

Financial Services and Markets

Countdown to AIFMD – Treasury consultation

On 11 January 2013, HM Treasury published the first of two consultation papers setting out its proposals as to how the Alternative Investment Fund Managers Directive ("**AIFMD**" or "**the Directive**") will be transposed into UK law on 22 July 2013. The document, which attaches the draft implementing instrument, The Alternative Investment Fund Managers Regulations 2013 ("**the UK Regulations**"), was originally expected towards the end of last year. Due to its late publication, the Treasury consultation is only open for a relatively short period – it closes in less than 6 weeks, on **27 February 2013**. A copy of the paper is available [here](#).

Terminology

The manager of an alternative investment fund which does not meet size criteria specified in the Directive is excluded from the Directive, unless it expressly opts-in. These funds are referred to in the consultation paper as "sub-threshold AIF", and the UK Regulations refer to the manager of a sub-threshold AIF as a "small AIFM". The UK authorised manager of an AIF within the scope of the Directive is referred to as a "full-scope UK AIFM". We use these terms in this note to have the same meaning. Unless expressly stated otherwise we use the term "AIF" to refer to an AIF that is of a size to be within the scope of the Directive. This note refers to the Financial Conduct Authority ("FCA") as this will replace the Financial Services Authority before the UK Regulations come into force.

Key Implications

Some of the key issues addressed in the Treasury consultation and the UK Regulations are set out below. Important points for firms to note are that:

- new categories of regulated activity will be created. This will be particularly relevant to full-scope UK AIFMs, AIFM depositaries and some small AIFMs. The changes will impact on the UK permissions regime and so the regulatory permissions of all these firms will change; the mechanism by which this will happen is not clear. All relevant firms should consider their current regulatory profile and the impact that the new categories will have and consider whether the changes may have additional consequences which they may need to address;
- firms which are managing AIFs immediately before 22 July 2013 will have until 22 July 2014 to become fully compliant. Their existing permissions will apply and they will not be subject to the AIFMD provisions until the earlier of 22 July 2014 and the date they are authorised as full-scope UK AIFM. Despite this, we believe that UK AIFMs who are within the scope of the AIFMD may need to be authorised as full-scope UK AIFM before they can market their funds in the rest of the EEA, so the transitional relief may not be of practical use to all firms. Similarly AIFMs from other EEA States who are within the scope of the AIFMD do not appear to be able to market an AIF in the UK until they have been authorised under the Directive in the relevant EEA State;
- marketing, both in the UK and in the rest of the EEA, will become much more visible to regulators and subject to formal requirements. Full-scope UK AIFMs will have to seek approval from the FCA before marketing a UK or EEA AIF in the United Kingdom. Third country AIFMs must apply for approval to market a particular fund in the UK, and these will be recorded on a register maintained by the FCA. Both UK and non-UK firms (and their associates) will need to take these requirements into account.

The following pages provide more detail on these and other issues for those who are interested.

Amendments to the UK regulated activities regime

The UK Regulations will amend the Financial Services and Markets Act (Regulated Activities) Order 2001.

Under current UK law, fund operators must be authorised to carry on the activity of establishing, operating and winding up a collective investment scheme. There are also separate activities of acting as a sole director or as depositary of an open-ended investment company (“OEIC”) and of acting as a trustee of an authorised unit trust.

The UK Regulations will divide the activity of establishing, operating or winding up a collective investment scheme into a number of new separate activities as follows:

- managing a UCITS (collective portfolio management of a UCITS, together with any other ancillary activities in connection with or for the purposes of the management of that UCITS);
- acting as the trustee or depositary of a UCITS;
- managing an AIF (performing risk management or portfolio management);
- acting as trustee or depositary of an AIF;
- establishing, operating or winding up a collective investment scheme that is not an AIF or a UCITS. This will include operating sub-threshold AIFs where the manager has not opted into the Directive, and other arrangements which fall within the UK concept of a collective investment scheme but which are not alternative investment funds within the meaning of the Directive.

Some points to note in relation to the new activities are as follows:

