s general rule-making power).

(3) The FCA may give guidance consisting of such information and advice as it considers appropriate with respect to this Part.

(4) If the FCA proposes to give guidance with respect to this Part, subject to paragraphs (5) and (6), the procedures in subsections (1), (2)(e), and (3) of section 138I of the Act apply to the proposed guidance as those procedures apply to proposed rules.

(5) The FCA need not consult the PRA.

(6) The procedures mentioned in paragraph (4) do not apply if the FCA considers that the delay caused by those procedures would be prejudicial to the interests of a non-listed company or issuer, or the shareholders or employees of such a company.

PART 8

MARKETING OF AIFS

CHAPTER 1

General Provisions

Meaning of “markets an AIF” and “able to promote an AIF”

47.—(1) A person markets an AIF when the person makes a direct or indirect offering or placement of units or shares of an AIF.

(2) A person (“A”) is able to promote an AIF to another person (“B”) if A is able to communicate an invitation or inducement to participate in that AIF to B without breaching—

(a) the financial promotion restriction in section 21 of the Act, where A is an unauthorised person; or

(**a**) OJ L 26, 31.01.1977, p1.

(b) the scheme promotion restriction in section 238 of the Act, where A is an authorised person.

Prohibition on marketing

48. Subject to regulations 49 to 53, a person must not market an AIF to an investor domiciled or with a registered office in the United Kingdom.

Marketing by certain categories of small AIFMs

49. A person may market—

(a) an AIF managed by a small registered UK AIFM;

(b) an unauthorised AIF managed by a small authorised UK AIFM; or

(c) an AIF managed by a small registered EEA AIFM,

to an investor if that person is able to promote the AIF to that investor.

Passive marketing

50. A person may market an AIF to an investor if—

(a) the marketing is not at the initiative of that person; and

(b) that person is able to promote the AIF to that investor.

Marketing with consent from FCA or other competent authority

51. An AIFM described in an entry in column A of the table below, or a person acting on its behalf, may market an AIF described in the entry in column B in the same row of the table —

(a) to a professional investor if—

(i) the AIF is managed by the AIFM;

(ii) the condition in column C in the same row of the table is met; and

(b) to a retail investor if—

(i) the AIFM may market to a professional investor in accordance with sub-paragraph (a); and

(ii) the AIFM or, as the case may be, the person acting on its behalf, is able to promote the AIF to that investor.

A - AIFM	*B - AIF*	*C - Condition*
Full-scope UK AIFM	EEA AIF or UK AIF	FCA has approved marketing of the AIF in accordance with regulation 56.
Small authorised UK AIFM	Authorised AIF	FCA has approved marketing of the AIF in accordance with regulation 56.
EEA AIFM	EEA AIF or UK AIF	FCA has received a regulator's notice in relation to the AIF in accordance with Schedule 3 to the Act in relation to marketing to a professional investor.
Full-scope UK AIFM	An AIF falling within	FCA has approved marketing

	regulation 58(1)	of the AIF in accordance with regulation 58, and the AIF's entry on the Article 36 register has not been suspended or revoked.
AIFM authorised in accordance with Article 6.1 of the directive in an EEA State other than the United Kingdom	An AIF falling within regulation 58(1)	FCA has approved marketing of the AIF in accordance with regulation 58, and the AIF's entry on the Article 36 register has not been suspended or revoked.
Small third country AIFM	UK AIF, EEA AIF, or third country AIF	FCA has approved marketing of the AIF in accordance with regulation 59, and the AIF's entry on the register of small third country AIFMs has not been suspended or revoked.
Third country AIFM that is not a small third country AIFM	UK AIF, EEA AIF, or third country AIF	FCA has approved marketing of the AIF in accordance with regulation 60, and the AIF's entry on the Article 42 register has not been suspended or revoked.

Marketing to retail investors of an AIF managed by an AIFM authorised in another EEA State

52. A person may market a UK AIF or EEA AIF, managed by an AIFM authorised in accordance with Article 6.1 of the directive in an EEA State other than the United Kingdom, to a retail investor if—

(a) the FCA has approved such marketing in accordance with regulation 56; and

(b) that person is able to promote the AIF to that investor.

Marketing by a person other than an AIFM etc.

53.—(1) This regulation applies to the marketing of an AIF specified by paragraph (2) by a person other than—

(a) the AIFM which manages the AIF; or

(b) a person acting on the AIFM's behalf.

(2) An AIF is specified by this paragraph if it is described in an entry in column B of the table in regulation 51 and is managed by an AIFM described in the entry in column A in the same row of the table.

(3) A person may market the AIF to an investor if—

(a) the AIFM which manages the AIF may market the AIF to a professional investor, in accordance with regulation 51; and

(b) that person is able to promote the AIF to that investor.

Offences by unauthorised person

54.—(1) This regulation applies to marketing of an AIF by a person who is not an authorised person, if such marketing—

(a) contravenes regulation 48; but

(b) does not contravene section 21(1) of the Act (restrictions on financial promotion).

(2) Section 25 of the Act (contravention of section 21) applies to the marketing as it applies to the contravention of section 21(1) of the Act.

(3) Section 30 of the Act (enforceability of agreements resulting from unlawful communications) applies to—

(a) controlled agreements entered into in consequence of such marketing, as it applies to controlled agreements entered into in consequence of an unlawful communication; and

(b) the exercise of rights conferred by a controlled investment in consequence of such marketing, as it applies to the exercise of such rights in consequence of an unlawful communication.

Contravention by authorised person

55.—(1) This regulation applies to marketing of an AIF by an authorised person that is—

(a) in contravention of regulation 48; but

(b) does not contravene section 238 of the Act (restrictions on promotion).

(2) Section 138D(2) of the Act (actions for damages) applies to the marketing as it applies to a contravention mentioned in that section.

CHAPTER 2

Marketing of AIFs in the United Kingdom by authorised AIFMs

Marketing by authorised AIFMs

56.—(1) This regulation applies to—

(a) a full-scope UK AIFM seeking to market to professional investors in the United Kingdom a UK AIF or EEA AIF managed by the AIFM;

(b) a small authorised UK AIFM seeking to market to professional investors in the United Kingdom an authorised AIF managed by the AIFM; and

(c) an AIFM authorised in accordance with Article 6.1 of the directive, in an EEA State other than the United Kingdom, seeking to market to retail investors in the United Kingdom an AIF managed by the AIFM.

(2) The AIFM must—

(a) apply to the FCA for approval in such manner as the FCA may direct; and

(b) provide such information as the FCA may reasonably require for the purpose of determining the application.

(3) The FCA must determine the application from an AIFM falling within paragraph (1)(a) or (b) within 20 working days of receipt of a completed application.

(4) The FCA must determine an application from an AIFM falling within paragraph 1(c) within six months of receipt of a completed application.

(5) If the FCA approves the application, it must inform—

(a) the AIFM concerned; and

(b) where the AIF concerned is an EEA AIF, the competent authority of the AIF.

(6) If the FCA refuses the application—

(a) it must inform the AIFM concerned; and

(b) the AIFM may refer the matter to the Tribunal.

(7) The FCA may refuse an application if it appears to the FCA that—

(a) the AIFM does not or is unlikely to comply with the relevant provisions; or

(b) the AIF is a feeder AIF, the master AIF of which is either managed by a third country AIFM or is a third country AIF.

Change to notification particulars

57.—(1) If there is a material change to the information mentioned in regulation 56(2)(b), the AIFM must give written notice of the change to the FCA—

(a) in the case of a change planned by the AIFM ("planned change"), at least one month before implementing the change; or

(b) in other cases, immediately after an unplanned change has occurred.

(2) If a planned change would mean the AIFM no longer complied with the relevant provisions, the FCA must inform the AIFM without undue delay that it must not implement the change.

(3) If—

(a) a planned change is implemented, or

(b) an unplanned change takes place,

as a result of which the AIFM no longer complies with the relevant provisions, the FCA must take all due measures, including, if necessary, the express prohibition of marketing of the AIF.

(4) Without prejudice to other powers available to the FCA, the FCA may use its power under section 55J of the Act (variation or cancellation on initiative of regulator) in taking the due measures mentioned in paragraphs (3) and (4)(a).

CHAPTER 3

National Private Placement Registers

Article 36 register

58.—(1) An AIF falls within this paragraph if it is—

(a) a third country AIF, or

(b) a feeder AIF, the master AIF of which is either managed by a third country AIFM or is a third country AIF, and

managed by an AIFM falling within paragraph (2).

(2) An AIFM falls within this paragraph if it is—

(a) a full-scope UK AIFM; or

(b) an AIFM authorised in another EEA State in accordance with Article 6.1 of the directive.

(3) The FCA must maintain a register of AIFs falling within paragraph (1) that it has approved for marketing in the United Kingdom ("Article 36 register").

(4) The FCA must approve an AIF for marketing in the United Kingdom, on an application by the AIFM which manages the AIF, if it appears to the FCA that the conditions in paragraphs (5) to (8) are met.

(5) Subject to paragraph (6), the AIFM complies with the relevant provisions.

(6) The AIFM need not comply with relevant provisions relating to Article 21 of the directive, provided the AIFM—

(a) ensures that an entity, other than the AIFM, is appointed to carry out the duties mentioned in Article 21.7 to 21.9 of the directive ("Article 36 custodian"); and

(b) informs the FCA about the identity of the entity.

(7) Appropriate cooperation arrangements for the purpose of systemic risk oversight and in line with international standards are in place between the FCA and the supervisory authorities of the relevant third country in order to ensure an efficient exchange of information that enables the FCA to carry out its duties in accordance with the directive.

(8) The relevant third country must not be listed as a Non-Cooperative Country and Territory by the Financial Action Task Force.

(9) In this regulation, "the relevant third country" means—

(a) in the case of a third country AIF, the country where the AIF is established; and

(b) in a case falling within paragraph (1)(b), the country where the master AIF is established or managed.

AIFs managed by small third country AIFMs

59.—(1) The FCA must maintain a register of AIFs which—

(a) are managed by small third country AIFMs; and

(b) are approved by the FCA for marketing in the United Kingdom.

(2) The FCA must approve an AIF for marketing in the United Kingdom, on application by the AIFM which manages the AIF, if it appears to the FCA that—

(a) the AIF has a single AIFM;

(b) the AIFM is a legal person;

(c) the AIFM is a small third country AIFM.

(3) An AIFM managing an AIF on the register mentioned in paragraph (1) must provide the FCA with such information that the FCA directs on—

(a) the main instruments in which the AIFM trades, and

(b) the principal exposures and most important concentrations of the AIFs that it manages,

in order to enable the FCA to monitor systemic risk effectively.

Article 42 register

60.—(1) The FCA must maintain a register of AIFs ("Article 42 register") which—

(a) are managed by third country AIFMs that are not small AIFMs; and

(b) are approved by the FCA for marketing in the United Kingdom.

(2) The FCA must approve an AIF for marketing in the United Kingdom if it appears to the FCA that the conditions in paragraphs (3) to (8) are met.

(3) The AIF has a single AIFM.

(4) The AIFM is a legal person.

(5) The AIFM complies with the transparency provisions in Articles 22-24 of the directive in relation to the AIF for which approval is sought.

(6) If applicable, the AIFM complies with Part 7 in relation to the AIF for which approval is sought.

(7) Appropriate cooperation arrangements for the purpose of systemic risk oversight and in line with international standards are in place between the FCA and the supervisory authorities of the country where—

(a) the third country AIFM is established, and

(b) if applicable, the third country AIF is established,

in order to ensure an efficient exchange of information that enables the FCA to carry out its duties in accordance with the directive.

(8) The country where the third country AIFM or, if applicable, the third country AIF is established is not listed as a Non-Cooperative Country and Territory by the Financial Action Task Force.

Applications for approval

61.—(1) An application for approval for entry on a relevant register must—

(a) be made in such manner as the FCA may direct; and

(b) contain or be accompanied by such information as the FCA may reasonably require for the purpose of determining the application.

(2) At any time after receiving an application and before determining it, the FCA may require the applicant to provide it with such further information as it reasonably considers necessary to enable it to determine the application.

(3) Different directions may be given, and different requirements imposed, in relation to different applications or categories of applications.

(4) The FCA may require an applicant to provide information which it is required to give under this regulation in such form, or to verify it in such manner, as the FCA may direct.

Determination of applications

62.—(1) An application for approval for entry on a relevant register must be determined by the FCA within 20 working days of receipt of a completed application.

(2) The FCA may determine an incomplete application if it considers it appropriate to do so; and it must in any event determine such an application within two months beginning with the date on which it first receives the application.

(3) If the FCA approves an application, it must give written notice of its approval to the applicant.

Procedure when refusing an application

63.—(1) If the FCA proposes to refuse an application for approval for entry on a relevant register it must give the applicant a warning notice.

(2) If the FCA decides to refuse an application—

(a) it must give the applicant a decision notice; and

(b) the applicant may refer the matter to the Tribunal.

Removal from register

64. The FCA may revoke the registration of an AIF from a relevant register if it appears to the FCA that—

(a) the AIFM, or Article 36 custodian, has contravened any of the relevant provisions;

(b) the AIFM, or Article 36 custodian, has in purported compliance with the relevant provisions, knowingly or recklessly given the FCA information which is false or misleading in a material particular;

(c) one or more of the conditions for making the entry in the register is no longer satisfied;

(d) the AIFM which manages the AIF applies for, or consents to, the revocation;

(e) the AIF is wound up.

Procedure for removal from register

65.—(1) If the FCA proposes to revoke the registration of an AIF from a relevant register on a ground mentioned in regulation 64(a) to (c), it must give a warning notice to the AIFM and, in the case of revocation from the Article 36 register, to the Article 36 custodian.

(2) If the FCA decides to revoke the registration of an AIF from a relevant register—

(a) it must give a decision notice to the AIFM and, in the case of the Article 36 register, to the Article 36 custodian; and

(b) the AIFM or the Article 36 custodian may refer the matter to the Tribunal.

Suspension of register entry

66. If it appears to the FCA that—

(a) the AIFM, or Article 36 custodian, has contravened, or is likely to contravene, the relevant provisions,

(b) the AIFM, or Article 36 custodian, has in purported compliance with the relevant provisions, knowingly or recklessly given the FCA information which is false or misleading in a material particular, or

(c) one or more of the conditions for entry on a relevant register is no longer satisfied,

it may suspend the entry of the AIF from a relevant register for a specified period or until the occurrence of a specified event or until specified conditions are complied with.

In this regulation "specified" means specified by the FCA in a notice given under regulation 67.

Procedure on suspension

67.—(1) The suspension of an entry from a relevant register takes effect—

(a) immediately, if the notice given under paragraph (3) states that that is the case;

(b) on such date as may be specified in the notice; or

(c) if no date is specified in the notice, when the matter to which it relates is no longer open to review.

(2) A suspension may be expressed to take effect immediately (or on a specified date) only if the FCA, having regard to the ground on which it is exercising its power under regulation 66, considers that it is necessary for the suspension to take effect immediately (or on that date).

(3) If the FCA proposes to suspend an entry, or suspends with immediate effect, it must give separate written notice to the AIFM and (if applicable) the Article 36 custodian of the AIF concerned.

(4) The notice must—

(a) give details of the suspension;

(b) inform the person to whom it is given of when the suspension takes effect;

(c) state the FCA's reasons for giving the suspension and for its determination as to when the suspension takes effect;

(d) inform the AIFM to whom it is given that it may make representations to the FCA within such period as may be specified in it (whether or not it has referred the matter to the Tribunal); and

(e) inform the AIFM of its right to refer the matter to the Tribunal.

(5) The FCA may extend the period allowed under the notice for making representations.

(6) If, having considered any representations made by the AIFM to whom the notice was given, the FCA decides—

(a) to make the suspension in the way proposed, or

(b) if it has been made, not to revoke the suspension,

it must give separate written notice to the AIFM and (if applicable) the Article 36 custodian.

(7) If, having considered any representations made by a person to whom the notice was given, the FCA decides—

(a) not to make the suspension in the way proposed,

(b) to make the suspension in a way other than that proposed, or

(c) to revoke a suspension,

it must give separate written notice to the AIFM and (if applicable) the Article 36 custodian.

(8) For the purposes of paragraph (1)(c), whether a matter is open to review is to be determined in accordance with section 391(8) of the Act.

PART 9

TRANSITIONAL PROVISIONS

AIFMs managing AIFs immediately before 22nd July 2013

68.—(1) A UK AIFM falls within this paragraph if it carries on the activity of managing an AIF immediately before 22nd July 2013.

(2) An AIFM falling within paragraph (1) must submit an application for—

(a) permission under Part 4A of the Act to manage an AIF, or

(b) registration as a small registered UK AIFM,

before 22nd July 2014, but otherwise need not comply with the relevant provisions until the relevant date.

(3) Part 8 does not apply in respect of an AIF managed by an AIFM falling within paragraph (1) until the relevant date.

(4) Until the relevant date, amendments to other enactments made by these Regulations do not have effect in respect of—

(a) an AIFM falling within paragraph (1); or

(b) a person carrying on an activity described in regulation 51(1)(b) or (c) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 as it is in force immediately before 22nd July 2013 (acting as trustee of an authorised unit trust scheme or depositary of an open-ended investment company) for an AIF managed by an AIFM falling within paragraph (1),

except in so far as they relate to the making or determination of applications for registration as a small registered UK AIFM or for permission under Part 4A of the Act to manage an AIF or act as depository or trustee of an AIF.

(5) In this regulation, the "relevant date" means the earlier of—

(a) in cases where an AIFM complies with the requirement in paragraph (2) to submit an application before 22nd July 2014, the date on which the FCA notifies the AIFM that its application has been determined; and

(b) 22nd July 2014.

AIFs subject to prospectus directive

69.—(1) This regulation applies to an AIF, the securities of which are subject to an offer to the public under a prospectus that has been drawn up and published in accordance with the prospectus directive before 22nd July 2013, for the duration of the validity of that prospectus.

(2) Part 8 does not apply in respect of an AIF falling within paragraph (1), and a person may market such an AIF to an investor if that person is able to promote the AIF to the investor.

(3) In this regulation, "prospectus directive" means Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading(**a**).

(**a**) OJ L 345, 31.12.2003, p64.

Closed-ended AIFs that make no additional investments

70.—(1) This regulation applies to a UK AIFM which carries on the activity of managing an AIF immediately before 22nd July 2013, if all the AIFs managed by the AIFM are—

(a) closed-ended; and

(b) make no additional investments after 22nd July 2013.

(2) The AIFM need not

apply to the FCA for—

(a) permission under Part 4A of the Act to manage an AIF; or

(b) registration as a small registered UK AIFM.

(3) Subject to paragraph (4)—

(a) the AIFM need not comply with the relevant provisions; and

(b) amendments to other enactments made by these Regulations do not have effect in respect of the AIFM except in so far as they relate to the making or determination of applications of the type mentioned at paragraph (2)(a) or (b).

(4) If the AIFM applies for permission or registration of the type mentioned at paragraph (2)(a) or (b), from the date on which the FCA notifies the AIFM of the determination of its application paragraph (3) ceases to have effect.

