

UK Regulators Propose Implementing Rules and Regulations on AIFMD

March 28, 2013

FSA Second Consultation

On 19 March 2013, the UK Financial Services Authority (FSA) published Part II (CP2) of its three-part consultation series on Implementation of the Alternative Investment Fund Managers Directive (AIFMD). The consultation period closes on 10 May 2013.

CP2 proposes draft rules and guidance covering a broad range of topics, including:

- scope – the FSA's views on schemes not likely to qualify as alternative investment funds (AIFs);
- delegation – the extent to which an alternative investment fund manager (AIFM) may delegate its risk and portfolio management responsibilities;
- reporting frequency (with reporting content to be addressed in future draft rules);
- application of AIFMD rules to small (sub-threshold) AIFMs;
- marketing – when sales activities require regulatory permission; and
- implementation during the one-year AIFMD transition period.

The rules proposed in CP2 would apply to UK-based AIFMs, and the draft marketing and implementation rules also would apply to any AIFM seeking to market an AIF in the UK.

This alert aims to highlight particular areas of importance or interest to private investment fund managers presented in CP2.

Scope

In CP2, the FSA sets out its views regarding schemes that are likely *not* to be AIFs. These include, among others:

- carried interest vehicles;
- co-investment vehicles;
- acquisition vehicles or SPVs set up to facilitate transactions carried out by the AIFMs;
- timeshare schemes; and
- pension schemes.

The specific exclusion of carried interest vehicles and co-investment vehicles is particularly good news for AIFMs currently examining their investment structures, potentially leading to less complicated regulatory requirements and supervisory obligations.

The FSA also provides some practical factors to take into account when deciding whether a commercial venture is excluded from the definition of an AIF as a "joint venture". An AIF is more likely to fall under the joint venture exception when (i) the parties come together before the structure of the venture is determined and the capital raised; (ii) the venture relates to a business the parties are already carrying on at the time it is set up; (iii) the parties have an existing relationship; and (iv) the venture has a policy focused on the achievement of the parties' commercial goals as opposed to a defined investment policy.

Further, the FSA has proposed draft guidance in relation to English limited partnerships, providing answers to some of the outstanding questions in relation to the treatment of such partnerships under the AIFMD. According to the FSA, an AIF that is structured as an English limited partnership cannot be an internally managed AIF. However, it is possible for such an AIF to appoint its general partner as the *external* AIFM. The FSA did not, however, address the issue of migrated partnerships.

Delegation

Under the AIFMD, an AIFM cannot delegate the core functions of risk management and portfolio management to the extent that the AIFM becomes a "letterbox entity".

This assessment of whether a proposed delegation arrangement is permissible will be done on a qualitative, case-by-case basis. In other words, the Financial Conduct Authority (FCA), which will become the successor to the FSA as of 1 April 2013,[\[1\]](#) will not presume automatically that a UK-authorized AIFM is a "letterbox entity" merely because a percentage threshold has been reached on the investment management tasks proposed to be delegated. Instead, the FCA will look at a range of factors and examine, in each individual case, (i) an AIFM's compliance with the AIFMD's risk management requirements and the efficacy of its governance by the firm's governing body; (ii) control by the firm's senior management or supervisory function; and (iii) the objective and commercial imperatives for the delegation, with reference to specific, real-world operating models.

Currently, the FSA does not plan for the FCA to issue any guidance on how it will assess compliance with the AIFMD's delegation requirements, including the "letterbox entity" test. Firms may, however, make individual requests for guidance to the FCA.

During the AIFMD transitional period from 22 July 2013 to 21 July 2014, the FCA proposes that it will not make supervisory assessments of a firm's delegation arrangements until the firm applies for authorisation or a variation of permission to become an AIFM. However, for firms that do not benefit from the transitional period, the FCA will review their delegation arrangements as part of their application for authorisation as an AIFM.

Reporting to the FCA

The FSA proposes that "sub-threshold AIFMs" (AIFMs with less than €500 million under management that do not use leverage and have at least five-year investor lock-ups) should report to the FCA annually. Other AIFMs will report to the FCA quarterly. For all AIFM reporting requirements, end dates should correspond with the relevant quarterly end dates (for annual reporting, 31 December).

According to the FSA, the European Securities and Markets Authority (ESMA) is expected to publish in the near future a consultation paper regarding draft guidelines on AIFMD reporting obligations. The consultation paper is likely to cover:

- guidance on the specific data to be reported in accordance with the templates in Annex IV of the Level 2 Regulation;
- reporting periods and how these might align with the calendar year;
- reporting for specific types of AIF, such as feeder AIFs and umbrella AIFs; and
- IT and operational aspects.

Reporting is expected to commence in January 2014 for AIFMs that have been authorised by that point.

Conduct of business for sub-threshold AIFMs

The full AIFMD requirements and Level 2 regulations do not apply to sub-threshold AIFMs. For current operators of unregulated collective investment schemes (CISs) that will be in the category of sub-threshold AIFMs after implementation of the AIFMD (termed "small authorised UK AIFMs of unauthorised AIFs"), the current FSA Conduct of Business Sourcebook (COBS) rules will continue to apply as they do now.