- if the AIFM carries on the other ancillary activities as listed in the Directive (such as administration, marketing and activities related to the assets of the AIF etc), these activities, together with any other activities carried on “in connection with or for the purposes of the management of the AIF” will be included within the regulated activity of “managing an AIF”. This is helpful in defining and delineating clearly the scope of activities covered by a full-scope UK AIFM’s passport, but brings a wide range of activities which are currently unregulated more directly into the regulatory scope;
- firms that are authorised to carry on the new regulated activities of managing an AIF or a UCITS will not need to hold a permission to establish and operate a collective investment scheme in relation to the AIF or UCITS they have been authorised to manage. If the firm also operates other collective investment schemes which are not AIF, it is not clear whether they will need to establish a separate entity to do this, given the restrictions on the activities which a full-scope UK AIFM may carry on;
- firms that are authorised to act as the trustee or depositary of a UCITS and/or the depositary of an AIF will not need permission for the activity of safeguarding and administering investments unless they also carry on such activities for persons other than UCITS or AIFs;
- the activity of managing an AIF is defined as performing risk management or portfolio management for an AIF. While this is consistent with the wording in the Directive and therefore represents technically correct “copy out”, it does mean that a person would carry on the specified activity where he performed *either* risk management or portfolio management in the UK. We expect this provision to be subject to comment; for example, taken literally if an AIFM delegates portfolio management or risk management to a delegate in the UK, the delegate would appear to be carrying on the specified activity of “managing an AIF”. This is an unhelpful ambiguity created by poor drafting of the Directive.

Transitional provisions

The UK Regulations contain the following transitional provisions:

- **AIFMs:** UK firms managing AIFs immediately before 22 July 2013 will be permitted to continued managing AIFs for up to one year before submitting an application to the FCA for permission to manage an AIF. Applications must be submitted by 22 July 2014 by which time the firm must be compliant, even if not yet authorised as a full-scope AIFM. Until 22 July 2014 or, if earlier, the date on which its application for authorisation has been determined by the FCA, its existing regulatory permissions will continue to apply and it will not need to comply with: the UK Regulations, the Commission Delegated Regulation and any other directly applicable EU regulations made under the Directive or any relevant FCA rules made under the Directive. Importantly, the marketing provisions in the UK Regulations will not apply during that period to such a UK AIFM. The same one year transitional period applies to registration under the small AIFM regime (see below).
- **Depositaries:** a credit institution authorised under the Banking Consolidation Directive and established in the UK (this will include EU banks with UK branches) will be able to act as the depositary of EEA AIFs until 22 July 2017 without requiring

specific authorisation as an AIF depository, provided it complies with the implementing requirements in relation to liability. No other transitional relief is available in respect of AIF depositories.

- *UCITS managers, trustees and depositories*: as outlined above, the consultation paper proposes to split out the activities in relation to UCITS into new, “stand alone” activities. There are grandfathering provisions so that existing UCITS managers, trustees of authorised unit trusts and depositories of open-ended investment companies that are UCITS will be deemed to have the relevant new permission, provided they had the appropriate permission under the existing regime immediately before 22 July 2013.
- *Other transitional provisions*: other provisions which implement transitional measures in the Directive are included, i.e. those relating to:
 - AIFs with current Prospectus Directive offers;
 - AIFM of closed-ended AIFs that make no additional investments after 22 July 2013;
 - AIFM of closed-ended AIFs whose subscription period has closed before 22 July 2013 and which expire before 22 July 2016.

Sub-threshold AIFs – the small AIFM regime

The Directive allows flexibility as to the rules to be applied to small AIFM.

Whilst the definitions in the UK Regulations are confusing, there will essentially be two categories of small UK AIFM:

- **“small authorised UK AIFMs”** – these managers will not have exercised the right to “opt-in” to the full requirements of the Directive. They will have permission under Part IVA FSMA to manage AIFs. The rules that will apply to such AIFMs will differentiate between:
 - Managers of “unauthorised AIFs”: this will cover external managers of collective investment schemes to whom, broadly speaking, the existing FSA operator requirements, as carried forward into the rules of the FCA, will apply. The schemes that they manage will be subject to the applicable UK restrictions on marketing unregulated collective investment schemes. The Treasury’s second consultation will consider requirements in relation to externally managed investment companies and EIS;
 - Managers of “authorised AIFs” – i.e. Non-UCITS Retail Schemes (NURS) and Qualified Investor Schemes (QIS). They will be made subject to the full requirements of the Directive, with the important exception of provisions relating to letter-box entities, remuneration and transparency (although they will remain subject to the existing requirements as regards investor disclosure that apply to managers of authorised funds). Marketing will be subject to FCA approval;
- **“small registered UK AIFMs”** - which will be those sub-threshold AIFs constituted as closed-ended bodies corporate which are internally-managed, such as self-managed UK investment trusts or VCTs. A registration regime (with some minimal disclosure obligations) will apply to them (alongside existing requirements under UK company law and the Prospectus and Transparency Directives).

The provisions of the Commission Delegated Regulation will be relevant for determining assets under management (and the calculation of leverage) in order to determine whether a UK AIFM is (and can remain) a small authorised UK AIFM. There is no express statement that alternative investment funds in run-off or with a limited life should be excluded when calculating assets under management but we understand that the Commission view is that they should be left out of account, with which we agree.