Closed-ended AIFs whose subscription period has closed

71.—(1) This regulation applies to a UK AIFM which carries on the activity of managing an AIF immediately before 22nd July 2013, if all the AIFs managed by the AIFM—

(a) are closed-ended;

(b) have subscription periods for investors that closed before 22nd July 2013; and

(c) are constituted for a period of time that expires before 22nd July 2016.

(2) The AIFM need not

apply to the FCA for—

(a) permission under Part 4A of the Act to manage an AIF; or

(b) registration as a small registered UK AIFM.

(3) Subject to paragraphs (4) and (5)—

(a) the AIFM need not comply with the relevant provisions; and

(b) amendments to other enactments made by these Regulations do not have effect in respect of the AIFM except in so far as they relate to the making or determination of applications of the type mentioned at paragraph (2)(a) or (b).

(4) The AIFM must—

(a) be the only AIFM of the AIFs it manages;

(b) comply with Part 7 of these Regulations; and

(c) [comply with Article 22 of the directive (transparency)].

(5) If the AIFM applies for permission or registration of the type mentioned at paragraph (2)(a) or (b), from the date on which the FCA notifies the AIFM of the determination of its application paragraph (3) ceases to have effect.

Depositaries of EEA AIFs

72.—(1) This regulation applies if, in accordance with the transitional provision in article 61.5 of the directive, a competent authority permits a credit institution that is—

(a) authorised under the banking consolidation directive, and

(b) established in the United Kingdom,

to act as the depositary of an EEA AIF.

(2) Regulations 28 to 31 apply to such a depositary as they apply to the depositary of a UK AIF managed by a full-scope UK AIFM.

Deemed permission for existing managers of UCITS

73. A person who—

(a) on 22nd July 2013 carries on the regulated activity of managing a UCITS, and

(b) immediately before that date had permission under Part 4A of the Act to carry on the regulated activity of—

(i) establishing, operating or winding up a collective investment scheme, or

(ii) acting as sole director of an open-ended investment company,

is deemed to have permission under Part 4A of the Act from that date to carry on the regulated activity of managing a UCITS.

Deemed permission for trustees of UCITS that are authorised unit trust schemes

74. A person who—

(a) on 22nd July 2013 carries on the regulated activity of acting as the trustee of an authorised unit trust scheme that is a UCITS, and

(b) immediately before that date had permission under Part 4A of the Act to carry on the regulated activity of acting as trustee of an authorised unit trust scheme,

is deemed to have permission under Part 4A of the Act from that date to carry on the regulated activity of acting as the trustee of an authorised unit trust scheme that is a UCITS.

Deemed permission for depositaries of UCITS that are open-ended investment companies

75. A person who—

(a) on 22nd July 2013 carries on the regulated activity of acting as the depositary of an open-ended investment company that is a UCITS, and

(b) immediately before that date had permission under Part 4A of the Act to carry on the regulated activity of acting as the depositary of an open-ended investment company,

is deemed to have permission under Part 4A of the Act from that date to carry on the regulated activity of acting as the depositary of an open-ended investment company that is a UCITS.

PART 10

FINAL PROVISIONS

Review

76.—(1) The Treasury must from time to time—

(a) carry out a review of these Regulations,

(b) set out the conclusions of the review in a report, and

(c) publish the report.

(2) In carrying out the review the Treasury must, so far as is reasonable, have regard to how the directive (which is implemented by means of these Regulations) is implemented in other EEA States.

(3) The report must in particular—

(a) set out the objectives intended to be achieved by the regulatory system established by these Regulations;

(b) assess the extent to which those objectives are achieved; and

(c) assess whether those objectives remain appropriate and, if so, the extent to which they could be achieved with a system that imposes less regulation.

(4) The first report under this regulation must be published before the end of the period of five years beginning with the day on which these Regulations come into force.

(5) Reports under this regulation are afterwards to be published at intervals not exceeding five years.

Schedule 1

77. Schedule 1, which contains amendments and modifications to primary legislation, has effect.

Schedule 2

78. Schedule 2, which contains amendments to secondary legislation, has effect.

Name
Name
Two of the Lords Commissioners of Her Majesty's Treasury

Date

SCHEDULE 1

Regulation 77

AMENDMENTS AND MODIFICATIONS TO PRIMARY LEGISLATION

1.—(1) The Act is amended as follows.

(2) In section 168(4)(**a**) (appointment of persons to carry out investigations in particular cases), omit "or" at the end of paragraph (j), and after paragraph (j) insert—

"(ja) a person may have contravened any provision made by or under this Act for the purpose of implementing the alternative investment fund managers directive;".

(3) In section 193(1)(**b**) (interpretation of this Part), after paragraph (aa), insert—

"(ab) an EEA AIFM which is exercising, or has exercised, its right to market an AIF in the United Kingdom in accordance with Schedule 3;"

(4) In section 194A(**c**) (contravention by EEA firm with UK branch of requirement under markets in financial instruments directive: appropriate regulator primarily responsible for securing compliance), for "relevant EEA firm" in the heading, and subsection (1)(a) and (2), substitute "EEA investment firm".

(5) In section 195A(**d**) (contravention by EEA firm or EEA UCITS of directive requirements: home state regulator primarily responsible for securing compliance)—

(a) in the heading, for "relevant EEA firm", substitute "EEA AIFM, EEA investment firm";

(b) in subsection (1)(a), subsection (11), and in the definition of "home state" in subsection (12), for "a relevant EEA firm", substitute "an EEA investment firm";

(c) after subsection (1)(a) insert—

"(aa) that an EEA AIFM has contravened, or is contravening, a requirement falling within subsection (2A) (in a case to which Article 45.7 or 45.8 of the alternative investment fund managers directive applies);";

(d) after subsection (2) insert—

"(2A) A requirement falls within this subsection if it is imposed on the EEA AIFM—

(a) by or under any provision adopted in the AIFM's home state for the purpose of implementing the alternative investment fund managers directive; or

(b) by any directly applicable EU regulation made under that directive.";

(e) for subsection (8) substitute—

"(8) Condition B is that—

(a) in the case of an EEA investment firm or EEA UCITS, the firm or EEA UCITS is acting in a manner which is clearly prejudicial to the interests of investors in the United Kingdom or the orderly functioning of the markets; or

(b) in the case of an EEA AIFM, the AIFM is acting in a manner which is clearly prejudicial to the interests of investors in the United Kingdom or the financial stability or integrity of the markets in the United Kingdom.";

(f) in subsection (11B), after "(2)", insert ", (2A)";

(g) in subsection (12)—

(**a**) Section 168(4) was amended by s. 62, Schedule 7, Part 7, para 33(3) of the Counter-Terrorism Act 2008 (c. 28); S.I. 2007/126; the Financial Services Act 2010, s. 24(1), (2), Sched 2, Part 1, paras 1, 16 (c. 28); and the Financial Services Act 2012, (c. []).

(**b**) Section 193(1) was amended by S.I. 2011/1613, and by the Financial Services Act 2012, c. []

(**c**) Section 194A was inserted by S.I. 2007/126, and amended by the Financial Services Act 2012, c. [].

(**d**) Section 195A was inserted by S.I. 2007/126, and amended by the Financial Services Act 2012, c. [].

(i) in the definition of “appropriate regulator”, for “the relevant EEA firm” substitute “the EEA investment firm”;

(ii) insert at the appropriate place—

““EEA investment firm” means an EEA firm falling within paragraph 5(a) or (b) of Schedule 3 which is exercising in the United Kingdom a right deriving from the markets in financial instruments directive;”;

(iii) in the definition of “home state”, insert after paragraph (a)—

“(aa) in relation to an EEA AIFM, the EEA State in which the AIFM has its registered office;”;

(iv) omit the definition of “relevant EEA firm”.

(6) In section 199(**a**) (additional procedure for EEA firms in certain cases)—

(a) in subsection (3A), for “or (f)”, substitute “, (f) or (h)”;

(b) in subsection (3B), at the beginning insert “Subject to subsection (3C),”;

(c) after subsection (3B), insert—

“(3C) Subsections (6) to (8) do not apply to an incoming EEA firm falling within paragraph 5(h) of Schedule 3.”.

(7) In section 425(**b**) (expressions relating to authorisation elsewhere in the single market)—

(a) in the heading, for “relating to authorisation elsewhere in the single market” substitute “used in Schedules 3 and 4”;

(b) at the beginning of subsection (1)(a), insert ““alternative investment fund managers directive”,”;

(c) in subsection (1)(a), after ““life assurance consolidation directive””, insert ““EEA AIFM”,”.

(8) In Schedule 3 (EEA passport rights)—

(a) omit “and” at the end of paragraph 1(e), and after paragraph 1(f) insert “; and

(g) the alternative investment fund managers directive.”;

(b) after paragraph 4D (the emission allowance auctioning regulation), insert—

“The alternative investment fund managers directive

4E. “The alternative investment fund managers directive” means Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers.”;

(c) in paragraph 5 (EEA firm), omit “or” at the end of paragraph 5(f), and after paragraph 5(g), insert—

“; or

(h) an AIFM (as defined in Article 4.1.b of the alternative investment fund managers directive) which is authorised (in accordance with Article 6.1 of that directive) by its home state regulator.”;

(d) in paragraph 5A (definition of “relevant office” for EEA firm), after sub-paragraph (a), insert—

“(aa) in relation to a firm falling within sub-paragraph (h) of that paragraph, its registered office;”;

(e) in paragraph 7A (definition of “relevant office” for EEA right), after sub-paragraph (a), insert—

(**a**) Section 199 was amended by S.I. 2007/3253, S.I. 2007/126, and by [] of the Financial Services Act 2012.
(**b**) Section 425 was amended by S.I. 2003/2066, and S.I. 2004/3379.

"(aa) in relation to a person whose entitlement is subject to the conditions of the alternative investment fund managers directive, its registered office;";

(f) in paragraph 10A (definition of "relevant office" for UK firm), after sub-paragraph (a), insert—

"(aa) in relation to a firm whose EEA right derives from the alternative investment fund managers directive, its registered office;";

(g) after paragraph 10B (UK investment firm), insert—

"Full-scope UK AIFM

10C. "Full-scope UK AIFM" means a firm which is authorised by the FCA in accordance with Article 6.1 of the alternative investment fund managers directive.";

(h) after paragraph 11C (UCITS), insert—

"*AIF*

10D. "AIF" has the meaning given in regulation 3 of the Alternative Investment Fund Managers Regulations 2013.

EEA AIFM

10E. "EEA AIFM" means an EEA firm falling within paragraph 5(h) which is exercising in the United Kingdom a right deriving from the alternative investment fund managers directive.";

(i) in paragraph 13—

(i) in the first paragraph of sub-paragraph (1), for "or (f)", substitute ", (f) or (h)";

(ii) at the end of sub-paragraph (1)(ba), omit "and";

(iii) after sub-paragraph (1)(c), insert—

"and

(d) in the case of a firm falling within paragraph 5(h), its home state regulator has informed it that the consent notice has been sent to the FCA.";

(iv) in sub-paragraph (2)(b), after "5(a)", insert "or (h)";

(j) in paragraph 14—

(i) in sub-paragraph (1)(b), for "or (f)" substitute ", (f) or (h)";

(ii) in sub-paragraph (1)(c), for "or (e)", substitute ", (e) or (h)";

(iii) after sub-paragraph (1), insert—

"(1ZA) In cases where the firm is an EEA AIFM that seeks to market an AIF in exercise of its rights under Article 32 of the alternative investment fund managers directive, the FCA must ensure that the regulator's notice may be transmitted to it electronically.";

(iv) in sub-paragraph (2), for "or (e)", substitute ", (e) or (h)";

(k) in paragraph 19(1)—

(i) for "and (5A)", substitute ", (5A) and (7BB)";

(ii) after sub-paragraph (7B), insert the following—

"(7BA) If the firm's EEA right derives from the alternative investment fund managers directive and the first condition is satisfied, the FCA must—

(a) give a consent notice to the host state regulator if it is satisfied that the firm complies, and will continue to comply, with that directive;

(b) send with that notice confirmation that the firm has been authorised by it in accordance with Article 6.1 of that directive; and

(c) immediately notify the firm that it has given the consent notice to the host state regulator.

(7BB) If the firm's EEA right derives from the alternative investment fund managers directive, the third condition does not apply.";

(iii) in paragraph 19(12A)(a), after "UCITS directive", insert "or the alternative investment fund managers directive";

(l) in paragraph 20—

(i) in sub-paragraph (1), for "sub-paragraphs (4D) and (4E)", substitute "sub-paragraphs (4D) to (4F)";

(ii) after sub-paragraph (3C), insert—

"(3D) If the firm's EEA right derives from the alternative investment fund managers directive, the FCA must—

(a) within one month of receiving the firm's notice of intention, send a copy of the firm's notice of intention to the host state regulator, unless the FCA is not satisfied that the firm complies or will continue to comply with that directive; and

(b) send with that notice confirmation that the firm has been authorised by it in accordance with Article 6.1 of that directive, with such other information as may be specified; and

(c) immediately notify the firm that it has given the notice and confirmation to the host state regulator.";

(iii) in sub-paragraph (4B), after "any of the insurance directives or from", insert "the alternative investment fund managers directive,"; and

(iv) after sub-paragraph (4E), insert—

"(4F) This paragraph does not apply to—

(a) the operator of a UCITS established in the United Kingdom seeking to exercise an EEA right to market the units of that UCITS in the territory of another EEA State; or

(b) a UK firm seeking to exercise an EEA right under the alternative investment fund managers directive to market an AIF.";

(m) in the heading before paragraph 20B, after "market" insert "a UCITS";

(n) after paragraph 20B, insert—

Notice of intention to market an AIF

20C.—(1) A full-scope UK AIFM may exercise an EEA right to market a UK AIF or EEA AIF managed by it under the alternative investment fund managers directive when two conditions are satisfied.

(2) The first is that the full-scope UK AIFM has given the FCA, in the specified way, notice of its intention to market the AIF ("notice of intention") which contains, and is accompanied by, such information as may be specified.

(3) The second is that the FCA has sent a copy of the notice of intention to the host state regulator where the AIF will be marketed, and has given written notice to the full-scope UK AIFM that it has done so.

(4) The FCA must send a copy of the notice of intention to the host state regulator within 20 working days of receiving it, unless it considers that—

(a) the full-scope UK AIFM does not, or will not, comply with the rules and other provisions implementing the alternative investment fund managers directive, and any directly applicable EU regulations made under that directive; or

(b) the UK AIF or EEA AIF is a feeder AIF that does not comply with the requirement in sub-paragraph (5).

(5) Where the UK AIF or EEA AIF is a feeder AIF, its master AIF must be a UK AIF or EEA AIF that is managed by—

(a) a full-scope UK AIFM; or

(b) an AIFM authorised in another EEA State in accordance with Article 6.1 of the alternative investment fund managers directive.

(6) When sending a copy of the notice of intention to the host state regulator, the FCA must send with the notice confirmation that the full-scope UK AIFM concerned is authorised to manage AIFs with a particular investment strategy.

(7) If the notice of intention relates to an EEA AIF, the FCA must, when it sends a copy of the notice to the host state regulator, also inform the competent authority of the EEA AIF that the full-scope UK AIFM may start marketing the AIF in the EEA States covered by the notice.

(8) In this paragraph—

"competent authority" has the meaning given in regulation 2 of the Alternative Investment Fund Managers Regulations 2013;

"EEA AIF" has the meaning given in regulation 2 of the Alternative Investment Fund Managers Regulations 2013;

"feeder AIF" has the meaning given in Article 4.1.m of the alternative investment fund managers directive;

"master AIF" has the meaning given in Article 4.1.y of that directive;

"specified" means specified in rules;

"UK AIF" has the meaning given in regulation 2 of the Alternative Investment Fund Managers Regulations 2013."

(9) In Schedule 6 (Threshold Conditions)(**a**)—

(a) in paragraph 2C(1), for "or (4)(a)", substitute ", (4)(a) or (7)";

(b) in paragraph 2C(2), at the beginning insert "Subject to sub-paragraph (7),";

(c) after paragraph 2C(6), insert—

"(7) If A is seeking to carry on, or is carrying on, the regulated activity of managing an AIF, A must have its head office and registered office in the United Kingdom."

Modifications to the Act

2.—(1) For the purposes of these Regulations, the Act applies with the following modifications.

(2) The FCA may refuse an application by a full-scope UK AIFM under section 55H(2) of the Act (variation by FCA at request of authorised person) to vary the permission of the AIFM if the FCA considers that to be desirable in performance of the FCA's functions under Part 7.

(3) The FCA may exercise its power under section 55J of the Act (variation or cancellation on initiative of regulator) in relation to a full-scope UK AIFM if it appears to the FCA that it is desirable to exercise the power in performance of the FCA's functions under Part 7.

(4) Section 55J(6) applies as if it referred to—

(a) (i) a full-scope UK AIFM, or

(ii) a small authorised UK AIFM managing an authorised AIF,

instead of an investment firm; and

(b) the conditions in sub-paragraph (5) instead of the conditions in section 55K.

(5) The conditions are that the AIFM—

(a) has not used its permission under Part 4A of the Act to manage an AIF within 12 months of receiving the permission;

(b) has expressly renounced permission under Part 4A of the Act to manage an AIF;

(**a**) Parts 1A to 1G of Schedule 6 were inserted by S.I. 2013/[].

(c) has not carried on the regulated activity of managing an AIF for a period of at least six months;

(d) has obtained permission under Part 4A of the Act to manage an AIF by making false statements or by any other irregular means;

(e) no longer meets the conditions under which permission under the Act to manage an AIF was granted;

(f) no longer complies with Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions(**a**), in cases where the AIFM's permission includes the discretionary portfolio management service referred to in Article 6.4.a of the directive;

(g) has seriously or systematically infringed the relevant provisions.

(6) Where a person applies for permission under part 4 of the Act and, upon being granted such permission, would become a full-scope UK AIFM—

(a) section 55V(1) to (3) (determination of applications) does not apply;

(b) the regulator to which the application is made ("the appropriate regulator") must determine the application before the end of the period of three months beginning with the date on which it received the completed application.

(7) The appropriate regulator may extend the period mentioned in sub-paragraph (6)(b) for three additional months where the appropriate regulator considers it necessary due to the specific circumstances of the case, and where it has notified the applicant accordingly.

(8) Where the application cannot be determined by the appropriate regulator without the consent of the other regulator, the other regulator's decision must also be made within the period required by sub-paragraph (6)(b) or (7), as the case may be.

(9) An application is completed for the purposes of sub-paragraph (6)(b) if it contains—

(a) information on the persons effectively conducting the business of the applicant;

(b) information on the identities of the applicant's shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings and on the amount of those holdings;

(c) a programme of activity setting out the organisational structure of the applicant, including information on how the applicant intends to comply with its obligations under relevant provisions relating to Chapter 2 (authorisation of AIFM), Chapter 3 (operating conditions for AIFM), and Chapter 4 (transparency requirements) of the directive and, where applicable, Chapter 5 (AIFMs managing specific types of AIF), Chapter 6 (rights of EEA AIFM to market and manage EEA AIFs in EEA States), Chapter 7 (rules for third countries) and Chapter 8 of the directive (marketing to retail investors);

(d) information on the remuneration policies and practices of the applicant adopted pursuant to relevant provisions relating to Article 13 of the directive;

(e) information about the investment strategies, including the types of underlying funds if the AIF is a fund of funds, and the applicant's policy as regards the use of leverage, and the risk profiles and other characteristics of the AIFs the applicant manages or intends to manage, including information about the EEA States or third countries in which AIFs are established or are expected to be established; and

(f) information on where the master AIF is established if the AIF is a feeder AIF.

