

## *Financial Services and Markets*

### *Countdown to AIFMD – Second FSA consultation*

On 19 March 2013, the FSA published the second of its consultations on the new Financial Conduct Authority ("FCA") rules implementing the Alternative Investment Fund Managers Directive ("AIFMD"). The second consultation paper should be read with the first paper which was published last November (see our briefing [here](#)). Contrary to the FSA's original intention, this will not be the regulator's last word on implementation of the AIFMD. Other issues will need to be dealt with between now and July, so further communications from the FSA and the Treasury can be expected over the next few weeks.

The consultation is open until **10 May 2013**. A copy of the paper can be accessed [here](#).

Some key issues addressed in the second consultation paper include:

#### **Cross-border passporting**

*Applications for authorisation/variation of permission before 22 July 2013 – complete the survey by 28 March!*

The FSA recently invited prospective UK AIFM to complete a survey eliciting information about the activities those firms intend to conduct after 22 July 2013. It appears that some firms may not have received this. **If your firm needs to be authorised under the AIFMD on or shortly after 22 July 2013 (for example, because it plans to be marketing in Europe in the summer), it is vital that this survey is completed and returned by 28 March. Failure to do so may seriously prejudice the ability to obtain early authorisation and hence passporting rights. The survey is accessible [here](#).**

The FSA had previously indicated that it would not be in a position to accept applications for authorisation under the Directive (or variation of permission where relevant) before 22 July 2013 and that, even then, such applications might take up to three months to process. In the consultation paper, the FSA confirms that it is now working towards being able to receive applications for authorisation or variation of permission before 22 July 2013 from those firms that need to be able to exercise passport rights (both managing and marketing passports) in order to carry on their existing business without disruption. Unfortunately, the FSA falls short of promising that it will be in a position to do so. Nevertheless, completion of the survey is necessary if firms are to have a chance of early authorisation.

#### *New guidance on marketing and management passports*

The consultation paper contains guidance on the AIFMD marketing passport and a notification form by which authorised AIFM will be able to give notice of their intention to passport.

Significantly, the forms allow for the passporting of discretionary segregated portfolio management and other "non-core" MiFID-style services for which an AIFM may obtain a "top-up" permission. As we have previously reported, there remains some disagreement between EU authorities as to whether the Directive permits such "top-up" activities to be passported. In particular, the European Commission is indicating that a passport for such activities is not available.

#### *Transitional*

The FSA confirms that it proposes to permit UK firms to make full use of the 12 month transitional period. This will enable UK firms to continue to manage funds and market them in the UK and non-EEA countries during the period 22 July 2013 to 21 July 2014. However, UK firms which need to market their funds in Europe will need to be authorised under AIFMD in order to obtain the marketing passport for marketing in the EEA, so this will not assist all firms. The FSA's proposed interpretation of "marketing" (see below under "Marketing") means that some preliminary marketing can be done without authorisation, assuming that other Member States have the same approach. Unfortunately, there is still no clarity on whether all Member States will take the same view as the FSA.

### Proposed perimeter guidance on AIFMD concepts

The FSA proposes guidance on the definition of an Alternative Investment Fund, (incorporating draft guidance from ESMA but going further in some respects). In this context:

- the FSA gives examples of arrangements that are "not likely" to be considered AIFs, such as pension schemes and pension common investment funds;
- it states that carried interest vehicles are "generally" not AIFs on the basis that the employee participation scheme exclusion will apply (they also may be excluded on the grounds that participants making nominal capital contributions are not "investors" from whom capital is being raised in any meaningful sense). The FSA does not discuss the critical related uncertainty about whether (or how) an AIFM will be permitted to continue to act as the operator of a carried interest vehicle or other collective investment scheme which is not an AIF. Its draft rules simply copy out the Directive's restrictions on the other activities of an AIFM. Submissions have already been made to both HM Treasury and the FSA on this point and we await feedback;
- the FSA appears inclined to the conclusion that co-investment vehicles should not be treated as AIFs. However, the guidance is unclear as to whether a co-investment vehicle becomes an AIF if the manager makes anything more than a nominal capital contribution to it;
- the FSA adopts a neutral position in relation to UK REITs – there is no presumption as to whether or not these are AIF. The basic principles must be applied on a case-by-case basis. In our view, REITs listed under Chapter 6 of the UK Listing Rules are very unlikely to be AIF, but those listed under Chapter 15 (the special regime for closed-ended funds) may be AIF;
- joint ventures are "not normally" caught – there is detailed guidance as to what might constitute a joint venture;
- generally, an SPV or acquisition vehicle owned by an AIF should not be treated as a separate AIF in its own right. It does not generally "raise capital" but is a vehicle for deploying the capital. Where third parties invest in the SPV (such as members of a private equity portfolio company management team), the FSA suggests that this might be excluded on the basis it is a joint venture;
- investment compartments of an AIF (such as sub-funds in an umbrella fund or protected cell company) should not be treated as separate AIF for the purposes of the general prohibition in section 19 FSMA;
- exchange traded funds (and implicitly, but not expressly, other exchange traded products) are likely to be AIF (unless they are UCITS); and
- there is helpful guidance on the extent of the holding company exclusion under AIFMD, including confirmation that it is capable of extending to limited liability partnerships.

