TRAVERS SMITH

Talking. Secondaries.

Demystifying the secondaries market

Part 10: Is a continuation vehicle an AIF?

Continuation vehicles are typically structured as limited partnerships, with the investors (both rolling and new) constituting limited partners in the vehicle and the GP acting as manager of the vehicle. From a regulatory perspective, this continuation vehicle will typically fall within one of two regulatory categories: an alternative investment fund ("AIF") or a non-AIF collective investment scheme ("CIS").

The AIF vs. non-AIF CIS distinction can have significant implications in terms of market access, lead times, cost, compliance burden and, in some cases, compliance uplift. The regulatory analysis applying to the continuation vehicle can therefore often be a critical early step in any CV process. This deck summarises the key concepts and some of their associated implications.

What is an AIF/Alternative Investment Fund?

EU law derived concept. Broadly:

- A collective investment undertaking
- Which raises capital from a number of investors
- With a view to investing it in accordance with a defined investment policy
- For the benefit of those investors
- Which is not a UCITS

Do the concepts overlap?

Yes, very often. A vehicle can be both an AIF and a CIS. In this case, the rules applying to AIFs will typically apply to the vehicle.

What is a CIS/Collective Investment Scheme?

UK-law derived concept. Broadly:

- Any arrangements with respect to property of any description
- The purpose or effect of which is to enable persons taking part in the arrangements to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income
- Is not excluded from being a CIS under legislation

Do the concepts always overlap?

No. Because of the subtly different definitions (and exemptions), you can have non-AIF CIS (and vice versa). In the case of non-AIF CIS, the rules for CIS apply.

For continuation vehicles, what factors are important in determining whether the vehicle is an AIF?

Determining the classification of the continuation vehicle as an AIF or a non-AIF CIS is a case-by-case assessment. Certain factors may be indicative:

- **Pre-defined asset.** Where parties come together to acquire a single, pre-identified asset (in contrast to a blind-pool fund where the manager takes the investment decision) = Points towards non-AIF CIS
- **Focus of discussions.** Where the discussions are focussed on the underlying deal/investment, with the vehicle merely constituting the means by which the parties regulate their arrangements and deploy their capital = Points towards non-AIF CIS
- **Stage of vehicle formation.** Where the parties have reached an in-principle decision to invest in the underlying target and formal heads of terms are exchanged before the co-investment vehicle is structured, negotiated or established = Points towards non-AIF CIS
- **Fees/carried interest.** If the vehicle is established on a no fee/no carry basis = Points towards non-AIF CIS
- **Follow on capital.** The presence of a pool of follow-on capital = Points towards an AIF
- **Labelling/badging.** Where the vehicle is described/labelled as a 'fund' in discussions with prospective participants and in documentation = Points towards an AIF
- **Number of investors.** The greater the number of limited partners = Points towards an AIF
- **Other considerations.** There are other ways to conclude a vehicle is not an AIF on a particular fact pattern (e.g. certain single investor vehicles etc.)

Why does this matter?

Significant implications for a secondary transaction

Benefits of non-AIF CIS

Timing. Registering with relevant regulators to manage/market an AIF comes with material lead times that need to be built into the process. Setting up a non-AIF CIS is significantly quicker and requires fewer filings.

Cost. There are additional costs associated with AIFMD compliance for an AIF, not least the cost of appointing a depositary.

Portfolio company provisions. AIFs are subject to the portfolio company provisions (including the anti-asset stripping rules) contained within AIFMD. A non-AIF CIS is not subject to this regime.

Market access. Non-EU AIFs can only be marketed in Europe under national private placement regimes, where such regimes exist. Practically speaking, certain key investor jurisdictions (e.g. France, Spain, Italy) do not have them. There is no equivalent pan-EU regime limiting the offering of non-AIF CIS in the EU (except, arguably, the Prospectus Regulation) – although domestic laws may have an impact. The Prospectus Regulation can usually be navigated relatively easily. Local counsel guidance on the domestic definition of AIF may be required, in case local glosses affect the general conclusion that the vehicle is not an AIF.

Benefits of AIFs

Feasibility/licensing. Not all managers will have the license to manage a non-AIF CIS (where this is not done in connection with their management of AIFs). If required, varying license permissions can take time and be costly.

Compliance uplift. Where a manager is not accustomed to managing a non-AIF CIS, there is a (potentially significant) compliance uplift in complying with the FCA's custody rules in CASS, as well as other conduct of business rules that apply to a non-AIF CIS. These requirements may be new to a GP that has not previously managed a standalone non-AIF CIS.

Familiarity. Investors tend to be familiar with AIFs. Some investors are less familiar with a non-AIF CIS, and so may require further explanation.

Market Access: Marketing an AIF in the EU is subject to a well worn and predictable regime where it is possible (e.g. Germany, Nordics, Low Countries etc.). There may also be arguments that rolling investors make reverse enquiries.

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Travers Smith has extensive experience in complex private markets transactions, with a focus on liquidity solutions across the private markets capital structure with exposure across all asset classes.

70+

We advise over 70 GPs across our firm.

£92bn

In transaction value during the last c.five years.

$4tn+

Assets managed by our clients in the private capital sector.

150+

Specialists focused on private equity, infrastructure, financial sponsor and M&A transactions. 30 of these dedicated specialists are partners in the business.

$5bn+

In 2022 we advised on the deployment of $5.1bn+ in commitments across more than 100 primary, co-investment and fund-of-one transactions.

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M&A transactions acted on since 2016.

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Partner

Elena Rowlands
Partner

Aaron Stocks
Partner

James Barnard
Senior Counsel

Sarah Stewart
Senior Counsel