(10) An AIFM may start managing an AIF with the investment strategies described in its application—

(a) if it has been granted permission by the FCA under Part 4A of the Act to manage an AIF; and

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(**a**) OJ L 177, 30.6.2006, p201.

(b) at least one month has passed after it supplied the information required under relevant provisions relating to Articles 7.2.e and 7.3.c to 7.3.e of the directive (information to be provided in application for authorisation).

(11) The disclosure obligations of small registered UK AIFMs in regulation 20 are to be treated as provisions made by or under the Act for the purposes of section 168(4)(ja) (appointment of persons to carry out investigations in particular cases).

(12) Where a unit trust scheme is an AIF—

(a) section 243(5) and (5A) (authorisation orders) does not apply;

(b) the manager of the AIF must be a body corporate incorporated in the United Kingdom, and its affairs must be administered in the United Kingdom;

(c) the trustee must—

(i) be a body corporate incorporated in the United Kingdom or another EEA State; and

(ii) have a place of business in the United Kingdom; and

(d) the trustee's affairs must be administered in the country in which it is incorporated.

(13) The FCA's functions under these Regulations are to be treated as—

(a) qualifying functions for the purposes of paragraph 20(2) of Schedule 1ZA to the Act (fees); and

(b) included in the functions mentioned in paragraph 22 of Schedule 1ZA (exemption from liability in damages).

SCHEDULE 2

Regulation 78

AMENDMENTS TO SECONDARY LEGISLATION

Amendments to Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001

1. For article 3(2)(g) of the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001(**a**), substitute—

"(ga) article 51ZA (managing a UCITS);

(gb) article 51ZB (acting as a trustee or depositary of a UCITS);

(gc) article 51ZC (managing an AIF);

(gd) article 51ZD (acting as a trustee or depositary of an AIF);

(ge) article 51ZE (establishing etc. a collective investment scheme);".

Amendments to Financial Services and Markets Act 2000 (Professions) (Non-Exempt Activities) Order 2001

2. For article 4(d) of the Financial Services and Markets Act 2000 (Professions) (Non-Exempt Activities) Order 2001(**b**), substitute—

"(da) article 51ZA (managing a UCITS);

(db) article 51ZB (acting as a trustee or depositary of a UCITS);

(dc) article 51ZC (managing an AIF);

(dd) article 51ZD (acting as a trustee or depositary of an AIF);

(de) article 51ZE (establishing etc. a collective investment scheme);".

Amendments to Financial Services and Markets Act 2000 (EEA Passport Rights) Regulations 2001

3. The Financial Services and Markets Act 2000 (EEA Passport Rights) Regulations 2001(**c**) are amended as follows—

(a) after regulation 2(5) insert—

"(6) In the case of an EEA AIFM, the prescribed information is—

(a) a statement that the firm is an EEA AIFM;

(b) the requisite details of the branch; and

(c) the identity of the AIFs that the EEA AIFM intends to manage.";

(b) after regulation 3(4) insert—

"(5) In the case of an EEA AIFM, the prescribed information is—

(a) a statement that the firm is an EEA AIFM;

(b) if the EEA AIFM wishes to manage an AIF in the United Kingdom—

(i) particulars of the programme of operations to be carried on in the United Kingdom, including a description of the particular EEA activities to be carried on; and

(ii) the identity of the AIFs that the EEA AIFM intends to manage; and

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(**a**) S.I. 2001/1177.
(**b**) S.I. 2001/1227.
(**c**) S.I. 2001/2511.

(c) if the EEA AIFM wishes to market an AIF in the United Kingdom—

(i) the documents and information set out in Annex IV to the alternative investment fund managers directive; and

(ii) a statement to the effect that the AIFM concerned is authorised to manage AIFs with a particular management strategy.”

(c) after regulation 7 insert—

“EEA AIFM: changes to branch details or services

7A.—(1) An EEA AIFM which is exercising an EEA right in the United Kingdom deriving from the alternative investment fund managers directive must not make a material change to any of the matters referred to in regulation 2(6)(b) or (c), or 3(5)(b) or (c) unless the relevant requirement has been complied with.

(2) Where the relevant requirement has been complied with, the EEA AIFM’s permission is to be treated as varied accordingly.

(3) For the purposes of this regulation, the “relevant requirement” is that the home state regulator has informed the FCA that it has approved the proposed change.”;

(d) after regulation 17 insert —

“Full-scope UK AIFM: changes to branch details or services

17A.—(1) A full-scope UK AIFM which has exercised an EEA right, deriving from the alternative investment fund managers directive, to establish a branch must not make a material change to—

(a) the requisite details of the branch, or

(b) the identity of the AIFs it manages in the State in which it has established a branch,

unless the relevant requirements have been complied with.

(2) A full-scope UK AIFM which is providing services in exercise of an EEA right deriving from the alternative investment fund managers directive, other than the EEA right to market an AIF, must not make a material change to—

(a) the programme of operations, or the EEA activities, to be carried out in exercise of that right,

(b) the States in which it manages AIFs, or

(c) the identity of the AIFs it manages in those States,

unless the relevant requirements have been complied with.

(3) A full-scope UK AIFM which is marketing an AIF in exercise of an EEA right deriving from the alternative investment fund managers directive, must not make a material change to any of the following matters, unless the relevant requirements have been complied with—

(a) the programme of operations identifying the AIF the AIFM intends to market and information on where the AIF is established;

(b) the AIF rules or instruments of incorporation;

(c) identification of the depositary of the AIF;

(d) the description of, or any information on, the AIF available to investors;

(e) where the master AIF is established, if the AIF is a feeder AIF;

(f) any additional information referred to in Article 23.1 of the alternative investment fund managers directive, for each AIF the AIFM intends to market;

(g) the EEA States, other than the United Kingdom, in which the AIFM intends to market the units or shares of the AIF to professional investors;

(h) information about arrangements made for the marketing of the AIF and, where relevant, arrangements established to prevent the AIF from being marketed to retail investors, including in the case where the AIFM relies on the activities of independent entities to provide investment services in respect of the AIF.

(4) For the purposes of this regulation, the "relevant requirements" in the case of a planned change are that—

(a) the AIFM has given written notice of the change to the FCA at least one month before implementing the change; and

(b) either—

(i) the FCA has consented to the change; or

(ii) the FCA has not objected to the change in the period of one month beginning on the day on which the firm gave notice.

(5) For the purposes of this regulation, the "relevant requirements" in the case of an unplanned change are that—

(a) the AIFM has given written notice of the change to the FCA immediately after an unplanned change has occurred; and

(b) the FCA has not objected to the change.

(6) If a change means the AIFM no longer complies with the relevant provisions, the FCA must inform the AIFM without undue delay that—

(a) the FCA objects to the change; and

(b) the AIFM must not implement the change.

(7) If—

(a) a planned change is implemented, or

(b) an unplanned change takes place,

as a result of which the AIFM no longer complies with the relevant provisions, the FCA must take all due measures, including, if necessary, the express prohibition of marketing of the AIF.

(8) In this regulation—

"depositary" has the meaning given in regulation 2 of the Alternative Investment Fund Managers Regulations 2013;

"feeder AIF" has the meaning given in Article 4.1.m of the alternative investment fund managers directive;

"master AIF" has the meaning given in Article 4.1.y of that directive.".

B Impact assessment

B.1 The following pages contain the impact assessment for the proposals detailed in this consultation document.

Title: Alternative Investors Fund Managers Directive **IA No:** **Lead department or agency:** HMT - Financial Regulation and Markets **Other departments or agencies:** FSA	**Impact Assessment (IA)** **Date:** 10 January 2013 **Stage:** Consultation **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries:** Sameen Farouk Sameen.farouk@hmtreasury.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
-£4,872m	-£4,848m	£951m (in scope £7m)	Yes	IN

What is the problem under consideration? Why is government intervention necessary?

The UK is required to implement the Alternative Investment Fund Managers Directive (AIFMD) into law by July 2013. AIFMD aims to address the risks:

- Regulatory fragmentation may inhibit the effective regulation, supervision and macro-prudential oversight of alternative fund managers, including hedge fund and private equity fund managers by failing to take account of the cross-border dimension of their activities; and
- Regulatory fragmentation may also impede market integration and the development of the single market by creating barriers to the efficient cross-border distribution of alternative funds.

What are the policy objectives and the intended effects?

AIFMD will establish 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 investment funds. The Directive contains provisions relating to the conduct of business, transparency and marketing, and provides for the cross-border managing and marketing of funds. In implementing the Directive, the Government aims to maintain and enhance UK competitiveness, promote investor choice, and maintain strong investor protection and the integrity of the marketplace.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Non-implementation of AIFMD (Option 0) has been discounted as it would be counter to the UK’s treaty obligations and deny UK-based managers the right to passport across the EU.
AIFMD permits the introduction of a more minimal regime for managers managing funds below a size threshold, though the UK may choose to “level up” requirements:
Option 1- implement AIFMD with maximum gold plating for sub-threshold AIFMs
Option 2- implement AIFMD with no gold plating for sub-threshold AIFMs
Option 3 – implement AIFMD in line with the Government’s preferred option for sub-threshold AIFMs – which it considers to represent an appropriate balance of investor protection, costs and flexibility
A further option - Option 4 – is considered, which has the same sub-threshold regime as Option 3 but introduces further deregulation through the removal of retail marketing restrictions.

Will the policy be reviewed? Yes. **If applicable, set review date:** 2018.

Does implementation go beyond minimum EU requirements?			Yes		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** 0	**Non-traded:** 0	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Date: 10/01/2013

Summary: Analysis & Evidence

Policy Option 1

Description: Implement AIFMD with maximum gold plating for sub-threshold AIFMs

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 5	Net Benefit (Present Value (PV)) (£m)		
			Low: -8.313	High: -4,617	Best Estimate: -6,465

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	331		917	4,617
High	356	1	1,703	8,313
Best Estimate	344		1,310	6,465

Description and scale of key monetised costs by 'main affected groups'

For all managers – the main affected groups with be asset managers, custodian banks and investors. . Costs arise largely from conduct and prudential requirements on managers – up to c. £1m average for some types of manager but can be much lower - and requirements on custodian banks. Costs are applied to managers but many are likely to flow through to consumers. FSA will also incur costs. Under Option 1, there would be no reduction in these requirements for managers managing funds below the size threshold. Costs within scope of the Government's One-In, One-Out policy are the gold plating costs above the status quo. Under option 1, these are the difference between policy option 1 (maximum gold plating) and policy option 2 (no gold plating), which give a business net present value of £1630m and a net cost to business per year (EANCB on 2009 prices) of £320m.

Other key non-monetised costs by 'main affected groups'

(1)Some managers may choose – or be forced – to restructure, imposing costs and reducing flexibility.
(2)There are potentially also competitiveness costs for option 1, as other Member States are likely to have more proportionate regimes for hedge fund, venture capital and private equity fund managers in particular. A reduction in the latter two categories in particular could reduce investment in the UK.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				
Best Estimate	Best Estimate		Best Estimate	Best Estimate

Description and scale of key monetised benefits by 'main affected groups'

Potential benefits have not been quantified at this stage.

Other key non-monetised benefits by 'main affected groups'

In the context of the financial crisis and the Madoff fraud, AIFMD supports (1) the ability of regulators to monitor systemic risk and take action as necessary, (2) provide greater protection for investors in alternative funds, (3) the removal of barriers to the cross-EU marketing of alternative funds.
Under option 1, investors benefit from a strong, harmonised level of protection regardless of the size of fund being managed.

Key assumptions/sensitivities/risks **Discount rate (%)** **3.5**

- Not possible to quantify increase or decrease in Assets Under Management or restructuring costs at this stage
- Assumptions based on limited data for impact on different regulatory regimes and managers of sub-threshold funds
- Average compliance staff cost is £65k – costs are particularly sensitive to this

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 1264	Benefits: 0	Net: -1264	Yes	IN

Summary: Analysis & Evidence — Policy Option 2

Description: Implement AIFMD with no gold plating for sub-threshold AIFMs

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 5	Net Benefit (Present Value (PV)) (£m)		
			Low: -£6,684	High: -£2,988	Best Estimate: -£4,836

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	192	1	598	2,988
High	217		1,384	6,684
Best Estimate	205		991	4,836

Description and scale of key monetised costs by 'main affected groups'

Even under *de minimis* approach, the costs of implementing AIFMD are c. 70% of maximalist approach. This is because for above threshold managers, costs are as option 1 and the Government has no discretion over application of AIFMD for this group. FSA costs are also as option 1.
For sub-threshold managers, additional costs would be minimal as the vast majority of AIFMD requirements are disapplied under option 2.
Costs within scope of the Government's One-In, One-Out policy are zero under option 2 as the Government would be imposing no gold plating.

Other key non-monetised costs by 'main affected groups'

For sub-threshold managers, option 2 is deregulatory and represents a significant reduction in investor protection as FSA regulatory oversight would largely be withdrawn. This could lead to investor detriment – especially for retail investors – and could reduce confidence in the UK regulatory system and potentially UK competitiveness. For some sub-threshold managers – principally investment companies, which would be new to FSA regulation - option 2 this represents status quo. For above threshold managers, as option 1.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Potential benefits have not been quantified at this stage.

Other key non-monetised benefits by 'main affected groups'

Option 2 is deregulatory for managers of most sub-threshold funds including hedge funds private equity funds and venture capital funds – reductions in cost in comparison to the current regulatory regime have not been quantified at this stage but will be lower – some savings may well be passed on to investors. It is possible this could make the UK more competitive as a place to manage the funds.
For above threshold managers, as option 1.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

- Not possible to quantify increase or decrease in Assets Under Management or restructuring costs at this stage
- Assumptions based on limited data for impact on different regulatory regimes and managers of sub-threshold funds
- Average compliance staff cost is £65k – costs are particularly sensitive to this

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: £944	**Benefits: 0**	**Net: -944**	Yes	IN

Summary: Analysis & Evidence

Policy Option 3

Description: Implement AIFMD in line with the Government's preferred options for sub-threshold AIFMs

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 5	Net Benefit (Present Value (PV)) (£m)		
			Low: -6,720	High: -3,023	Best Estimate: -4,872

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	194	1	605	3,024
High	219		1,391	6,720
Best Estimate	207		998	4,872

Description and scale of key monetised costs by 'main affected groups'

The Government's preferred option applies a near-status quo regime for many sub-threshold managers so costs are close to the *de minimis* level. The Government would apply most AIFMD requirements for sub-threshold managers of authorised funds in order to provide a strong consistent regime for retail investors. However, some provisions imposing direct costs are not applied.
For above threshold managers, and FSA, costs are as option 1.
Costs within scope of the Government's One-In, One-Out policy are the gold plating costs above the status quo. Under option 3, these are the difference between policy option 3 (preferred option) and policy option 2 (no gold plating), which give a business net present value of £37m and a net cost to business per year (EANCB on 2009 prices) of £7m.

Other key non-monetised costs by 'main affected groups'

Status quo regime is effectively maintained for many sub-threshold managers so costs would be minimal for these managers. For managers of sub-threshold authorised funds, some AIFMD measures which potentially impose indirect restructuring costs or are providing uncertainty in the industry are not applied. If increase in costs means some investors move to other retail funds (UCITS funds), there could be a reduction in investor choice. For above threshold managers, as option 1

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				
Best Estimate	Best Estimate		Best Estimate	Best Estimate

Description and scale of key monetised benefits by 'main affected groups'

Potential benefits have not been quantified at this stage.

Other key non-monetised benefits by 'main affected groups'

Option 3 gives greater investor protection for investors in sub-theshold authorised funds – including retail investors unlikely to distinguish between sub and above threshold funds. For investors in other sub-threshold funds, UK's investor protection regime is maintained, bringing the reputational benefits and investor confidence of operating under a baseline and proportionate level of investor protection. For above threshold managers, as option 1.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

- Not possible to quantify increase or decrease in Assets Under Management or restructuring costs at this stage
- Assumptions based on limited data for impact on different regulatory regimes and managers of sub-threshold funds
- Average compliance staff cost is £65k – costs are particularly sensitive to this

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 951	Benefits: 0	Net: -951	Yes	IN

Summary: Analysis & Evidence — Policy Option 4

Description: As option 3 but with removal of retail marketing restrictions

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 5	Net Benefit (Present Value (PV)) (£m)		
			Low: -6,720	High: -3,023	Best Estimate: -4,872

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	194	1	605	3,024
High	219		1,391	6,720
Best Estimate	207		998	4,872

Description and scale of key monetised costs by 'main affected groups'

Option 4 applies the same regime to sub-threshold funds as option 3 so direct costs will be as option 3. Removal of retail restrictions could lead to potential changes in Assets Under Management under option 4 – which would affect overall costs. These have not been quantified at this stage.
Costs within scope of the Government's One-In Out-Out policy are the same as for option 3.

Other key non-monetised costs by 'main affected groups'

As option 3 – and in addition:
- Greater potential for retail investors to invest in funds which may well not meet their needs, for example funds with a long lock-in period or funds with considerable risk; and
- Loss of confidence in UK regulatory system as a result of investors making unsuitable investments.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Potential benefits have not been quantified at this stage.

Other key non-monetised benefits by 'main affected groups'

As option 3- and in addition:
- Greater choice of investment for retail investors, who may now be marketed to by all funds, including hedge funds and private equity funds; and
- A wider market for the managers of funds who were previously unable to market to retail investors.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

- Not possible to quantify increase or decrease in Assets Under Management or restructuring costs at this stage
- Assumptions based on limited data for impact on different regulatory regimes and managers of sub-threshold funds
- Average compliance staff cost is £65k – costs are particularly sensitive to this

BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 951	**Benefits: 0**	**Net:--951**	Yes	IN

Impact Assessment

PART A – POLICY CONTEXT FOR TRANSPOSITION OPTIONS

BACKGROUND

The Alternative Investment Fund Managers Directive (AIFMD) will establish 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 investment funds. The Directive contains provisions relating to the conduct of business, transparency and marketing, and provides for the cross-border managing and marketing of funds.

The Directive covers the managers of the major types of fund that aren't already subject to EU regulation through the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, and as such covers managers of funds including hedge funds, private equity funds, venture capital funds and real estate funds.

AIFMD was adopted by the European Parliament and Council in June 2011 and must be transposed into national law by 22 July 2013. The Directive also provides for an extensive set of more detailed implementing measures. Following advice provided by the European Securities and Markets Authority, the Commission is currently developing such measures and it is anticipated these will be adopted shortly.

RATIONALE FOR INTERVENTION

The Directive was introduced by the European Commission in the context of the systemic financial crisis of 2008 and the fraud perpetrated by Bernie Madoff in the United States. The rationale for intervention at a European level has been set out in the impact assessment of the European Commission:

- Regulatory fragmentation may **inhibit the effective regulation, supervision and macro-prudential oversight of AIFM by failing to take account of the cross-border dimension of their activities**. This may result in incomplete or inconsistent monitoring and control of the macro-prudential, micro-prudential and market efficiency risks; weaknesses in frameworks for ensuring investor protection; and insufficient public accountability of AIFM investing in and managing companies; and

- Regulatory fragmentation may also **impede market integration and the development of the single market** by creating barriers to the efficient cross-border distribution of AIFM products.