### Delegation and the "letterbox" test

As we reported in our November briefing, the FSA's first consultation paper provided some useful statements as to how the regulator will assess the "letterbox" test. In the second paper, the FSA supplements its original statements with some helpful comments, for example:

- the FCA will undertake a "proportionate supervisory assessment" that will be "more qualitative than quantitative" – it will not make automatic assumptions based on a level of delegation over quantitative thresholds;
- senior management and the governing body must exercise effective oversight and control over risk and portfolio management and must supervise any delegate actively on an ongoing basis – this applies even where the delegation is intra-group;
- supervision must be active rather than passive, and must be continuous;
- the FCA will have regard to the objective reasons and commercial imperatives for delegation and it will have reference to specific, "real-world operating models"; and
- for as long as firms are relying on the twelve month transitional period from 22 July 2013, the FSA will not review or supervise existing delegation arrangements – whether against the Directive's delegation requirements generally, or the letterbox provisions specifically. This approach will cease as and when the firm applies for authorisation or variation of permission to become an AIFM.

It should be stressed that these FSA comments, within a consultation paper, do not constitute guidance and nor are there any plans to publish any such guidance (although firms may seek individual guidance). The statements should therefore be treated with a degree of caution – but they do suggest that the FCA will supervise delegation and the application of the letterbox test on a constructive and pragmatic basis.

### **Regulatory capital**

Small authorised UK AIFMs of NURS and QIS will be subject to the same prudential regime as will apply to full-scope UK AIFMs.

No changes will be made to the prudential regime for small authorised UK AIFMs of unauthorised AIFs. This means that sub-threshold AIFMs currently subject to a £5,000 or £50,000 capital requirement will continue to be subject to the existing requirement.

### **Marketing**

#### *New PERG Guidance*

The consultation paper includes new draft guidance on marketing under the AIFMD. The draft text includes useful guidance on:

- the meaning of offering and placement in the AIFMD – in the FSA's view, a person offers or places when he makes a unit or share of an AIF "available for purchase by a potential investor" and while an offering includes situations where units or shares are made available to the general public, a placement includes situations where units or shares are only made available to certain investors;
- the FSA's view is that marketing has a specific meaning for AIFMD purposes. It considers that communications in relation to early drafts of documentation are not within the meaning of an offer or placement and, as there is no unit in an AIF made available for purchase, the AIFM cannot apply for (and does not need) permission to market the AIF at that stage. The result of this approach is that these earlier communications are subject to national law, which dilutes the usefulness of the marketing passport. The UK will permit such communications to professional (and some other) investors without formality, but this may not be the approach in other Member States. It is, to say the least, unfortunate that there is no agreed view across Member States as to the meaning of "marketing".
- the meaning of an indirect offering or placement – in the FSA's view, the concept of indirect offering or placement should be interpreted broadly to include distribution of units or shares through a chain of intermediaries (the example is given of the purchase of shares or units by an underwriter or placement agent);
- passive marketing – unsurprisingly, the FSA construes this concept narrowly. In its view, only communications which are solicited by the investor should be considered to have occurred at the initiative of the investor. Documentation available on a website is not considered to be sent at the initiative of the investors, but communications in response to an approach from a potential investor with prior knowledge of the AIF and with no previous involvement with the AIFM could be at the initiative of the investor;
- the interaction between AIFMD marketing and the UK financial promotions regime – this includes the observation that it may be possible, although unusual, for a person to market an AIF without making a financial promotion; and
- the guidance is less helpful in relation to the territorial basis of marketing. The FSA seems to believe that marketing to an investor domiciled or with a registered office in the UK is "marketing in the UK" even if the marketing takes place outside the UK. In respect of non-EU AIFMs of non-EU AIF, this appears to be inconsistent with Article 2(1)(c) which says that the Directive applies to them if they "market one or more AIFs in the Union".

### **Other matters addressed in the consultation paper**

Other matters addressed in the consultation paper include:

- the application of SYSC and COBS to AIFM;
- changes to the client assets sourcebook (CASS) which will be particularly relevant to AIF depositaries;
- the types of AIFM and depositary that will be within the scope of the Financial Ombudsman Service (FOS) and/or the Financial Services Compensation Scheme (FSCS); and
- fees and how authorised AIFMs and AIF depositaries will be charged.

For detailed advice in relation to the matters raised by the consultation paper or on any aspect of AIFMD and its implementation, please contact any of the financial services partners named below.

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