Marketing of AIFs and the financial promotion regime

The most complex provisions in the UK Regulations are those which relate to marketing. The provisions are complicated by the fact that (a) the UK will be retaining both the UK concept of a “collective investment scheme” and the current UK financial promotion regime and (b) the Regulations contain the provisions relating to marketing to retail investors and marketing by small AIFMs.

In outline, marketing is addressed in the UK Regulations as follows:

- *Definition of “marketing”*: the definition is an incomplete copy-out of the definition in the Directive. It captures any “direct or indirect offering or placement of units or shares ” and does not include the concept of the marketing being at the initiative of or on behalf of the AIFM – some unwanted consequences might follow from this and it is not clear why the UK Regulations deviate from the Directive text.
- *Default prohibition*: The starting point is that any marketing of an AIF (including a sub-threshold AIF) to any investor domiciled or with a registered office in the UK is prohibited, subject to specific regulations which set out the basis upon which marketing is permitted.

- *Passive marketing/reverse solicitation:* Any person can market an AIF (including a sub-threshold AIF) to any investor (professional or retail) if the marketing is not at the initiative of that person (the Directive's "reverse solicitation" concept) provided that person does not breach the financial promotion regime.
- *Financial promotion regime exemption:* While the UK Regulations do not address this expressly, the Treasury confirms in its paper that the UK financial promotion regime will not apply to full-scope UK or EEA AIFMs when they are marketing the AIF which they manage to professional investors, provided that the AIFM is subject to the full requirements of the Directive and has complied with the applicable notification and approval.
- *National private placement:* The UK will have a national private placement regime. It will enable firms authorised under the Directive (full-scope UK AIFMs and other EEA AIFMs) to market non EEA AIFs which they manage (and certain feeder AIFs) to professional investors in the UK. It will also enable non-EEA AIFMs (that are not small AIFMs) to market AIFs which they manage to professional investors in the UK. The regime reflects the conditions required by the Directive. These include prior approval by the FCA and entry on a register maintained by the FCA and compliance with certain provisions of the Directive; for example, non-EEA AIFMs must also comply with the transparency and (if relevant) private equity disclosure provisions and full-scope UK AIFMs and other EEA AIFMs must comply with certain depositary requirements.
- *Sub-threshold:* Marketing by small AIFMs will be subject to a lighter touch regime – broadly, sub-threshold authorised/registered UK, EEA and non-EEA AIFM will be able to market all sub-threshold AIFs (except a NURS or a QIS) provided this is in accordance with the UK financial promotion regime. However, small third country AIFMs also need FCA approval and to be entered on the FCA register.
- *Marketing of a NURS or QIS:* Marketing of NURS or QIS will be subject to FCA approval.
- *Marketing to retail investors:* If an AIFM (whether UK, EEA or third country) is permitted to market to professional investors in accordance with the UK Regulations, then it can also market to certain types of retail investor provided that it does so in accordance with the UK financial promotion regime.
- *Transitioned UK AIFMs:* a UK AIFM which manages an AIF or a sub-threshold AIF immediately prior to 22 July 2013 will not be subject to the marketing provisions in the UK Regulations until the earlier of 22 July 2014 and the date on which it is notified that its application for permission or registration has been determined. Until that date it will be subject to the existing UK marketing laws when marketing the fund in the UK. It appears that this applies to both funds managed as at 22 July 2013 and new funds. This will assist some UK firms in terms of their marketing in the UK, but does not address any marketing in other EEA States which will depend upon how national authorities interpret the Directive. It also does not address the question of how EEA AIFMs which have not been authorised by 22 July 2013 will be able to market into the UK after that date.

Other issues covered in the Regulations

The UK Regulations also contain implementing provisions in relation to:

- the Directive's requirements as regards acquisition of substantial stakes in EU companies in Article 26 to 30 under the heading of "Private equity". These include provisions on "asset stripping";
- operating conditions as regards, for instance, the appointment of external valuers, delegation of portfolio management or risk management and depositary liability;
- duties on the FCA.

Issues to be covered in the Treasury's second consultation

The Treasury will be publishing a second consultation paper shortly which will cover a number of additional issues. These include: the impact of the European Venture Capital Funds Regulation and the European Social Entrepreneurship Funds Regulation; whether the FCA should be given additional disciplinary powers in relation to small registered UK AIFMs; marketing of EEA retail funds, third country retail funds and retail funds authorised in designated countries or territories and the application of the approved persons regime to internally managed investment companies.

Our other recent briefing notes on the countdown to AIFMD

[The countdown to AIFMD implementation: FSA consultation](#)

[Countdown to AIFMD – Level 2 Regulation](#)

[Countdown to AIFMD – two ESMA papers on scope](#)

For detailed advice in relation to the consultation paper or any aspect of AIFMD, please contact any of the financial services partners named below.

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