POLICY OBJECTIVE

The stated objectives of the European Commission in introducing the Directive were:

- **Appropriate authorisation and registration requirements** for all AIFM operating in the EU: this would require all AIFM to respect and satisfy a common set of requirements (minimum capital, fit and proper, transparency, etc.) before operating across the EU;

- **Improved monitoring of macro-prudential risks** through the provision of relevant information to prudential authorities;

- **Enhanced management of micro-prudential risks** through the imposition of strict risk management controls on market, liquidity, counterparty and operational risk;

- A **common approach to protecting investors in AIFM-managed funds**, including improvements in investor disclosures to ensure that due diligence can be performed effectively;

- **Greater public accountability of AIFMs investing in and managing companies** to ensure that such activities are subject to an appropriate level of public scrutiny; and

- The **removal of barriers to the efficient cross-border distribution of AIF** to allow an internal market in AIF in the EU to develop which is grounded in a robust and consistent regulatory supervisory framework.

AIFMD is mostly maximum harmonising with little Member State discretion over its implementation. However, there are decisions the Government may make, including the extent to which the AIFMs managing AIFs below a size threshold[1] may be permitted use of an exemption from the overwhelming majority of the Directive's requirements. AIFMs managing AIFs below the threshold are referred to in this impact assessment as sub-threshold AIFMs, with all AIFMs managing AIFs above the threshold deemed to be above-threshold AIFMs

In implementing the Directive, the Government has the objectives:

- To minimise gold plating in line with the Government's wider objectives in order to maintain and enhance UK competitiveness and minimise costs for investors;

- To maintain and expand investor choice and a competitive marketplace; and

- To maintain strong investor protection and the integrity of the regulatory regime.

APPLICATION OF AIFMD

The Directive applies requirements to AIFMs and its impact is dependent upon the types of AIF being managed. UK AIFMs currently operate under one of four regulatory regimes:

- **Non-UCITS Retail Scheme (NURS) funds.** The NURS regime sets out requirements for AIFs wishing to market to retail investors and consequently offers a high level of investor protection. NURS is broadly similar to the pan-EU UCITS regime but permits a wider range of investments. The fund's operator and the fund itself are regulated by the FSA.

- **Qualified Investment Scheme (QIS) funds.** The QIS regime permits a greater range of investments than the NURS regime; consequently QIS funds may only be marketed to high net worth, sophisticated and professional investors. In practice, QIS funds are usually used as pooling vehicles by pension funds and other institutional investors, in order to lower the cost of management and achieve economies of scale in investment. Again, the fund's operator and the fund itself are regulated by the FSA.

- **Unregulated Collective Investment Schemes (UCIS) funds.** With a few exceptions (see below), nearly all other AIFs in the UK are unregulated, in that the fund's operator is authorised by the FSA but the AIF is not. The UCIS regime offers considerable flexibility, and consequently may only be marketed to high net worth, sophisticated and professional investors. UCIS funds include hedge funds, private equity funds and venture capital funds. Some Enterprise Investment Scheme (EIS) funds also operate in this framework.

[1] Article 3(2)-(4) provides that Member States may apply a less stringent regulatory regime with opt-in procedures such that smaller AIFMs may benefit from the EU AIF management and/or marketing passport under Chapter VI of the Directive. See also Section III of the Final Report on ESMA's technical advice to the European Commission on possible implementing measures of the AIFMD, 16 November 2011

- **Investment Companies.** Investment companies are currently unregulated by the FSA, as they are excluded from the UK's definition of collective investment schemes. They include investment trusts, venture capital trusts and some limited liability partnerships. This impact assessment focuses on what we believe to be the largest group; investment trusts and venture capital trusts. Investment companies are subject to company law, and where appropriate listing requirements and the Prospectus Directive.

  Investment companies have a board of directors but many will outsource the formal AIFMD management role to an external management entity, which will be currently subject to FSA authorisation under the UK implementation of the EU MiFID Directive. In practice, the UK will be putting in place a subthreshold regime for external managers of investment companies that will be similar to the regime for UCIS AIFMs. For the purposes of calculating costs in this impact assessment only, external managers of investment companies are therefore considered together with the managers of UCIS funds. No inference should be drawn beyond this: for example, for marketing purposes, investment companies are considered separately. Managers of investment companies which do not outsource the AIFM management role are considered separately as a further category and for shorthand are described as internally managed investment companies.

The estimated population of UK AIFMs and the AIFs they manage, together with their assets under management (AUM) are as follows:

	Above-threshold AIFM			**Sub-threshold AIFM**			**Total**		
	AIFMs	AIFs	AUM (£m)	AIFMs	AIFs	AUM (£m)	AIFMs	AIFs	AUM (£m)
NURS	47	623	90,255	10	252	2,585	57	875	92,840
QIS	3	50	4,240	1	1	49	4	51	4,289
UCIS	246	292	335,797	370	423	40,404	616	715	376,201
...Of which Private Equity	88	116	87,527	111	84	9,676	199	200	97,204
Investment Companies	40	151	61,407	89	211	9,717	129	362	71,124
....of which internally managed	8	8	13,178	20	20	1,270	28	28	14,447

- For NURS and QIS populations and assets under management, the estimates are derived from data supplied by the Investment Management Association;

- For investment companies, the estimates are derived from data supplied by the Association of Investment Companies; and

- For UCIS populations and Assets Under Management, the estimates are derived from FSA authorisations, supplemented with data from Morningstar, a commercial information service.

The populations are subject to uncertainty for reasons including:

- There isn't a single set of data for each of the populations. So for the UCIS population, where AIFMs are authorised, FSA will authorise a UCIS manager along with other investment managers. Thus, separating and then calculating the quantum of assets under management for the UCIS managers from that of investment managers is difficult;

- AIFMs will often manage more than one type of AIF. Working with FSA, we have attempted to remove duplicates through analysis of FSA permissions and Morningstar data; and

- There may well be movement within populations as a result of the implementation of AIFMD. So, for example, reducing regulatory requirements for sub-threshold managers may encourage them to remain onshore.

PART B – APPROACH TAKEN IN THIS IMPACT ASSESSMENT

The Directive is mostly maximum harmonising with only limited Member State discretion over its implementation. However, there are a number of Member State derogations, and three decisions in particular will have a significant impact. The Government must decide on:

- **Treatment of sub-threshold AIFMs.** Sub-threshold AIFMs may be exempt from the vast majority of the Directive's requirements. However, Member States may decide to require some or the entire Directive's other requirements to be applied to sub-threshold AIFMs. The operators of NURS, QIS and UCIS are already authorised, though the Directive's requirements go beyond the existing regime, and the UK will need to decide whether to largely maintain the status quo, scale back existing requirements where permitted or impose the full requirements of the Directive on sub-threshold AIFMs.

- **Marketing of AIFs to retail investors.** By default, the Directive does not permit the marketing of AIFs to retail investors, however the UK may maintain or modify its existing retail regime, in which NURS and investment companies may be marketed to all investors, and QIS and UCIS to sophisticated and high net worth retail investors.

- **Private Placement Regime**. Managers based overseas are required to be subject to conditions that have the same effect as the Directive. However, until at least 2018, the UK has the option to permit overseas managers to market to professional investors in the UK through "private placement". These managers will only be subject to minimal Directive requirements.

IMPLEMENTATION OPTIONS

This impact assessment first sets out the overall qualitative benefits and costs of introducing the Directive, before assessing the impact of the decisions the Government must take. In practice, given the breadth of AIFMD, there are numerous potential permutations of options relating to the three issues above. To provide meaningful support for the decisions the Government is realistically likely to take, this impact assessment considers four options:

- **Options 1 - 3** vary the cost of implementation by modifying the sub-threshold regime – representing maximum gold-plating, no gold-plating, and the Government's preferred, intermediate, option – a sub-threshold regime that the Government considers to represent an appropriate balance of investor protection, costs and flexibility.

- **Option 4** builds upon the Government's preferred option – option 3 – by qualitatively considering the impact of further deregulation through the removal of retail marketing restrictions.

All options are assessed against a notional **Option 0**, not to implement the Directive. This option has been discounted; it would be counter to the UK's treaty obligations, infraction proceedings would be taken, UK AIFMs would lose the right to passport AIFs around the EU, and the UK would lose credibility when seeking to influence future negotiations.

There are two further regulatory decisions that the Government could take in relation to the three issues above but that have been discounted at an early stage and therefore not considered further in this impact assessment. Both involve significant gold plating:

- **Restricting further the marketing AIFs to retail investors.** At present, NURS AIFs may be marketed to retail investors, and QIS and UCIS AIFs may be marketed to high net worth and sophisticated investors who aren't classified as "professional" under the EU MiFID

definition of the term. The UK could decide to restrict further the marketing of these regimes – either by closing NURS to retail investors or by restricting the marketing of QIS and UCIS to professional investors only.

The Government has decided not to place further restrictions on marketing; a position supported by nearly all respondents to an earlier Treasury discussion paper. NURS has been designed for retail investors so the Government considers it suitable. More broadly, the Government considers the current investor protections in QIS and UCIS to render them suitable to sophisticated and high net worth individuals.

- **"Levelling up" the UK's private placement regime.** AIFMD permits member states to maintain a national private placement regime for at least the first five years from when the Directive comes into force. Third country (i.e. non-EU) managers of third country AIFs that wish to market their funds to UK professional investors need comply with only minimal Directive requirements. However, the Government may opt to apply some or all additional Directive requirements for these managers.

  If the UK were to do this, it would represent a significant change from the current UK approach and an increase in investor protection. However, it would also increase costs and reduce investor choice. The Government therefore intends to maintain the current approach, in which professional investors are judged to be protected by the regulation of the third country, and to be in a position to undertake their own due diligence. Again, this position was supported by nearly all respondents to the earlier Treasury discussion paper.

APPROACH TAKEN TO DEVELOP IMPACT ASSESSMENT

Both the Treasury and the Financial Services Authority published discussion papers in early 2012 asking for qualitative industry feedback on their proposed approach. In addition, the FSA conducted a quantitative survey in spring 2012 on the costs of implementing the Directive, with 36 AIFMs responding. The impact assessment has used the responses to these as a starting point and validated assumptions against other sources including discussions with trade bodies, companies and reports including:

- Charles River Associates (2009) 'Impact of the proposed AIFMD Directive across Europe'.[2] The CRA report was commissioned by the FSA;
- Deloitte (2012) 'Responding to the new reality: Alternative Investment Fund Managers Directive Survey'[3];
- Ernst & Young (2012) 'AIFMD: get ready for European depositary reform'[4]; and
- The European Commission's impact assessment from 2009.[5]

[2] The CRA report can be accessed here: http://www.fsa.gov.uk/pubs/other/Impact_of_AIFM_Directive.pdf

[3] The Deloitte report can be accessed here: http://www.deloitte.com/assets/Dcom-UnitedKingdom/Local%20Assets/Documents/Industries/Financial%20Services/uk-fs-aifmd-survey-responding-new-reality.pdf

[4] The Ernst & Young report can be accessed here: http://www.ey.com/Publication/vwLUAssets/AIFMD_-_prepare_for_European_depositary_reform/$FILE/AIFMD_20March2012.pdf

[5] The European Commission's impact assessment from 2009 can b e accessed here: http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_impact_assessment.pdf

LIMITATIONS TO APPROACH

Despite the focus on the Directive from a large number of AIFMs and other bodies, there is considerable uncertainty over the costs of implementing the Directive. This was particularly true when the cost survey was conducted. The main reasons for this are:

- AIFMD is a new, complex Directive with a broad reach, and AIFMs are only beginning to consider the costs and benefits. In many cases, AIFMs themselves do not yet know how much it will cost them to implement – or the degree of restructuring they are likely to need to undertake;

- Some costs will depend upon a new market equilibrium. This is particularly the case for depositaries, whose regime is one of the mostly costly elements of the Directive; and

- The industry is also awaiting the adoption of more detailed implementing measures at a European level, which at the time of drafting this impact assessment were not available. This includes both measures that may leads to significant costs - and confirmation of how widely the Directive applies. Dependence on these is highlighted in the relevant sections.

As industry preparations advance and the impact of the implementing measures becomes known, industry understanding of its costs will improve. At least one trade body is also establishing an independent workstream to develop its own understanding of the costs. We will seek further data and validation of our assumptions through our consultation and discussions with individual firms ahead of our final consultation.

Further limitations at this stage are:

- **The overall increase or reduction in assets managed or domiciled within the UK cannot be determined at this stage.** AIFMs make a significant economic contribution to the UK economy through taxation and employment - and a change in the assets under management would affect this. The impact of AIFMD is too uncertain at this stage to quantify a potential shift into or out of the UK so the effects of any potential shift are described qualitatively.

- **Restructuring costs that are dependent upon more detailed implementing measures at a European level cannot be determined at this stage.** In particular, it is possible that some restructuring will be necessary as a result of more detailed provisions on delegation, however, it would be disproportionate for industry to determine this ahead of final measures being published. The impact assessment instead notes qualitatively the potential impact.

- **Costs are borne by AIFMs.** We assess the costs to the extent that they are incurred by AIFMs, but have not modelled or assessed how these may be passed through to other parties, including investors. In practice, some may be borne by related parties or service providers, for example depositaries, or passed onto investors through higher fees and expenses. To determine the equilibrium of costs would require a set of assumptions about the profitability of a heterogeneous set of AIFMs and the competitive pressure brought to bear. Investors including institutional investors such as pension funds that seek to pass costs on to end clients. Industry has indicated it will seek to pass on some or all costs to investors but at this stage, there is insufficient evidence to make the assumptions necessary to attempt to apportion the costs between the participants.

- In addition to AIFMs considered here, it is likely that some AIFMs have not been caught. In particular, it is assumed that:

- Unauthorised Unit Trusts are managed by AIFMs which are captured already in this impact assessment through their management of other AIFs (though their assets under management have not been captured);

- Analysis of internally managed non-CIS AIFs is limited to investment companies at this stage, though in practice there are other entities, for example some Enterprise Investment Schemes, that fall within this regulatory category; and

- Charity funds assets under management are grouped together with UCIS but the sub-threshold regime for this category will be considered in a second Treasury consultation paper.

Costs to non-UK AIFMs, from within the EU and from third countries are not considered as they are out of scope for this impact assessment.

ASSUMPTIONS

The costings in this impact assessment are particularly sensitive to the following factors and assumptions:

- **Variation of costs across the four regulatory regimes.** The cost of AIFMD will differ by sector on account of the different rules currently in place, and variations in the size, risk and complexity of the assets being managed. This impact assessment makes some high level assumptions around variation in costs that will be assessed during consultation. The assumptions are based upon a high-level gap analysis to determine the extent to which AIFMD requirements are new, any published evidence on costs across the regulatory regimes, and reasonable deductions about applicability of the Directive. Some AIFMs manage more than one type of AIF and we have sought to avoid double-counting;

- **Variation of costs for sub-threshold AIFMs.** Given that the Government must decide on its preferred regime for sub-threshold AIFMs, the costs for this group needs to be determined. There were very few responses to the FSA survey from sub-threshold firms as this group was not specifically targeted. Where AIFM-level costings are often expressed in terms of a range with high and low estimates for the above threshold AIFMs, unless otherwise stated, the lower cost estimate for the activity has been used when calculating sub-threshold AIFMs. However, where this seems to be implausible, based upon discussions with FSA and industry, we have estimated a lower figure, usually the lower bound or half the lower bound.

- **Transition.** For simplicity, it is assumed that AIFMs will incur both one-off transition costs and the first year of ongoing costs in year 0. In practice, it is likely that some AIFMs will apply for authorisation in July 2013 in order to take advantage of passporting benefits from the start, while others will make full use of transitional arrangements under AIFMD which give them until July 2014 to apply for authorisation; and

- **The average cost for compliance and other staff across sectors of £65,000 p.a.** including overheads**.** This assumption is based upon industry surveys, where in practice there is a broad range of salaries depending upon role and seniority. The surveys are the Hudson Banking and Financial Surveys 2012 Salary Guide for London[6] and the Alexander Lloyd Compliance Staff Survey 2012[7]. Assuming a 225 day working year, this works out at

[6] http://uk.hudson.com/Portals/UK/documents/SalarySurveys/banking-finance-salary-survey-2012.pdf
[7] http://www.alexanderlloyd.co.uk/content/Alexander%20Lloyd%20Compliance%20Salary%20Survey%202012.pdf

£289 per day. The main driver for many of the costs is the labour of AIFMs' compliance staff. It has been suggested that the cost of compliance staff is higher for hedge fund and private equity AIFMs, but at present there is insufficient evidence for differentiating between sectors.

PART C – COSTS AND BENEFITS OF IMPLEMENTATION

The analysis of costs and benefits is divided into two sections:

- Section A is a broad description of the main requirements of AIFMD, together with their overall qualitative benefits and costs; and
- Section B considers through options 1-3 how the Government may apply the requirements of AIFMD to sub-threshold AIFMs, and considers the more specific qualitative and quantitative costs and benefits that derive from these decisions, Option 4 then considers qualitatively the impact of further deregulation through the removal of some or all retail marketing restrictions.

SECTION A - MAIN REQUIREMENTS, BENEFITS AND COSTS OF THE DIRECTIVE

The Directive makes the following requirements:

A Authorisation & registration

The Directive requires AIFMs to be authorised by a Competent Authority as the basis for regulatory oversight. To become authorised, the AIFM must meet the standards set out in the Directive, supply information on itself and the AIFs it manages, and hold a minimum amount of capital.

The principal benefit is investor protection; the FSA will have regulatory oversight of the AIFMs, be able to exercise its supervision responsibilities and where necessary to apply sanctions. In the UK, authorisation is already the cornerstone of financial regulation.

The Directive allows AIFMs managing sub-threshold AIFMs to be subject to a much more limited registration regime, which limits FSA regulatory oversight and imposes few requirements. Sub-threshold AIFMs have the right to opt up to full authorisation in order to benefit from a pan-EU management and marketing passport.

B General operating and organisational conditions

The Directive sets out a series of conditions governing how AIFMs should be run. The primary benefit of these conditions is again investor protection. In practice, many of the principles behind these requirements are in place in regulation or in current practice. AIFMD strengthens the requirements further and applies them in a uniform manner. The conditions are:

- AIFMs must have a strong **risk management system** in place. This includes ensuring a risk management function that is functionally and hierarchically separated from operational units in order to ensure genuine independent challenge. This should provide investors with confidence that risk is in line with fund and investor objectives;
- As part of the risk management system, AIFMs are required to set a **maximum level of leverage** which they employ for each AIF, depending upon factors including the type and investment strategy of the AIF, interlinkages with other financial services institutions, the need to limit exposure to counterparties and the extent to which the leverage is collateralised;

- AIFMs must have effective organisation and administrative arrangements in place to manage and, where appropriate, prevent **conflicts of interest.** There are particular requirements on AIFMs, typically hedge funds, in selecting prime brokers to ensure clarity over reuse of AIFs' assets and to ensure appropriate due diligence is undertaken;
- AIFMs are required to employ an appropriate **liquidity management system** in order to ensure AIFs can meet their obligations to investors seeking to redeem their investments in accordance with AIF rules. This should reduce the risk that a fund defaults in times of market stress due to liquidity constraints. Stress testing is required to support this.