The FSA does not intend to change the regulatory capital regime for small authorised UK AIFMs of unauthorised AIFs or to the operators of unregulated CISs that also are not managing an AIF. This means that current regulatory capital requirements (for example, the £5000 "own funds" regulatory capital requirement applicable to venture capital CIS operators) will continue to apply to these types of firms.

Marketing

The AIFMD is unclear on the point at which communication with potential investors in an AIF becomes "marketing an AIF" to those potential investors. In the FSA's view, however, communicating with investors in relation to draft documentation is not "marketing an AIF" under the AIFMD. Rather, "marketing an AIF" occurs when a person makes a unit or share of an AIF available for purchase by a potential investor. An AIFM is not able to seek permission to market an AIF without documentation finalised in all material respects, and only after receiving permission to market the AIF can the AIFM make units or shares of the AIF available for purchase by an investor.

In practical terms, this means that communications and negotiations with investors in relation to draft documents will fall outside the scope of the AIFMD. According to the FSA, the AIFMD's requirements regarding marketing are triggered only at the point when virtually finalised documents are available. Further, an AIFM is prohibited from accepting an investment by an investor on the basis of draft documents (because the AIFM cannot receive permission to market the AIF on the basis of draft documentation). Although communications regarding draft documentation fall outside the scope of the AIFMD's requirements, the UK financial promotions regime will continue to apply to communications which do not amount to "marketing an AIF", including, in all likelihood, communications regarding draft documents. As a result, AIFMs will need to take care to approach only those categories of sophisticated investors to whom marketing is permitted under the UK financial promotions regime.

The FSA also sets out its views on reverse solicitation and passive marketing, which fall outside the scope of marketing under the AIFMD. Only communications which are solicited by the investor should be considered to have occurred at the initiative of the investor. For example, communications which are sent to investors as part of an organised marketing campaign or documentation which is available on a publically accessible website should not be considered as having been sent at the initiative of the investor. However, communications in response to an approach from a potential investor with prior knowledge of the AIF and no previous involvement with the AIFM could be seen as having been at the initiative of the investor.

Additionally, the FSA proposes Chapter 10.5 of the new Investment Funds Sourcebook (FUND), setting out the required notifications and other processes applicable to marketing under the UK's private placement regime. The precise detail and documents to be included in the notifications, as well as instructions on how to submit them, will be set out by the FSA or FCA before 22 July 2013.

Implementation and Transition

The FSA proposes to permit UK AIFMs managing and/or marketing AIFs in the UK to make full use of the 12-month transitional period to 21 July 2014. All firms within the scope of the AIFMD must comply fully with its requirements by that date, whether or not their application to the FCA for the relevant category of permission has been determined by then. This applies regardless of the jurisdiction of the AIF concerned.

Additional Information

For further details on the context of this FSA consultation series and an overview of AIFMD implementing measures from UK and European regulators, please see our [alert on Part I of the consultation series \(CP1\)](#).

HM Treasury Second Consultation

On 13 March 2013, HM Treasury published its second consultation on Transposition of the AIFMD alongside additional draft regulations. The consultation is brief and closes on 5 April 2013.

This consultation covers the following topics:

- charity and church-run investment funds – charity funds are expected to fall within the AIFMD scope while church-run funds are not, as they do not raise external capital and are not run as businesses;
- marketing of authorised and recognised schemes (such as NURS, QIS and recognised overseas schemes) to retail investors;
- legislative changes providing for the application of the "Approved Persons" regime to external AIFMs (including sub-threshold AIFMs), and the disapplication of the "Approved Persons" regime to internally managed investment companies; and
- extent of the application of the UK Financial Services Compensation Scheme to non-UK AIFMs within the European Economic Area.

Additionally, the consultation clarifies that AIFMs marketing AIFs into the UK under the UK's private placement regime have a continuing obligation to comply with AIFMD's transparency requirements.

Timing and Next Steps

The second HM Treasury consultation period closes on 5 April 2013. The consultation and instructions on how to respond are available on [HM Treasury's website](#). The FSA's CP2 consultation period closes on 10 May 2013. CP2 and instructions on how to respond are available on the [FSA's website](#).

Part III of the FSA's consultation series is due to be published by the FCA in May 2013, and the FSA expects that the FCA will publish a final policy statement in relation to the consultation series in June 2013. However, the FSA intends to confirm some of its final policy positions before June 2013 to give affected firms as much time as possible to continue their AIFMD preparation. The FSA expects these earlier statements to cover whether it will receive potential AIFM authorisation applications and variations of permission before 22 July 2013, taking into consideration the responses received in relation to its AIFMD survey. They also may include the FSA's final decisions in relation to the prudential rules for AIFMs and the requirements for AIF depositaries.

In the interim, firms expecting to be affected by the AIFMD should continue to prepare to be "AIFMD-ready", especially those firms intending to manage AIFs for the first time after 22 July 2013.

[\[1\]](#) CP2 is taking place in the context of significant reform of UK financial regulation due in the first part of 2013, when the FSA will be split into, and succeeded by, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). Under the new regime, the FCA will be both the conduct and prudential regulator for AIFMs.

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