  During the financial crisis, there was extensive restriction of investors' ability to withdraw their investments in full. The liquidity requirements reduce the risk that investors are unable to withdraw their investments - or at least not at a price in line with expectations – at times of market stress.

- AIFMs must have **remuneration policies and practices** in place for significant staff that are consistent with and promote sound risk management, and apply proportionately a set of principles which govern implementation and oversight of remuneration policy, and appropriate use of variable remuneration;

  The remuneration provisions help to align incentives of the AIFM and the investors; and reduce the risk of individuals seeking short-term gains at the expense of long-term performance;

- AIFMs are required to ensure that where they invest in loans that have been repackaged into **tradeable securities**, they originator has met particular conditions, including the original lender retaining a net economic interest of not less than 5%; and

- AIFMs are required to ensure that AIFs are valued to a consistent standard and that the **valuation is carried out independently** – either through an external valuer or within the same AIFM so long as functional separation is assured from the portfolio management group.

- AIFMs are subject to **capital requirements** that reduce the risk of an AIFM failing; and help to ensure that if it does fail, transition of the AIF to a new manager or an orderly run-down may be carried out smoothly. Most asset management companies already hold substantial capital under the requirements of the Capital Requirement Directive (CRD), but the requirements is new for private equity and venture capital funds, which are not currently subject to CRD.

C Delegation provisions

AIFMs may delegate their functions to third parties but must demonstrate there are objective reasons for doing so and that the delegate is capable of taking on such a task. They must also notify their Competent Authority. AIFMD includes the requirement that the AIFM mustn't delegate to the extent that they become a "letterbox entity" which is incapable of providing effective oversight and control, among other requirements;

The principal benefit of the delegation provisions is investor protection. The requirements ensure that where AIFMs appoint third parties to help manage the funds, the same high conduct requirements are maintained and that the AIFM retains overall control rather than becoming a "letterbox entity".

D Depositary requirements

The Directive requires AIFMs to appoint a depositary to hold in custody set categories of financial instruments and to verify ownership. Depositaries must also ensure AIF cash flows are properly monitored and provide oversight to ensure AIFs are run legally and in accordance with the law. Depositaries have significant liability to investors – for assets held in custody, depositaries would normally have a restitution obligation in the event of loss. Depositaries may delegate part of their role – but their ultimate liability normally remains.

Again, the principal benefit of the depositary requirements is investor protection. In the UK many AIFMs are already required to have a depositary for certain categories of AIF – or at least a custodian for assets - but this regime is extended to all AIFs and the liability regime for depositaries has been strengthened. In practice, there are stronger requirements on depositaries to prevent investor loss; and greater requirements to make restitution in the event of loss. Investors will therefore have greater certainty that their assets are being managed and held in compliance with schemes rules and that there will be restitution in the event of detriment caused by fraud or insolvency.

E **Transparency requirements**

The Directive places obligations on AIFMs both to investors and their Competent Authorities. To investors AIFMs must make available an annual report produced to set standards and make available an extensive set of further information around the AIFM and AIF and how they are run. To Competent Authorities, AIFMs must make available information to allow systemic risk to be assessed. In exceptional circumstances, the Competent Authority may require additional reporting or limit the leverage the AIF may deploy.

The principal benefit from the transparency requirements is therefore supporting the monitoring and managing of systemic risk.

The transparency requirements increase the level of information available for smaller professional investors, reducing information asymmetries and helping to increase investor protection.

F Private Equity provisions

The Directive places specific obligations on Private Equity AIFMs to make disclosures to their Competent Authority in the event of acquiring significant holdings in non-listed companies, and to the company and the shareholders in the event of acquiring control of the company. AIFMs are required to ask that this information be made available to employees and to set out their intentions for the company. The Directive also has provisions to prevent asset stripping through preventing distributions for the first 24 month following a Private Equity AIF's purchase of a company. The principal benefit is therefore employee protection.

G Passporting provisions

The Directive introduces a 'single market framework' for AIFs. It provides for two types of passport:

- A **management passport** will allow AIFMs to manage AIFs in other member states, subject to a notification procedure. This has the potential to reduce costs associated with running management companies by allowing funds to consolidate management activity. In practice, cross-border management of AIFs already takes place widely; the provisions extend the practice to all member states and standardise the notification procedure. Currently funds may in some cases be required to appoint a management company in the same jurisdiction as the funds but the management company will then delegate to managers in other

jurisdictions. Ensuring that AIFs may be managed across EU borders could lead to consolidation of management activity and a reduction in cost for investors.

- A **marketing passport** will permit AIFs managed by UK AIFMs to be marketed to professional investors in other member states, subject to a notification procedure. In practice, this already happens widely but is either dependent upon the private placement regime of the individual Member State or the use of reverse solicitation. AIFMD requires all Member States to allow passporting and has the potential to reduce costs by introducing a standardised process for doing so. Where a Member State already has a liberal private placement regime with low regulatory requirements, this is unlikely to lead to significant savings and may lead to increased regulatory costs (for notification etc) but in other Member States it could do so.

Overarching benefits of the Directive

In summary, the principal benefits of the Directive are therefore:

Management of systemic risk

A principal benefit of the Directive is to increase the ability of regulators to monitor and manage systemic risk, as part of a wider regulatory framework governing Europe's financial system. The transparency requirements allow regulators will receive and exchange information on leverage and have the power to intervene to prevent a future financial crisis by placing limits on the leverage.

It would be disproportionate to quantify this macroeconomic benefit for this Directive as calculating it would depend upon determining the reduction in systemic risk as a result of the Directive and the probability and potential impact of a financial crisis. Both of these factors involve considerable uncertainty - the latter factor has been explored in the impact assessments of regulations focused more exclusively on the management of systemic risk. However, the risk can be considered on a qualitative basis. There is little evidence that alternative funds played a central role in the financial crisis but they may have contributed to it by transmitting and magnifying risks.

There is one often quoted example of alternative funds creating excess systemic risk; the collapse of the United States hedge fund, Long Term Capital Management (LTCM), which required a bailout of $3.6bn overseen by the Federal Reserve Bank of New York. LTCM was highly leveraged and were a similar risk to develop under the Directive, regulators would be well placed to identify it and take preventative action.

The UK already has a mechanism in place for identifying hedge fund systemic risk, the FSA surveys of hedge funds and counterparties of hedge funds. The surveys have been run annually since 2005 (2009 for hedge funds) and has so far not identified any particular systemic risks. The Directive strengthens this arrangement by requiring mandatory reporting, covering a broader range of funds and allowing for pan-European monitoring so broader trends can be identified and addressed.

Investor protection benefits

The Directive introduces greater protection for investors by placing a harmonised set of requirements on AIFMs governing how they may manage AIFs. In practice, the UK's current regime already has many of the requirements of AIFMD but the Directive strengthens them and expands the regime to types of funds – principally companies - which are exempted from FSA oversight as funds. UK investors choosing to invest in AIFs managed from overseas will also benefit from the enhanced protection they offer.

It is not possible to quantify the benefits additional investor protection will offer. However, the Madoff fraud is the most prominent recent example of investor loss. In this case, investor loss has been estimated at $17 bn[8], though the final figure is likely to be lower than this. The measures in the Directive seek to prevent this type of fraud.

More broadly, empirical research suggests fund failure due to excessive risk taking is associated with weak operational controls and oversight – which the AIFMD measures will help to strengthen.

Single market benefits

In a UK context, the management and marketing passports have the potential to:

- represent an export opportunity, improving the ability of UK AIFMs to enter other EEA markets, potentially enhancing the international competitiveness of the UK; and

- lead to increase competition and lower costs for UK investors.

These benefits will be particularly important for real estate funds as the current market is very fragmented along national borders and passporting could give rise to significant economies of scale.

We do not believe that it is possible to quantify accurately at this stage the single market benefits of the marketing and management passports. These will:

- depend substantially on the uptake of the new opportunity by a heterogeneous group of AIFMs which it is not possible at this stage to predict; and

- require data in order to calculate, such as the number of UK AIFs currently being marketed in other Member States which is not readily available and would require a disproportionate effort to gather or calculate.

In order to inform an illustrative indication of cost savings at the final stage, we will seek industry indication of the extent to which they will seek to use the management and marketing passports and the extent to which the marketing passport will lead to a decrease in costs compared to the existing private placement regimes.

Investor choice

At an EU level, AIFMD may increase investor choice but the UK already permits funds to be marketed to professional investors under a private placement regime, so the Directive is unlikely to lead directly to increased investor choice.

Market integrity benefits

A number of the investor protection measures will also help to improve market integrity by addressing liquidity and operational risks. The requirement for effective due diligence in the selection of counterparties strengthens protection against contagion in the event of default.

A consistent approach to transparency in fund accounts will further enhance confidence in market integrity by minimising perception that the accounts can be influenced by external pressures and providing assurance that the accounts are going to the regulator.

[8] http://www.bloomberg.com/news/2012-06-25/madoff-investor-appeal-won-t-be-heard-by-supreme-court.html

Competitiveness benefits

There is the potential for the Directive to replicate the success of UCITS, creating a strong brand in which investors globally have confidence and which provides an export opportunity for EU AIFMs. At present, from discussions with industry, there is a degree of scepticism within the industry over the potential for establishment of the brand – in part because of the heterogeneity of the funds it covers - but it should be noted that UCITS itself took a number of years to become established. In addition, UCITS is a product Directive – focused on the funds – while AIFMD focuses primarily on the conducts of AIFMs and depositaries.

It is not possible to quantify benefits at this stage as the scale of the benefits is too uncertain. We will aim to estimate a broad range in the final impact assessment.

Overarching costs of the Directive

The overall costs of the Directive are:

Direct Compliance costs

Many of the AIFM requirements are based on current regulatory requirements or established market practice. However, as noted above, some requirements will impose significant extra cost, including the additional depositary and transparency requirements. Options 1- 3 seek to quantify these higher costs, and option 4 builds qualitatively upon option 3.

This interim impact assessment does not quantify AIFMD's capital requirements as part of its monetised costs. This is because the capital requirements for sub-threshold AIFMs are particularly uncertain as we do not have the data. However, FSA has undertaken analysis[9] of above-threshold AIFMs, based upon regulatory data firms are required to report on an ongoing basis.

AIFMD has two capital requirements:

- A capital requirement for own funds that reduces the risk of an AIFM failing; and that if it does fail, transition of the AIF to a new manager or an orderly run-down may be carried out smoothly; and
- Additional own funds to cover potential liability risks arising from professional negligence.

NURS, QIS and many UCIS (excluding venture capital and private equity) AIFMs are already subject to capital requirements under the UK's existing regime; the capital requirements are quite high as they were originally designed for banks. The FSA's analysis is that the AIFMs already have sufficient capital to meet the first of the two capital requirements, but there is in total a £104.1m shortfall of capital to meet the additional professional negligence liability requirement.

Venture capital AIFMs are currently subject to a lower £5,000 capital requirement. Many above-threshold firms already hold own funds that are significantly greater than AIFMD levels. However, for other firms, the FSA has calculated a total capital shortfall of approximately £31.6m under the AIFMD. Like for other firm categories, the professional negligence requirement will be new and, on an aggregate basis, firms would have to increase own funds by approximately £7m to meet it.

For internally managed non-CIS AIFs, the FSA analysed the latest balance sheets of eight above-threshold investment trusts based on their reported assets under management. As these investment trusts are large active investors, they tend to have large amounts of cash and cash equivalents on the balance sheet, as well as substantial equity (an approximation for own funds). The AIFMD capital requirements for these firms, including additional own funds for the professional negligence requirements are less than the cash on their balance sheet. Based on this analysis, the FSA does not expect a capital shortfall for this type of AIF.

Indirect costs through impact on business models and strategies

It is likely that a number of AIFMs will restructure in order to comply with the Directive in the most efficient manner. The extent of restructuring is unclear, especially as this will be dependent upon the final details of Commission implementing measures that had yet to be adopted at the time this impact assessment was prepared. It is therefore not possible to quantify the impact at this stage.

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[9] FSA AIFMD consultation paper, November 2012

However, a number of reports have set out qualitatively the potential impact. These include the CRA report commissioned by the FSA[10] and a Deloitte survey. For example, 89% of respondents to the Deloitte survey did not expect the Directive to have an impact the investment strategies of their funds. However, the forthcoming Level 2 regulations on delegation may change the nature of relationship between AIFMs and service providers, particularly if managers are not longer allowed to outsource as many functions as they did in the past.

Other changes are also possible. For example, if depositary costs are too high, informal feedback from industry is that some AIFMs may seek to reduce costs by changing their execution strategy – for example from equities to synthetic exposure.

Competitiveness costs

As noted above, there are potential competitiveness benefits as a result of introduction of passporting and the establishment of a brand. However, as with any regulation, there is a risk of going too far, with the risk of an increase in compliance or depositary costs causing a number of AIFMs to withdraw from the EU market. Respondents to the Deloitte firm survey indicated that compliance costs are particularly likely to affect medium-sized AIFMs above the AIFMD threshold, as compliance costs are likely to constitute a larger proportion of total costs than for larger firms. This means that larger firms may have a cost advantage compared to the smaller firms. Some respondents to the FSA firm survey were concerned that depositary costs could force AIFMs to re-domicile to non-EU jurisdictions.

Incentives to relocate will be largely affected by the regimes to be introduced in the other non-EU countries. 66% of AIFMs that responded to the Deloitte firm survey think that AIFMD will reduce the competitiveness of the EU AIF industry.

On the other hand, the UK markets for AIFs may become more competitive if managers from elsewhere in the EEA use the new marketing passport to market funds in the UK. However, respondents to the Deloitte survey did not think that the benefits of the passport will be sufficient to compensate for the increase in compliance costs.

Regulating previously non-regulated firms and requirements for non-EEA AIFMs may also increase barriers to entry.

Costs to FSA

The FSA estimates the one-off costs to FSA of implementing the AIFMD to be around £5m. These cover staff costs and costs of anticipated systems developments following the high-level gap analysis on the back of the initial interpretation of the Directive:

- Interpretation of Directive, production of consultation papers, Policy Statement and Revised Handbook;
- Definition of operational requirements to administer Directive – authorisation, supervision and reporting;
- Revision to operational processes and procedures;
- Revision/Development of IT systems;

[10] See, in particular, European Commission's impact assessment (http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_impact_assessment.pdf) and the CRA report (link in footnote number 2).

- Communication to all relevant stakeholders – internal and external; and

- Project and line management.

Additional supervisory staff may be needed on an ongoing basis due to the increase in the number of regulated firms. However, most potential AIFMs are already authorised by the FSA, so it does not expect a significant number of new managers, either start-ups or new entities consolidating previous businesses. In particular, investment managers of NURS, QIS and UCIS and the external managers of investment companies are already authorised and supervised by the FSA.

SECTION B – COSTS AND BENEFITS OF OPTIONS 1-4

This section considers the specific costs and benefits arising from the choice of sub-threshold regime and relaxing marketing restrictions. The summary of the costs of applying the Directive in options 1- 3 is supported by more detailed analysis in Annex A.

OPTION 1 – SUB-THRESHOLD AIFMS SUBJECT TO THE SAME REQUIREMENTS AS ABOVE-THRESHOLD AIFMS

Under option 1, the Government will apply the requirements in part A in full to sub-threshold AIFMs. The main features of option 1 are therefore:

- AIFMs under all four regulatory regimes must be fully authorised; no use of a discretionary registration-only regime would be permitted for sub-threshold AIFMs;
- All AIFMs are subject fully to the Directive's requirements; there will be no reduction in requirements for sub-threshold AIFM (though in practice FSA would be likely to apply the regime proportionately);
- The current marketing boundary and private placement regime is maintained but supplemented with AIFMD rules.

Option 1 represents maximum gold plating. The impact is greatest on internally managed investment companies, as they have not previously been subject to FSA regulation, and least on NURS and QIS AIFMs, as these are already subject to a high level of regulation, with many rules broadly consistent with UCITS.

Benefits of Option 1

Strong, consistent investor protection

Option 1 avoids a "two-tier' regulatory regime, in which investors may be uncertain about the level of protection they receive, which would vary depending upon the assets under management of a firm. There would be a high, consistent standard of protection across regulatory regimes for the investors of both sub-threshold and above-threshold AIFMs.

Professional investors in UCIS are regarded as having an appropriate understanding of the complexities of hedge funds, private equity and venture capital industries, and can take a significant amount of time conducting due diligence before making an investment. While this is not universally the case, they are generally aware of the risks involved in investing with a particular firm. The extent to which they benefit from the additional investor protection in exchange for the additional cost will therefore vary.

By not implementing a registration-only regime, the Government would also avoid the risk of investor detriment as a result of the FSA not having the necessary powers to take action against an AIFM.

Confidence in the regulatory system

Taken in conjunction with the regulatory reform already underway in the UK, for example the Financial Services Bill, Option 1 would further strengthen the reputation of the UK for strong investor protection.

Costs of Option 1

Direct costs

The direct costs of implementing the Directive's requirements under Option 1 are estimated in Annex A and summarised below for above-threshold and sub-threshold AIFMs. The tables contain three separate cost elements:

- The majority of costs are considered on a per AIFM basis. The first two columns estimate the average cost per AIFM under each of the four regulatory regimes. The figures are derived by summing the estimated cost per AIFM for each of the elements in Annex A;
- Some additional transparency costs are considered on a per AIF basis. The third and fourth columns provide the total transparency costs accruing to the AIFs under each of the four regulatory categories; and
- Depositary costs are estimated as a proportion of total assets under management for each of the four regulatory categories.

The final two columns in the tables provide the total estimated costs for each of the four regulatory categories. These are then summed to estimate a total estimated cost for industry.

Above-threshold AIFMs

The direct cost of implementing the Directive remains largely the same for options 1-3 as the Government does not have discretion over the elements to apply:

Provision	Cost per AIFM		Total AIF Reporting Costs One-Off (£000)	Total AIF Reporting Costs Ongoing (£000)	Depositary ongoing costs (£000)	Total Cost	
	One-off cost (£000)	Ongoing cost (£000)				One-off cost (£000)	Ongoing cost (£000)
NURS	420-485	785-1061	935	623	45128-180510	20669-23739	82023-230994
QIS	420-485	785-1061	75	50	2120-8480	1335-1531	4525-11713
UCIS	583-658	1057-1412	1,631	1,088	192013-680525	163733-184551	486808-1074149
Int Invest Company	517-604	823-1155	24	16	13178-52712	4163-4857	19776-61965
TOTAL						189899-214678	593131-1378820

Sub-threshold AIFMs

For sub-threshold AIFMs, option 1 represents the highest cost option and involves significant gold plating. Costs are as follows:

Provision	Cost per AIFM		Total AIF Reporting Costs One-Off £000	Total AIF Reporting Costs Ongoing £000	Depositary ongoing costs (£000	Total Cost	
	One-off cost (£000)	Ongoing cost (£000)				One-off cost (£000)	Ongoing cost (£000)
NURS	219	419	378	126	3,231	2,573	7,550
QIS	219	419	2	1	61	221	481
UCIS	301	552	2,303	768	56,226	134,464	299,431
Int Invest Company	201	413	60	20	3,175	4,075	11,448
TOTAL						141,333	318,909

Total costs are as follows and include £5m p.a. FSA costs. For subsequent years, the ongoing costs are applied assuming that there is no underlying change to the base population of AIFMs. A five year period has been chosen as beyond this, it is anticipated that AIFMD will be reviewed at European level. Assuming costs are at midpoint of the estimates, discounted present value costings are:

Year	0	1	2	3	4	TOTAL
Low estimate (£m)	1,248	886	856	827	799	**4,617**
High estimate (£m)	2,059	1,645	1,589	1,536	1,484	**8,313**
Mid-point estimate (£m)	**1,654**	**1,266**	**1,223**	**1,181**	**1,141**	**6,465**

*All figures given at present value on basis of 3.5% p.a. discount.

As noted earlier, for the purpose of this impact assessment, the costs are assumed to be borne by the AIFM but in practice the majority may well be passed on to investors.

Competitiveness

Feedback to the Treasury's discussion paper argued strongly that a decision to apply all AIFMD requirements to all sub-threshold AIFMs would place the UK at a significant competitive disadvantage relative to other Member States. This is further supported by a survey from Open Europe[11] in which, almost unanimously, fund managers considered the Directive's 'one size fits all' approach to be inappropriate.

From discussions with industry, it is likely there would be relocation of AIFMs and restructuring as a result of option 1.

Sub-threshold UCIS are the category of AIFM most likely to relocate. Hedge funds AIFMs in particular are highly mobile, as are Private Equity AIFMs. Some UCIS AIFMs would move to other EU Member States with more proportionate regimes, others would move outside of the EEA and market to professional investors through private placement until at least 2018. In the latter case, the AIFMs may well delegate some portfolio and risk management back to the UK to the extent allowed under the Directive, which would mitigate the loss of economic activity.

Some sub-threshold i**nternally managed investment companies** are also likely to relocate. The impact of this category of AIFM may be greater on this category as internally managed investment companies have not previously been subject to FSA funds regulation.

NURS and QIS are UK regimes and therefore AIFMs managing NURS and QIS AIFs will not be able to relocate. It is possible that there will be a reduction in their uptake, though given these regimes are already subject to greater regulation in any case, this is less likely. Another possibility is that over time, there will be a shift from NURS to UCITS funds, for which the costs may be somewhat lower, at least until the next UCITS Directive is implemented. UCITS funds are similar but more restrictive in terms of permissible investments, for example property investments are not permitted, so this may have the effect of restricting retail investor choice. UCITS is an EU regime so some funds could potentially move out of the UK.

[11] The EU's AIFM Directive: Likely Impact and the Best Way Forward (2009) OpenEurope, Matt Perrson

Investment

Sub-threshold private equity and venture capital AIFMs, in particular, tend to manage venture and growth funds, undertaking early stage investments. It is possible that a reduction in the number of such funds based in the UK could reduce the amount invested in the UK proportionately, though in practice investors preferring to invest in UK companies may well to continue to do so. In addition, applying the private equity provisions of the Directive to sub-threshold firms could also constrain their investment strategies.

OPTION 2 – SUB-THRESHOLD AIFMS SUBJECT TO MINIMUM DIRECTIVE REQUIREMENTS

Under option 2, the Government would apply only the minimal Directive requirements to sub-threshold AIFMs. The main features of option 2 are therefore:

- Only above-threshold AIFMs under the four regulatory regimes would be authorised; sub-threshold AIFMs would be subject to registration only – with a very basic level of FSA oversight;
- Sub-threshold AIFMs would be largely exempt from the Directive's other requirements unless they opted to become fully authorised in order to benefit from the Directive passporting regime; and
- The current marketing boundary and private placement regime would be maintained.

The UK already has a strong regulatory regime and option 2 would remove nearly all current requirements for sub-threshold NURS, QIS and UCIS AIFMs. It is therefore highly deregulatory. For internally managed investment companies, option 2 would represent the smallest possible regulatory burden.

Benefits of Option 2

Direct costs

Ongoing costs for NURS, QIS and UCIS AIFMs would be reduced as a result of no longer being authorised and subject to regulation under the Financial Services and Markets Act. As noted in Part B, many of the principles behind the requirements of AIFMD already apply in domestic legislation, so these costs would be removed. Where professional investors undertook their own due diligence, this would allow them to ensure a level of protection that met their needs.

It is not considered possible to quantify the reduction in direct costs resulting from this approach at this time because:

- AIFMs would choose to apply an uncertain level of investor protection safeguards in any case in order to gain the confidence of investors;
- Investors would be required to undertake greater due diligence for sub-threshold AIFMs and the costs of this are highly uncertain; and
- The costs of applying existing regulation are unknown and it would be disproportionate to seek to determine them unless it is likely the Government will take this approach.

However, for illustrative purposes, internally managed investment companies are entirely new to regulation by FSA as funds whereas NURS / QIS and UCIS AIFMs, and external managers of investment companies, are already authorised. By comparing the difference in costs for these regimes under option 1, a very crude indication of possible costs could be £20k per AIFM in the first year plus depositary costs of 5-40 bps.

Competitiveness

For sub-threshold **UCIS AIFMs**, the removal of existing regulation could potentially make the UK more competitive, lowering the regulatory burden for sub-threshold AIFMs and allowing greater flexibility. It could also lower barriers to entry, allowing for greater competition. A number of respondents to the Treasury's discussion paper supported such an approach. We believe a number

of other Member States will choose this option – and the United States has an equivalent of a *de minimis* regime for sub-threshold hedge fund AIFMs.

However, this would need to be offset against the reputation of the UK regulatory regime. The UK currently has a strong UCIS AIFM sector with its current level of investor protection; and it is likely that there is professional investor support for a baseline level of protection, which this would remove. For this reason, the majority of respondents to the Treasury's discussion paper, including the major trade bodies, did not argue for the introduction of a *de minimis* regime for UCIS AIFMs.

For sub-threshold **internally managed investment companies**, application of the minimum Directive requirements would maintain their competitiveness as an investment opportunity.

Costs of Option 2

Direct costs

Above-threshold AIFMS

The costs for above-threshold AIFMs would be the same as for Option 1.

Sub-threshold AIFMs

Provision	Cost per AIFM		Total Cost	
	One-off cost (£000)	Ongoing cost (£000)	One-off cost (£000)	Ongoing cost (£000)
NURS	6	-	59	-
QIS	6	-	6	-
UCIS	6	-	2,585	-
Int Invest Companies	6	-	118	-
TOTAL			2,768	-

For internally managed investment companies, option 2 represents the minimum cost in implementing the Directive.

Year	0	1	2	3	4	TOTAL
Low estimate (£m)	791	578	558	539	521	**2,988**
High estimate (£m)	1,601	1,337	1,292	1,248	1,206	**6,684**
Mid-point Estimate (£m)	**1,196**	**957**	**925**	**894**	**864**	**4,836**

*All figures given at present value on basis of 3.5% p.a. discount

Investor protection

Reducing substantially the current regulatory requirements for NURS, QIS and UCIS AIFMs would represent a significant reduction in investor protection for the reasons set out in Part B. This would be particularly significant for retail investors in NURS, who typically would not be in a position to undertake their own due diligence.

Applying only the minimum Directive requirements for sub-threshold internally managed investment companies would miss the opportunity to provide a consistent harmonised approach to regulation, with investors not benefitting from the additional protection of FSA authorisation. However, this

would largely maintain the status quo, with company law, listing rules where appropriate, and other EU Directives, including the Prospectus Directive, providing the current level of protection.

Competitiveness

NURS and QIS AIFMs would not realistically relocate as the schemes are domestic. But reducing the regulatory requirements is likely to reduce investment:

- Professional investors choosing to invest in the regimes do so on account of the strong investor protection offered (as well as other benefits including pooling). Reducing this protection for sub-threshold AIFMs may well make the schemes less attractive rather than more unless industry put its own safeguards in place;

- In practice, over two thirds of retail funds are already UCITS funds and applying these rules may tip the balance further towards investment in UCITS funds which may not necessarily be managed from the UK. This could also reduce investment in assets, such as property, that are not permissible under UCITS;

- In line with its investor protection remit, the FSA would be obliged to take steps to protect retail consumers. At the least, sub-threshold NURS AIFMs would be obliged to place prominent warnings over the reduced level of regulation, which would make the products unattractive, but there would be a case for going further and restricting their marketing to retail investors.

In practice QIS AIFs are often used as pooling vehicles attracting large volumes of funds, so at any given time, there are very few sub-threshold QIS AIFMs; presently we believe there is only one. Any new QIS AIFM would seek to rapidly grow assets to above threshold so we believe a reduced regulation sub-threshold regime would have very limited commercial relevance.

Confidence in the regulatory system

It is likely that a substantial reduction in investor protection for NURS, QIS and UCIS AIFMs would lead to greater investor detriment. The FSA would have limited powers to address this under registration-only arrangements and this could undermine investors' confidence in the UK regulatory approach.

OPTION 3 – PREFERRED OPTION FOR APPLICATION OF DIRECTIVE TO SUB-THRESHOLD AIFMs

Under option 3, the Government would apply a regime with a level of regulation between options 1 and 2. From initial discussions with industry and the FSA, and responses to its earlier Discussion Paper, the Government considers this to be optimal; maintaining a strongly competitive UK regime, promoting investor choice and ensuring appropriate protection for investors, especially retail investors. The main features of option 3 are:

- Sub-threshold internally managed investment companies AIFs would be subject to the AIFMD minimum requirements, establishing a regime resembling the status quo as closely as possible, which the Government considers to have appropriate safeguards through company law, the Prospectus Directive where relevant and other legal requirements;

- Sub-threshold UCIS AIFMs, and the external management of investment companies, would continue to be authorised and subject to arrangements closely resembling the status quo, which the Government considers to provide professional, high net worth and sophisticated investors with an appropriate level of protection. No additional AIFMD requirements would be placed upon UCIS AIFMs;

- Sub-threshold NURS and QIS AIFMs would be authorised and subject to most of the AIFMD requirements. This is to avoid a two-tier system of investor protection within the same regulatory regime, which retail investors in particular are unlikely to understand; and

- However, in three areas full Directive requirements would not be applied to sub-threshold NURS and QIS AIFMs (existing standards would remain in place). The Government considers it is possible to maintain a similar level of protection for investors in sub-threshold and above-threshold NURS and QIS AIFMs without applying these additional requirements, and in doing so will reduce costs and uncertainty where their application is dependent upon implementing measures. The three areas are:

    - Level 2 implementing measures specifying the circumstances in which an AIFM has become a letter box entity, and can no longer be considered to be a manager. There is at present uncertainty over the impact of the final implementing in this area;

    - Level 2 transparency requirements, for which there is at present uncertainty over both the reporting burden for AIFMs and application of accountancy provisions; and

    - The remuneration provisions, for which it is judged that current FSA arrangements remain appropriate.

Benefits of Option 3

Investor protection

Option 3 takes a proportionate approach to investor protection:

- Flexibility and a lower regulatory burden is maintained for UCIS AIFMs, which may be marketed to high net worth and sophisticated investors only. These investors could be reasonably assessed to understand that investments in AIFs managed by sub-threshold AIFMs would be subject to less regulation than in AIFs managed by above-threshold AIFMs. The level of regulation is higher than the Directive minimum but ensures a baseline level of protection;

- Sub-threshold internally managed AIFMs would retain existing investor protection but not be subject to additional regulatory cost. There is no gold plating for sub-threshold internally managed investment companies;

- Option 3 avoids a “two-tier’ regulatory regime for retail and other investors in NURS and QIS regulated funds. This will be of benefit to those investors who choose the funds on account of their high level of investor protection;

Unlike option 1, some elements of AIFMD have not been applied to sub-threshold NURS and QIS AIFMs. These have been chosen based on their potential cost, uncertainty over their application, and the extent to which they can be removed without significant loss of investor protection:

- Consultation with industry has indicated that the transparency requirements of the Directive will be a source of significant ongoing costs for sub-threshold operators. Existing reporting requirements would continue to be applied to sub-threshold AIFMs which manage authorised funds and so it is not anticipated that not applying the transparency requirements would have any significant investor protection implications

- To provide certainty over the approach to delegation provisions, the approach also confirms that the status quo approach to assessing whether an AIFM is a letterbox entity will be maintained for sub-threshold NURS and QIS AIFMs. This already offers a high level of investor protection;

- Given the investment strategies typically adopted by NURS and QIS AIFMs, it is unlikely that the AIFMD remuneration provisions will add significantly to investor protection.

Competitiveness

Option 3 offers the opportunity to maintain and enhance competitiveness:

- Sub-threshold UCIS AIFMs would be largely subject to existing levels of regulation which response to Treasury’s discussion paper largely considers to strike an appropriate balance between investor protection and cost;

- Sub-threshold internally managed investment companies would be subject to the minimum additional cost; with investor protection broadly reflecting the status quo; and

- Sub-threshold NURS and QIS AIFMs would maintain their reputation for a high level of investor protection. And they would not be subject to warnings of a “two tier” regime that could be damaging for competitiveness.

<u>Costs of Option 3</u>

Direct costs

<u>Above-threshold AIFMS</u>

The costs for above-threshold AIFMs would be the same as for Option 1.

Sub-threshold AIFMs

Estimated costs for sub-threshold AIFMs are as follows:

Provision	Cost per AIFM		Total AIF Reporting Costs One-Off £000	Total AIF Reporting Costs Ongoing £000	Depositary ongoing costs (£000)	Total Cost	
	One-off cost (£000)	Ongoing cost (£000)				One-off cost (£000)	Ongoing cost (£000)
NURS	144	356	189	63	3,231	1,627	6,858
QIS	144	356	1	0.3	61	145	418
UCIS	6	0	0	0	-	2,585	-
Int Invest Company	6	0	0	0	-	118	-
TOTAL						4,475	7,276

Total estimated costs under option 3 are therefore:

Year	0	1	2	3	4	TOTAL
Low estimate (£m)	800	585	565	546	528	3,024
High estimate (£m)	1,610	1,344	1,299	1,255	1,212	6,720
Mid-point Estimate (£m)	1,205	965	932	900	870	4,872

*All figures given at present value on basis of 3.5% p.a. discount

In order to ensure a consistent standard of investor protection in regulated funds, there is some gold plating for NURS and QIS AIFMs. However, as noted above, this is mitigated by not applying some AIFMD requirements.

Competitiveness

The opportunity would not be taken under Option 3 to reduce regulatory requirements for UCIS AIFMs. As noted, we believe a number of other Member States may choose to implement a registration-only regime for funds targeted only at professional investors. However, the Government considers the investor protection and reputational benefits of maintaining a proportionate level of investor protection to outweigh the direct costs of the regulation.

OPTION 4 – AS OPTION 3 BUT WITH MARKETING RESTRICTIONS RELAXED

EU regulations categorise investors into professional and retail. The UK AIF marketing regime for funds offers considerable flexibility for professional investors, together with types of retail investors who are deemed sufficiently sophisticated or with a high net worth. For other retail investors, however, there is an emphasis on ensuring the products are appropriate through:

- Sufficient liquidity to ensure investors may access their funds easily at a fair price;
- Appropriately managed investment risk – including sufficient diversity to reduce exposure to any single poorly performing asset; and limits on exposure and leverage; and
- Transparency – to give investors a greater understanding of what they are buying.

The NURS regime is designed to achieve this through restrictions on investment powers - so NURS AIFs may already be marketed to all investors – including retail investors. Investment companies are suitable for retail investment in a different way; investment companies are listed on a primary market, which typically provides them with some liquidity, and there is disclosure of investment strategy and other material features through their prospectuses.

QIS rules have much more limited restrictions, for example they may invest in relatively illiquid or non-diversified products. UCIS schemes typically have no such restrictions.

Under option 4, the restrictions on NURS and QIS AIFs being marketed to retail investors would be removed.

Benefits

A key benefit of broadening the marketing regime is that there would be greater choice for retail investors, with a wider range of permissible investment strategies. For example, private equity and hedge funds could be marketed to retail investors; retail investors' access to such funds is currently very limited.

Riskier strategies with higher returns may attract more investment from retail investors into UK AIFMs in the short term, boosting the profitability of AIFMs. It is unlikely that UK AIFMs would be permitted to market such schemes to other EU Member States, so the investment would come from UK investors.

Costs

This option doesn't alter substantially the direct costs set out in option 3. However, there may be an indirect cost as a result of mis-selling of inappropriate products to retail investors. It would be disproportionate to quantify the extent of this risk, however, however, the FSA has recently consulted over misselling[12] of similar products to retail investors. It is likely that if marketing regimes were relaxed, misselling would increase.

Respondents to the Treasury discussion paper were broadly not in favour of removing marketing restrictions from the NURS and QIS schemes.

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[12] http://www.fsa.gov.uk/library/policy/cp/2012/12-19.shtml

PART D – FURTHER IMPACT TESTS

Statutory Equality Duties Impact Test

The Government has considered its obligations under the Equalities Act 2010. We do not believe these measures will impact upon discrimination, equality of opportunity or good relations towards people who share relevant protected characteristics under that act.

Small Firms Impact Test

In implementing the Directive for small firms in a way that reduced regulatory burdens, the Government could decide to apply the *de minimis* registration-only approach set out in option 2 for microbusinesses only. Option 2 sets out the costs and benefits of this approach:

- The regulatory burden on small AIFMs would be reduced, allowing greater flexibility and reduced costs, which would be passed on to retail investors;

- Investor protection would be significantly reduced, and in the case of NURS, exposing retail investors to significant risk;

- Confidence in the UK regulatory regime would be undermined; in the long term potentially leading to a reduction in assets being managed within the UK; and

- FSA is likely to require microbusinesses to publish a prominent warning that their products weren't subject to the same protection as those managed by non-microbusiness AIFMs. While some institutional and sophisticated investors may accept this, this may well put microbusiness retail AIFMs at a disadvantage to other AIFMs.

For these reasons, we believe applying an exemption for microbusinesses is prejudicial to their interests and those of consumers.

The number of NURS and QIS microbusinesses has previously been estimated by the Treasury, in its impact assessment for the introduction of Tax Transparent Funds, as four. FSA data suggests only one hedge fund manager meets the Treasury definition of a microbusiness.

Taking a maximalist estimate that 30% of sub-threshold AIFMs are microbusineses under each category, and using the same assumptions as for sub-threshold AIFMs under option 3, the total cost of implementing the Directive for all microbusinesses is therefore approximately £1.3m one-off cost and £2.3m p.a. ongoing costs.

Human Rights Impact Test

The proposals in this impact assessment are compatible with the Convention rights.

One In One Out

Where the Government introduces gold plating above the status quo, this element of gold plating is subject to the Government's One In One Out policy. Under the Government's preferred option – option 3, sub-threshold NURS and QIS AIFMs would be subject to many of the requirements AIFMD places on above-threshold AIFMs. This goes further than the status quo and counts as an "in".

Gold-plating under the Government's preferred option is calculated as the difference between options 2 and 3. Option 2 is used as the baseline as it implements AIFMD with no gold plating.

Although this is substantially deregulatory – rather than simply representing the status quo - the deregulatory elements have not been quantified.

The difference between options 2 and 3 is c £2m transition costs and c £7m annual costs. Expressed in 2009 prices to ensure comparability with other One In One Out measures gives a net cost to business per year resulting from the gold plating of c £7m. This is c. 0.7% of the net cost to business per year from AIFMD as a whole, which is £951m expressed in 2009 prices.

ANNEX A – CALCULATION OF AIFM COSTS (OPTIONS 1 – 3)

A Authorisation & registration

Option 1

In order to authorise, AIFMs must:

- **Take legal advice on the regulatory regime they should comply with;**
- **Supply FSA with data**; and
- **Respond to FSA questions / challenges.**

Investment companies will need be authorised for the first time and for simplicity we have assumed that that other AIFMs will apply for changes in permission only based on existing authorisation; in practice a small number of AIFMs from other categories are likely to be authorised as well but it would be disproportionate to consider these at this stage. These include AIFMs which are entering the UK and AIFMs which are significantly restructuring

On average, applying for variation of permission is likely to be cheaper than applying for authorisation from scratch - as the AIFM is familiar with the process and has already supplied data, though this will depend upon the number of AIFs being managed and the complexity of the funds. We expect non-staff costs to be a combination of legal and professional fees to support analysis of whether an AIFM is above or below threshold – and to support preparation of the necessary documentation.

In the table below and in all other tables in Annex A, the average cost for compliance and other staff across sectors is estimated at £65,000 p.a. including overheads. A 225 day working year is assumed, working out at approximately £289 per day.

Operating Requirement / Regime (& assumption)	**Above-threshold AIFMs**		**Sub-threshold AIFMs**	
	One-off cost per AIFM – staff days	**Other costs (£000)**	**One-off cost per AIFM – staff days**	**Other costs (£000)**
Vary permission NURS, QIS, UCIS	10-30	10-25	10	3
Authorisation Internal Invest Companies	40-50	25-50	40	25

Option 2

All above-threshold AIFMs would be authorised but all sub-threshold AIFMs would be subject to a de minimis registration regime only. Firms would potentially incur legal and potential independent valuation fees in determining whether they were sub-threshold and hence eligible for the registration regime. . Registered firms will also be expected to make clear to their consumers that they are not authorised by the Financial Services Authority which may result in some additional costs.

This would be strongly deregulatory for sub-threshold NURS, QIS and UCIS AIFMs, together with the AIFMs of externally managed investment companies, which are already authorised. However, as these are already authorised there would be some minimal costs in applying for registration. For internally managed investment companies, there will be the costs of applying for registration from scratch.

Applying for registration would be significantly less of a regulatory burden than applying for authorisation. AIFMs will need to take legal advice on whether they comply with the sub-threshold AIFM regime – and discussions with industry suggest that some investment companies may restructure themselves to become internally managed if the sub-threshold AIFMs regime involves sufficiently less cost. And the AIFMs will have to provide basic information to FSA – there will not be an ongoing process of scrutiny prior to approval however.

Operating Requirement / Regime (& assumption)	**Above-threshold AIFMs**		**Sub-threshold AIFMs**	
	One-off cost per AIFM – staff days	**Other costs (£000)**	**One-off cost per AIFM – staff days**	**Other costs (£000)**
Vary permission NURS, QIS, UCIS	10-30	10-25	n/a	n/a
Authorisation External Invest Companies	40-50	25-50	n/a	n/a
Registration (all)	n/a	n/a	10	3

Option 3

Maintenance of a regime that as closely as possible mirrors the status quo would require sub-threshold NURS, QIS and UCIS AIFMs, together with the AIFMs of externally managed investment companies, to remain authorised. Internally managed investment companies would be permitted to use the registration-only regime.

Costs for sub-threshold AIFMs are likely to be less than for larger ones; as they are likely to be less complex to authorise or register. We therefore take the lower bound of costings to be the estimated cost for sub-threshold AIFMs. Based on the other estimates in options 1 and 2, the monetised costs would therefore be:

Operating Requirement / Regime (& assumption)	**Above-threshold AIFMs**		**Sub-threshold AIFMs**	
	One-off cost per AIFM – staff days	**Other costs (£000)**	**One-off cost per AIFM – staff days**	**Other costs (£000)**
Vary permission NURS, QIS, UCIS	10-30	10-25	10	3
Authorisation External Invest Companies	40-50	25-50	40	25
Registration (external Invest Companies)	n/a	n/a	10	3

SUMMARY

Regulatory Regime	**Size**	**Option 1 One-off cost per AIFM (£000)**	**Option 2 One-off cost per AIFM (£000)**	**Option 3 One-off cost per AIFM (£000)**
NURS	Above	13 – 34	13 – 34	13 - 34
	Sub	6	6	6
QIS	Above	13 – 33	13 – 34	13 - 34
	Sub	6	6	6
UCIS	Above	13 - 34	13 - 34	13 - 34
	Sub	6	6	6
Int Invest Company	Above	37-64	70 -126	70 – 126
	Sub	37	6	6

Operating requirements

Option 1

Under option 1, the Government would require all AIFMs to apply in full the AIFMD operating requirements. In practice, many AIFMs already have arrangements in place to a greater or lesser extent – and a number of the requirements are inter-related – so any breakdown of costings is only likely to be a high level approximation. The principles behind these provisions already represent good practice for well-run AIFMs. Many of the requirements are already present in the rules governing NURS and QIS, in particular. However, the AIFMD requirements are in some cases more prescriptive, and for investment companies in particular, many of them represent a formal requirement for the first time.

There are insufficient responses to the FSA firm survey to differentiate between costs to AIFMs governed by each the four current regulatory regimes. Furthermore, a number of AIFMs manage more than one type of AIF. However, from a high-level gap analysis comparing the Directive with the existing UK regulatory regime, and feedback from the other surveys and consultations, we make some further qualitative and quantitative assumptions around the requirements:

- **Establishing permanent compliance and internal audit functions.** All authorised AIFMs must establish a permanent compliance function and an internal audit function. These functions must be separate from other functions and activities of the AIFM. The purpose of the compliance function is to detect and remedy any risk of failure by the AIFM to comply with its obligations under AIFMD. The larger AIFMs are in practice likely to already have central compliance functions, but there will be one-off costs in updating compliance polices and preparing for AIFMD. There will be incremental ongoing costs resulting from the greater compliance burden of AIFMD.

  Our estimate for the compliance function cost for above-threshold AIFMs departs significantly from the FSA survey data, which is £0-29,000 in one-off costs. Informal industry feedback has suggested there will be a need for restructuring in some AIFMs in relation to compliance functions which may not be fully captured by the survey. From the FSA survey data, it appears that the cost of compliance is broadly proportional to the assets under management. The cost is likely to vary with size and complexity of AIFs. At this interim stage, we have allowed for an element of restructuring by estimating £100k one-off costs, but note that broader restructuring costs are particularly uncertain and will be revisited in light of increased industry understanding of costs and the adoption of Commission level 2 implementing measures.

  It seems likely that internally managed investment companies will incur greater costs for their compliance functions as they are new to the regulatory regime – we have estimated this as twice the cost for the other regulatory categories. Hedge fund managers may also face somewhat higher costs on account of the complexity of their strategies we have estimated costs for UCIS AIFMs as being 1.25 times those for NURS and QIS AIFMs;

- **Ensuring suitable electronic systems are in place for a timely and proper recording of portfolio transactions and subscription or redemption orders.** This may well be more expensive for hedge funds than for other regulatory categories, on account of the potential complexity in arrangements and frequency in trading. However, this is partly offset by hedge funds already having arrangements in place on which to build, and for the UCIS category as whole by the inclusion of AIFMs for closed-ended AIFs that trade infrequently and will not need to handle subscriptions & redemptions. These include private equity and venture capital funds.

For other regulatory categories, internally managed investment companies will not need to handle subscriptions & redemptions, and NURS and QIS AIFMs are likely to have similar arrangements already in place. We therefore assume costs for NURS, QIS and internally managed investment companies to be half the costs for UCIS AIFMs.

- **Putting in place standardised accounting policies to allow for depositary verification of securities**;

- **Putting in place due diligence arrangements** which are proportional to the nature, scale and complexity of the assets invested in. Many AIFMs will have in practice have due diligence procedures that will need updating; for example the survey evidence from Ernst & Young noted 96% of UCIS respondents already had a due diligence process in place;

- **Putting in place arrangements to ensure conflicts of interest with counterparties and prime brokers are appropriately managed**; if counterparties are also used for custody services, that they be either replaced or separated from the AIFs' depositaries functionally and hierarchically. This is relevant primarily to hedge funds. The Deloitte survey suggested that at least a quarter of fund managers currently use their prime broker for custody services;

- **Putting in place procedures to ensure fair treatment of investors;**

- **Implementing and running a strong risk management approach**, which includes introducing a functionally and hierarchically separate risk management function; the Deloitte survey suggested this may require investment for 20% of fund managers. While larger AIFMs may well already have separated risk functions, for the smaller AIFMs, this may prove more challenging. AIFMs will need to update their risk management policies, maintain them and report on them; and

- Ensuring all reasonable steps are taken to identify and **manage conflicts of interest –** which includes maintaining organisation and administrative arrangements to identify, prevent, manage and monitor the conflicts.

Based upon FSA survey data and the assumptions above, estimated costings under option 1 are:

Operating Requirement / Regime (& assumption)	**Above-threshold AIFMs**				**Sub-threshold AIFMs**			
	One-off Costs		**Ongoing Costs**		**One-off Costs**		**Ongoing Costs**	
	Staff Days	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**	**Staff Days**	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**
Compliance NURS, QIS (x1)	15-30	100	1-2	20-50	15	10	0.5	20
UCIS (x1.25), Int Invest Companies (x2)								
Internal Audit	20-50	1	0.3	20-25	5	10	0.15	25
Electronic record systems (UCIS x1)	20	10	1	10-20	5	10	0.5	10
NURS, QIS, Int Invest Companies (x0.5)								
Accounting Policies and Procedures	10	10	1.5	5	10	10	0.75	2
Due Diligence	2-5	10	0.4	5-10	2	5	0.2	5

Operating Requirement / Regime (& assumption)	**Above-threshold AIFMs**				**Sub-threshold AIFMs**			
	One-off Costs		**Ongoing Costs**		**One-off Costs**		**Ongoing Costs**	
	Staff Days	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**	**Staff Days**	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**
Appointing counterparties UCIS (x 0.5 as hedge funds only)	5	10-20	0.5	1-5	5	5	0.25	1
Fair treatment	10	10	0.5	1-5	5	5	0.25	1
Risk management	20	20	1-2	2-5	5	20	0.5	2
Conflicts of interest	5-30	5	0.5	1	5	5	0.25	1

Option 2

Under option 2, sub-threshold AIFMs would be subject to no formal operating requirements. This would be substantially deregulatory for NURS and QIS funds, and deregulatory for UCIS funds and would represent the status quo for investment companies. Costs are therefore the same as for option 1 but with all sub-threshold AIFM costs £0.

Option 3

Under option 3, sub-threshold UCIS AIFMs would be subject only to current operating requirements, and sub-threshold internally managed investment companies would be subject to no formal operating requirements. Sub-threshold NURS and QIS AIFMs would be subject to full AIFMD operating requirements. Costs are therefore the same as for option 1 but with sub-threshold UCIS and internally managed investment companies costs as £0.

SUMMARY

Regulatory Regime	**Size**	**Option 1**		**Option 2**		**Option 3**	
		One-off cost per AIFM (£000)	**Ongoing cost per AIFM (£000)**	**One-off cost per AIFM (£000)**	**Ongoing cost per AIFM (£000)**	**One-off cost per AIFM (£000)**	**Ongoing cost per AIFM (£000)**
NURS	Above	188-209	435-612	188-209	435-612	188-209	435-612
	Sub	75	247	0	0	75	247
QIS	Above	188-209	435-612	188-209	435-612	188-209	435-612
	Sub	75	247	0	0	75	247
UCIS	Above	227-254	511-718	227-254	511-718	227-254	511-718
	Sub	88	290	0	0	0	0
Int Invest Companies	Above	292-317	520-792	292-317	520-792	292-317	520-792
	Sub	90	299	0	0	0	0

Liquidity management requirements

Option 1

Under option 1, all AIFMs would be required to comply with AIFMD's liquidity requirements, which set out obligations for managing liquidity risks in all AIFs other than closed-ended non-leveraged funds. The main requirements are:

- **Ensure appropriate systems and processes** are in place to manage liquidity and monitor the risks, ensuring the liquidity profile of the investments of the AIF complies with its underlying obligations. AIFMs will need to ensure their liquidity management policies and procedures are documented and maintained;

- **Conduct stress tests** to assess liquidity risks of the AIFs – at least once a year; and

- **Make disclosures to investors** around the results of the stress tests and ensure redemption policies are clear.

AIFMs will review at least annually liquidity risk profiles of managed AIFs, maintain appropriate liquidity measurement arrangements and conduct stress testing on a periodic basis, not less than once a year. The frequency and rigour of stress testing will depend upon FSA supervisory guidance which will vary in relation to the size and complexity of the AIF and the nature of the assets. AIFMs will need to implement policies and procedures to put in effect tools and arrangements required to manage the liquidity risk of each AIF under management. They will also need to determine whether redemption restrictions are appropriate.

Hedge funds in particular will need sophisticated liquidity management systems on account of the complexity and relatively high leverage they deploy. From discussions with industry, many of them have already increased their focus on leverage following the financial crisis – but the requirements will fall particularly heavily on them. By contrast, private equity AIFMs and venture capital AIFMs are unlikely to be severely affected. For the UCIS category as a whole, we therefore make a broad assumption that costs will be twice those for the AIFMs of NURS and QIS AIFs.

From informal discussions with industry and the FSA, we understand that few investment companies would be caught by Directive liquidity requirements; many investment companies will be unleveraged and closed-ended (closed-ended funds do not accept not accept subscriptions or redemptions). For leveraged investment companies, we would expect that all would have liquidity policies in place, and any adjustments required to come into compliance should not cause significant costs.

Sub-threshold AIFMs are likely to manage fewer and smaller AIFs – and many of them will be unleveraged. Consequently, liquidity management requirements are likely to be considerably less for sub-threshold AIFMs; cost estimates are based loosely on the very limited data in the FSA survey.

Liquidity Management Requirement / Regime (& assumption)	Above-threshold AIFMs				Sub-threshold AIFMs			
	One-off Costs		Ongoing Costs		One-off Costs		Ongoing Costs	
	Staff Days	Non-Staff Costs £000	Staff FTE	Non-Staff Costs £000	Staff Days	Non-Staff Costs £000	Staff FTE	Non-Staff Costs £000
Systems & Procedures NURS, QIS (x1)	50	25	0.3-0.5	10-20	3	10	0.2	2
UCIS - hedge funds (x2)								
Stress testing	20	5	0.3 -0.5	2-5	5	5	0.2	2
NURS, QIS (x1)								
UCIS- hedge funds (x2)								
Disclosure to investors NURS, QIS (x1)	5	10	0.3	10	5	5	0.2	5
UCIS- hedge funds (x2)								

Option 2

Under option 2, sub-threshold AIFMs would be subject to no formal liquidity management requirements. This would be deregulatory for NURS, QIS and UCIS AIFMs and would represent the status quo for investment companies. Costs are therefore as option 1 but with all costs for sub-threshold AIFMs being £0.

Option 3

Under option 3, sub-threshold UCIS AIFMs would be subject only to current liquidity management requirements and sub-threshold internally managed investment companies would be subject to no formal liquidity requirements. Sub-threshold NURS and QIS AIFMs would be subject to the AIFMD liquidity requirements, however the level 2 implementing measures for the liquidity disclosure requirements would be disapplied. The extent to which FSA would be in a position to introduce a less burdensome regime would depend upon the final level 2 measures. At this stage, we have therefore assumed that costs are therefore as option 1 but with sub-threshold UCIS and internally managed investment companies costs £0.

SUMMARY

Regulatory Regime	Size	Option 1		Option 2		Option 3	
		One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)
NURS	Above	62	77-116	62	77-116	62	77-116
	Sub	24	37	0	0	24	37
QIS	Above	62	77-116	62	77-116	62	77-116
	Sub	24	37	0	0	24	37
UCIS	Above	123	155-233	123	155-233	123	155-233
	Sub	48	73	0	0	0	0
Int Invest Companies	Above	0	0	0	0	0	0
	Sub	0	0	0	0	0	0

Leverage requirements

Option 1

Under option 1, all AIFMs would be required to comply with AIFMD's requirements for managing leverage, which are broadly:

- **Establishing and maintaining a policy to manage leverage in its AIFs.** The policy will need to be documented and scrutinised. Tools may need to be developed;

- **Calculating leverage levels for each AIF.** Leverage levels will have to be calculated in accordance with AIFMD implementing measures;

- **Setting a maximum leverage level for each AIF**, taking into account a range of factors including the type of AIF, linkages which could expose systemic risk and exposure to a single counterparty. Leverage levels may need to be adjusted in accordance with this maximum leverage levels;

- **Disclosing leverage levels to investors and keeping them updated**; and

- **Demonstrating to the FSA that the leverage levels set are reasonable** and are being complied with.

AIFMs typically already have a leverage management system in place. However, the requirement will affect hedge funds in particular as they are typically more highly leveraged than other AIFMs. At this stage, we estimate the impact on UCIS AIFMs as a whole – which includes other types of AIFMs - as being twice that on AIFMs fitting within other regulatory categories, which where leveraged are also likely to have some leverage policy in place. The extent to which additional costs apply will also be dependent upon the level of prescription in level 2 measures.

Leverage Requirement / Regime (& assumption)	**Above-threshold AIFMs**				**Sub-threshold AIFMs**			
	One-off Costs		Ongoing Costs		One-off Costs		Ongoing Costs	
	Staff Days	**Non-Staff Costs £000**	**Staff FTE**	**Non-Staff Costs £000**	**Staff Days**	**Non-Staff Costs £000**	**Staff FTE**	**Non-Staff Costs £000**
Leverage policy NURS, QIS, int Invest Companies (x0.75)	2-5	5	0.2-0.25	2.5	2	2	0.1	2.5
UCIS (x1.5)								
Calculating leverage for each AIF NURS, QIS, int Invest Companies (x0.75)	2-5	15	0.2-0.25	2.5	2	5	0.1	2.5
UCIS (x1.5)								
Setting max leverage level NURS, QIS, int Invest Companies (x0.75)	10-20	5	0.25	3	5	5	0.1	3
UCIS (x1.5)								
Disclosure to investors NURS, QIS, int Invest Companies (x0.75)	5	5	0.25	3	5	5	0.1	3
UCIS (x1.5)								
Disclosure to FSA NURS, QIS, int Invest Companies (x0.75)	6	5	0.5	3	3	5	0.3	3
UCIS (x1.5)								

Option 2

Under option 2, sub-threshold AIFMs would be subject to no formal leverage management requirements. This would be deregulatory for NURS, QIS and UCIS AIFMs and would represent the status quo for investment companies. Costs are therefore as for option 1 but with all sub-threshold AIFM costs being £0.

Option 3

Under option 3, sub-threshold UCIS AIFMs would be subject only to current leverage management requirements and sub-threshold internally managed investment companies would be subject to no formal leverage requirements. Sub-threshold NURS and QIS AIFMs would be subject to full AIFMD leverage requirements - but the level 2 implementing measures would not be applied. The extent to which FSA would introduce a regime with lower regulatory burdens would depend upon the final level 2 measures, but potentially reporting requirements could be less frequent. Costs are therefore as option 1 but with costs for sub-threshold UCIS and internally managed investment companies being £0. Costs for sub-threshold NURS and QIS AIFMs are as option 1, with the exception of disclosure costs where they are assumed to be half those of option 1.

SUMMARY

Regulatory Regime	Size	Option 1		Option 2		Option 3	
		One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)
NURS	Above	32-35	79-84	32-35	79-84	32-35	79-84
	Sub	20	45	0	0	16	33
QIS	Above	32-35	79-84	32-35	79-84	32-35	79-84
	Sub	20	45	0	0	16	33
UCIS	Above	63-70	158-167	63-70	158-167	63-70	158-167
	Sub	40	89	0	0	0	0
Int Invest Companies	Above	32-35	79-84	32-35	79-84	32-35	79-84
	Sub	20	45	0	0	0	0

Delegation requirements

Option 1

Under option 1, the Government would require all AIFMs to comply with Directive delegation requirements, which will impose consistent regulatory standards for delegates and sub-delegates, as well as requiring reviews and monitoring by AIFMs. AIFMs will have to notify the FSA if they intend to delegate functions to third parties to carry out on their behalf. The AIFM will also have to review the services provided by each delegate on an ongoing basis. As a minimum, requirements on AIFMs will therefore be:

- **Reviewing services provided by each delegate**; and
- **Reporting to the FSA on delegation.**

Respondents to the Deloitte survey listed delegation as one of the most pressing concerns from a cost perspective. If technical advice from the European Securities and Markets Authority (ESMA) is followed in Level 2 implementing measures then the cost impact is not likely to be significant. However, if the Level 2 imeplemting measures set a limit on the tasks that the AIFM can delegate that is significantly more stringent than current practice, firms may need to change business models. As Deloitte also notes, some internally managed funds may need to 'insource' functions that are currently delegated. In this impact assessment, costs are considered on the basis of the most recent publicly available document, the ESMA advice. In practice therefore only direct costs are considered.

NURS, QIS, UCIS AIFMs and external managers of investment companies are already required to notify the FSA of delegation so in practice this cost will fall more heavily on internally managed investment companies. We have estimated the cost to internally managed investment companies as being 1.5 times that for the other regulatory categories. The E&Y survey indicated that Private Equity funds do not typically delegate management functions so they will be much less affected by the delegation provisions.

Delegation Requirement / Regime (& assumption)	**Above-threshold AIFMs**				**Sub-threshold AIFMs**			
	One-off Costs		**Ongoing Costs**		**One-off Costs**		**Ongoing Costs**	
	Staff Days	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**	**Staff Days**	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**
Reviewing services provided by each delegate NURS, QIS, UCIS (x1)	40	10-20	0.2	10	20	1	0.1	5
Int Invest Companies (x1.5)								
Reporting to FSA NURS, QIS, UCIS (x1)	20	10-20	0.2	10	10	1	0.1	5
Int Invest Companies (x1.5)								

Option 2

Under option 2, sub-threshold AIFMs would be subject to no formal delegation requirements. This would be deregulatory for NURS, QIS and UCIS AIFMs and would represent the status quo for investment companies. Costs are therefore as option 1 but with all costs for sub-threshold AIFMs being £0.

Option 3

Under option 3, sub-threshold UCIS AIFMs would be subject only to current delegation requirements, and sub-threshold internally managed investment companies would be subject to no delegation requirements. Sub-threshold NURS and QIS AIFMs would be subject to full AIFMD delegation requirements. Costs are therefore as option 1 but with sub-threshold UCIS and internally managed investment companies' costs being £0.

However, the Government would not apply the Level 2 implementing measures specifying the circumstances in which an AIFM has become a letter box entity, and can no longer be considered to be a manager. This means that the measures set a limit on the extent that AIMs may delegate that is significantly more stringent than current practice, there would then be a substantial difference in cost for sub-threshold and above-threshold NURS and QIS AIFMs. We shall review this when the implementing measures have been adopted.

SUMMARY

Regulatory Regime	Size	Option 1		Option 2		Option 3	
		One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)
NURS	Above	37-57	40	37-57	40	37-57	40
	Sub	11	20	0	0	11	20
QIS	Above	37-57	40	37-57	40	37-57	40
	Sub	11	20	0	0	11	20
UCIS	Above	37-57	40	37-57	40	37-57	40
	Sub	11	20	0	0	0	0
Int Invest Companies	Above	56-86	60	56-86	60	56-86	60
	Sub	16	30	0	0	0	0

Valuation requirements

Option 1

Under option 1, all AIFMs would have to comply with AIFMD's requirement to ensure independence of valuation through separation from portfolio management - potentially through appointing an independent valuer and requiring professional guarantees. Private equity and real estate firms typically have illiquid assets and may not currently rely on external valuers so it is assumed that they may have somewhat higher costs. Likewise, some hedge funds deploying complex strategies may require more effort to appoint independent valuers. As a rough estimate, the cost to UCIS AIFMs is therefore assumed to be twice that of other AIFMs.

	Above-threshold AIFMs				Sub-threshold AIFMs			
Valuation Requirement / Regime (& assumption)	**One-off Costs**		**Ongoing Costs**		**One-off Costs**		**Ongoing Costs**	
	Staff Days	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**	**Staff Days**	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**
Appointing an external valuer NURS, QIS, int Invest Companies (x1)	5	10	0.3	5-10	5	5	0.2	5
UCIS (x 2)								

Option 2

Under option 2, sub-threshold AIFMs would be subject to no formal requirements around relating to valuation. This would be deregulatory for NURS, QIS and UCIS AIFMs and would represent the status quo for investment companies. Costs are therefore as option 1 but with costs for all sub-threshold AIFM s being £0.

Option 3

Under option 3, sub-threshold UCIS AIFMs would be subject only to current valuation requirements, and sub-threshold internally managed investment companies would be subject to no valuation requirements. Sub-threshold NURS and QIS AIFMs would be subject to full AIFMD valuation requirements. Costs are therefore as option 1 but with sub-threshold UCIS and internally managed investment companies costs being £0.

SUMMARY

Regulatory Regime	Size	Option 1		Option 2		Option 3	
		One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)
NURS	Above	11	25-30	11	25-30	11	25-30
	Sub	6	15	0	0	6	15
QIS	Above	11	25-30	11	25-30	11	25-30
	Sub	6	15	0	0	6	15
UCIS	Above	23	50-60	23	50-60	23	50-60
	Sub	13	30	0	0	0	0
Int Invest Companies	Above	11	25-30	11	25-30	11	25-30
	Sub	6	15	0	0	0	0

Remuneration requirements

Option 1

Under option 1, all AIFMs would be required to comply with AIFMD's remuneration requirements. These are broadly similar to existing requirements for firms regulated under MiFID and involve establishing a remuneration policy and following it on an annual basis.

In practice, most regulated AIFMs already have some remuneration processes in place which would decrease direct costs. However, there is at present industry concern over the extent to which FSA will be able to apply the remuneration principles set out in AIFMD proportionately to the industry. ESMA is currently consulting over guidance. Indirect costs could be much higher, for example the ability to retain staff, if there is ultimately insufficient flexibility.

For remuneration requirements, we do not have FSA survey data, however, the FSA undertook a similar exercise when implementing the European Banking Authority guidelines, to which these requirements are similar, to credit institutions and MiFID investment firms via the UK's Remuneration Code. The FSA received 19 responses from investment firms and the estimated costings below are based upon this survey. The survey confirmed that the main costings would be:

- **Changing the remuneration policy.** Changes may be needed to the ways in which remuneration policies are set within an AIFM, including the need to change the way remuneration is determined on the level of divisions or business units. This may involve changes in firms' processes, systems and controls, additional data collection, reporting and record keeping;

- **Issuing an annual remuneration statement.** New processes may have to be implemented and the additional level of detail required for the statement;

- **Senior management board or committee time.** Members of boards and remuneration committees may have to spend additional time to meet the enhanced regulatory requirements. Firms might also incur additional costs if they seek external advice;

- **Enhanced risk management function.** Risk and compliance functions will be required to take a more active role in remuneration policies; and

- **Adjusting remuneration structures.**

The average of costs reported to the survey was £7000 per AIFM one-off costs and £4000 per AIFM ongoing costs. For the purposes of this interim assessment, we have used these figures directly.

Option 2

Under option 2, sub-threshold AIFMs would be subject to no formal remuneration requirements. This would be deregulatory for NURS, QIS and UCIS AIFMs and would represent the status quo for internally managed investment companies. Costs are therefore as option 1 but with all sub-threshold AIFM costs being £0.

Option 3

Under option 3, additional AIFMD remuneration requirements would not be applied to any sub-threshold AIFMS. Costs are therefore as option 2.

SUMMARY

Regulatory Regime	Size	Option 1		Option 2		Option 3	
		One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)
NURS	Above	7	4	7	4	7	4
	Sub	7	4	0	0	0	0
QIS	Above	7	4	7	4	7	4
	Sub	7	4	0	0	0	0
UCIS	Above	7	4	7	4	7	4
	Sub	7	4	0	0	0	0
Int Invest Companies	Above	7	4	7	4	7	4
	Sub	7	4	0	0	0	0

Transparency requirements

Option 1

The Government would require all AIFMs to comply with Directive transparency requirements. These fall into three categories – the first two are considered together:

- **Prior disclosure to investors**; and
- **Annual reporting to investors**.

AIFMs will have to disclose certain information to investors before they invest in the AIF (or if any material changes have been made). However, because no particular format of disclosure is prescribed and firms will be able to carry on with their current business practice, we do not expect the requirement to impose significant costs on most firms.

Given existing requirements, we have assumed costs for NURS and QIS will be half and reflecting potential complexity for many hedge funds, we have applied a multiplier for costs of 1.25 for UCIS.

In addition to the costs per AIFM, disclosure costs will also be proportionate to the number of AIFs, so we have indicated these separately below.

Disclosure to investors includes the Directive disclosure requirements not already covered within leverage and liquidity requirements, which have been considered separately in those sections.

The third category is:

- **Reporting obligations to the FSA.** AIFMs will also be required to report to the FSA regularly on each AIF under their management.

Some UCIS AIFMs already report similar data to the FSA as part of the hedge fund survey though disclosure requirements are more extensive and frequent under the Directive. However, this may in practice be offset by the increased complexity of some hedge funds. Given the uncertainty on impact, we have not made assumptions about the relative cost for UCIS AIFMs relative to other regulatory categories.

Estimated transparency costs per AIFM, excluding, as noted, leverage and liquidity disclosure requirements are:

	Above-threshold AIFMs				**Sub-threshold AIFMs**			
Transparency Requirement / Regime (& assumption)	**One-off Costs**		**Ongoing Costs**		**One-off Costs**		**Ongoing Costs**	
	Staff Days	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**	**Staff Days**	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**
Disclosure to investors Int Invest Companies (x1)	-	25	-	20	-	25	-	20
NURS & QIS (x0.5), UCIS (x1.25)								
Reporting to FSA	27	50	1	50-100	27	50	0.5	10

Estimated additional transparency costs per AIF are:

	Above-threshold AIFs				Sub-threshold AIFs			
Transparency Requirement / Regime (& assumption)	**One-off Costs**		**Ongoing Costs**		**One-off Costs**		**Ongoing Costs**	
	Staff Days	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**	**Staff Days**	**Non-Staff Costs (£000)**	**Staff FTE**	**Non-Staff Costs (£000)**
Disclosure to investors Int Invest Companies (x1)	-	3	-	2	-	3	-	1
NURS & QIS (x0.5), UCIS (x1.25)								

Option 2 & Option 3

Under options 2 costs would be as option 1 but for all sub-threshold AIFMs and AIFs managed but sub-threshold AIFMs, costs would be £0. Under option 3, transparency requirements would be applied but the level 2 implementing measures relating to the transparency requirements would not be applied. The extent to which FSA would introduce a regime with lower regulatory burdens would depend upon the final level 2 measures, but potentially reporting requirements could be less frequent or use a more simple form. Costs are therefore as option 1 but with costs for sub-threshold UCIS and internally managed investment companies being £0. Costs for sub-threshold NURS and QIS AIFMs – and NURS and QIS AIFs managed by sub-threshold AIFMs - are assumed to be half those of option 1.

SUMMARY - PER AIFM

Regulatory Regime	Size	Option 1		Option 2		Option 3	
		One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)	One-off cost per AIFM (£000)	Ongoing cost per AIFM (£000)
NURS	Above	70	125	70	125	70	125
	Sub	70	53	0	0	35	26
QIS	Above	70	125	70	125	70	125
	Sub	70	53	0	0	35	26
UCIS	Above	89	140	89	140	89	140
	Sub	89	68	0	0	0	0
Int Invest Companies	Above	83	135	83	135	83	135
	Sub	83	63	0	0	0	0

AGGREGATED ADDITIONAL DISCLOSURE COSTS PER AIF

Regulatory Regime	Size	Option 1		Option 2		Option 3	
		Aggregated one-off cost for AIFs (£000)	Aggregated ongoing cost for AIFs (£000)	Aggregated one-off cost for AIFs (£000)	Aggregated ongoing cost for AIFs (£000)	Aggregated one-off cost for AIFs (£000)	Aggregated ongoing cost for AIFs (£000)
NURS	Above	935	623	935	623	935	623
	Sub	378	126	0	0	189	63
QIS	Above	75	50	75	50	75	50
	Sub	2	1	0	0	1	0.3
UCIS	Above	1,631	1,088	1,631	1,088	1,631	1,088
	Sub	2,303	768	0	0	0	0
Int Invest Companies	Above	24	16	24	16	24	16
	Sub	60	20	0	0	0	0

Depositary requirements

Option 1

Many AIFMs already have depositaries but the Directive expands their liabilities and obligations, and extends their use to new types of fund.

NURS and QIS AIFMs, together with some UCIS AIFMs (excluding private equity, venture capital and most property funds) are already required to appoint depositaries for at least custodian services. However, AIFMD places further obligations on depositaries; most significantly there will now be near-strict liability for the restitution of assets throughout depositaries' entire sub-custody chain; depositaries typically delegate to others where the AIFM wishes to invest in jurisdictions in which the depositary does not have a branch or subsidiary. Verification and oversight responsibilities are also strengthened.

Internally managed investment companies will be required to appoint depositaries for the first time. private equity, venture capital UCIS AIFMs and property AIFMs would need to appoint depositaries for the first time, however AIFM prescribes a special set of requirements for these on the basis that the majority of the requirements will be oversight as the majority of their assets – unlisted companies, properties – cannot be held in custody.

Depositary costs are particularly challenging to estimate, given the outcome will be dependent upon commercial drivers; the relative market power of depositaries versus AIFMs, and the extent to which depositaries regard the Directive as an opportunity to cross-sell other services. Liabilities in particular are also dependent upon the outcome of the Commission level 2 Regulation – which was not published at the time this impact assessment was developed.

Ernst & Young surveyed depositaries and a number of hedge funds on behalf of the Alternative Investment Managers Association (AIMA) to determine current costs and to seek to estimate costs of implementing AIFMD for full depositary services (i.e. including custody). Current fees were estimated at 20-35 bps; estimates of additional costs – mainly as a result of capital or insurance needed to meet liability requirements ranged from 10-25 bps to 100 – 150bps. The range reflected uncertainty at the time .

The E&Y survey itself emphasises the difficulty in calculating costs and notes that depositaries may have erred on the side of caution. This is quite likely as the incentive on depositaries was to provide the most pessimistic forecast. Moreover, the upper end of costs is likely to only apply to the most exotic and risky AIF strategies and to those managers deemed risky by depositaries.

By contrast, aggregated current fees negotiated by a large fund manager (with therefore strong purchasing power) we spoke to ranged from 0.18 – 1.00 bps for custody services in developed jurisdictions and additional 1.75 – 2.00 bps (in the UK and Ireland) for the provision of safekeeping and general oversight functions. Examples of their current custody costs in more exotic locations ranged from 25 – 50 bps though they stressed these represented only a small part of portfolios, even for frontier market funds. They noted that many of their euro-denominated securities would be cleared through Euroclear and they wouldn't expect the custody element of depositary costs for these to change at all.

For this data and wider informal feedback from fund managers, in this interim impact assessment, we will therefore assume an average increase in costs towards the lower end of the E&Y estimates – i.e. between 5-20 bps.

Given the considerable uncertainty over depositary fees, it would be misleading to attempt to quantify the variation in costs for sub-threshold AIFMs, although anecdotally they are less commercially attractive to depositaries and so may well have costs proportionate to assets under management that are slightly higher than for larger AIFMs. We have assumed costs for sub-threshold AIFMs are midway between the high and low estimates for above threshold AIFMs.

We do not have sufficient data to estimate the one-off cost of appointing a depositary and / or negotiating new terms. This is likely to be significant for internally managed investment companies and private equity / venture capital AIFMs which are appointing a depositary for the first time.

Depositary Requirement / Regime (& assumption)	**Above-threshold AIFMs Ongoing cost (bp)**	**Sub-threshold AIFMs Ongoing cost (bp)**
Depositary cost NURS, QIS, ext Invest Companies (x1)	5-20 (5 – 10 for Private Equity & Venture Capital)	12.5 (7.5 for Private Equity & Venture Capital)
Int Invest Companies	10-40	25

Option 2

Option 2 would involve removing depositary requirements for sub-threshold NURS and QIS AIFMs, together with sub-threshold UCIS AIFMs (excluding private equity, venture capital and most property funds) are already required to appoint depositaries for the purpose of oversight and custody. No new depositary requirements would be placed on other types of sub-threshold AIFM.

Estimates of costs are as Option 1 but with costs for all sub-threshold AIFMs being zero.

Option 3

Maintenance of a regime as close as possible to the status quo would not require internally managed investment companies and Private Equity UCIS AIFMs to have a depositary. NURS and QIS AIFMs, together with non-Private Equity UCIS AIFMs would maintain their existing depositary regimes with fewer requirements than AIFMD and lower liability on depositaries.

However, the Government took into account that this would lead to a two-tier system of investor protection in NURS and QIS, which retail investors (in the case of NURS) would be unlikely to comprehend.

Estimates of costs are therefore as for option 1 but with costs for sub-threshold UCIS and internally managed investment companies being zero.

SUMMARY

Aggregated estimated depositary costs for each regulatory regime are therefore:

Regulatory Regime	Size	Option 1 Ongoing cost (£m)	Option 2 Ongoing cost (£m)	Option 3 Ongoing cost (£m)
NURS	Above	45-181	45-181	45-181
	Sub	3	0	3
QIS	Above	2-8	2-8	2-8
	Sub	0.1	0	0.1
UCIS	Above	192-681	192-681	192-681
	Sub	56	0	0
Int Invest Companies	Above	13-53	13-53	13-53
	Sub	3	0	0

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This document can be found in full on our website: http://www.hm-treasury.gov.uk

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