28 February 2013

AIFMD Transposition
Financial Regulation and Markets
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

By email: aifmd@hmtreasury.gsi.gov.uk

Dear Sirs,

Re: BVCA Regulatory Committee response to the Treasury Consultation Paper on the Transposition of the Alternative Investment Fund Managers Directive

This response to the Treasury Consultation Paper on the Transposition of the Alternative Investment Fund Managers Directive (the "**Consultation Paper**") is made by the Regulatory Committee of the British Private Equity and Venture Capital Association (the "**BVCA**"). The BVCA is the industry body and public policy advocate for the private equity and venture capital industry in the UK. The BVCA Membership comprises over 250 private equity, midmarket and venture capital firms with an accumulated total of approximately £32 billion funds under management; as well as over 250 professional advisory firms, including legal, accounting, regulatory and tax advisers, corporate financiers, due diligence professionals, environmental advisers, transaction services providers, and placement agents.

Given that a number of our comments and concerns are not linked to particular questions posed by the Consultation Paper ("**Consultation Questions**"), but are instead of a more general nature, we have structured our response such that it comprises: (i) a series of general comments and concerns; (ii) answers to the Consultation Questions; and (iii) comments on the Draft Regulations.

We appreciate the very difficult task facing the Treasury, and the FSA, as regards the implementation of the Alternative Investment Fund Managers Directive (the "**Directive**") and welcome the opportunity to respond to the Consultation Paper. We stand ready to provide whatever further contribution to this work the Treasury would find helpful. In particular, we would be delighted to attend a meeting with the Treasury to discuss both the issues raised in our response and a number of other issues which, although outside the scope of the Consultation Paper (and therefore not covered in our response), are of concern to the BVCA's members. In particular, we have a number of concerns about leverage.

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Yours faithfully,

Margaret Chamberlain
Chair - BVCA Regulatory Committee

TREASURY CONSULTATION PAPER – TRANSPOSITION OF THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE

PART A: GENERAL COMMENTS AND CONCERNS

Gold-plating of the Directive's requirements

1. The Directive will impose significant burdens and costs on those firms which are within its scope, and will almost certainly increase costs for investors in affected funds. We do not, therefore, support any gold-plating of the Directive's requirements. If there is to be any gold-plating, it must be supported by strong justification and backed by proper evidence and detailed cost benefit analysis. We believe that the Treasury has, in a number of places, gold-plated the Directive's requirements, although it is not always clear if this is intentional. We set out in the relevant parts of our response those instances of gold-plating about which we are particularly concerned.

Applications for authorisation from prospective UK AIFMs and depositaries

2. As already discussed orally and in writing with the Treasury we are deeply concerned by the proposal regarding the time at which the FCA intends to accept applications for authorisation from prospective UK AIFMs. The marketing regime applicable to EU AIFMs which are marketing EU AIFs in the EU after 22 July 2013 is predicated upon authorisation. It is, therefore, vital that the FCA is in a position to accept and approve applications for authorisation from prospective UK AIFMs prior to 22 July 2013 such that those firms are authorised, and have the benefit of the marketing passport, with effect from 22 July 2013. Unless an earlier application date is set, it appears that it will not be possible for UK firms, including PE/VC firms, to market their funds in the EU for a potentially lengthy period of time this year.

3. This has the potential to cause damage to the competitiveness of the UK asset management industry, significant harm to the wider real economy and is of great concern to the BVCA's members. Many of the BVCA's members will be marketing in the EU as at 22 July 2013 and many more will want to commence marketing over the summer. Marketing is the means by which PE/VC firms (and others) raise the funds necessary to make significant contributions to the real economy and deliver returns to investors. Marketing is, for many PE/VC firms, a fundamental and continuously ongoing part of their activities – it is not something which can be "switched off" whilst they await authorisation.

4. We are particularly concerned about the competitiveness of the UK asset management industry given that, as far as we are aware, AIFMs from other EU Member States will not suffer a similar fate and will be able to market their funds throughout the EU, including in

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the UK, immediately after 22 July 2013. We understand that, for example, Ireland and Luxembourg intend to accept applications for authorisation from the end of March, so that their firms obtain authorisation on, or in advance of, 22 July 2013. The UK has the largest number of firms affected by the Directive, and is unusual in that these firms are already regulated, whereas many other Member States have not authorised alternative investment managers before. This means that the FSA already has (and the FCA will have) a considerable amount of information about these firms and they are already subject to many rules that are similar to those under the Directive. It is essential that the UK authorities develop a process pursuant to which firms are able to apply to the FCA for authorisation prior to 22 July 2013 and be granted authorisation (and the benefit of the marketing passport) with effect from that date. The date of effectiveness of the Directive has been known for a long time and the BVCA's members are very surprised that the UK is not planning to put them in a position where they can be authorised under it from the date on which it takes effect.

5. We believe that, given the constraints of both time and resources, it may be necessary for the FCA to offer a "short-form" authorisation procedure (which requires the prospective AIFM to provide information and various confirmations). Even on a new authorisation, the process incorporates confirmations that certain compliance procedures exist and in this case the issue concerns existing firms who have already been subject to many similar rules under the existing UK regime. We see no reason why an appropriate procedure cannot be developed in time for firms to be authorised with effect from 22 July 2013. Without doing so, not only will other EU firms be in a better position than UK firms as at 22 July 2013 but so too will third country (non-EU) firms as they will be able to market under existing private placement regimes (where such marketing is permitted by individual Member States). The FSA and the Treasury must take urgent steps to bridge this “marketing gap” if the UK asset management industry, and wider real economy, is not to suffer. We would be delighted to work with the Treasury, and the FSA, on developing an appropriate solution given the short timetable ahead.

6. Finally, given that there are no general transitional provisions relating to depositaries, it is imperative that the FCA is also able to accept and approve applications for authorisation from prospective depositaries prior to 22 July 2013, and that it publishes its full requirements as soon as possible. An AIFM is under an obligation to ensure that, for each AIF it manages, a single depositary is appointed. The authorisation procedure for depositaries must, therefore, sit alongside the authorisation procedure we describe above. In addition, many of the BVCA's members are having difficulties in finding an entity willing, or with appropriate expertise in servicing the private equity sector, to be a depositary where firms pursue PE/VC strategies and so are likely to need to use the services of one of the alternative types of depositary. We believe that there are a few firms hoping to provide this service, but they need certainty as to what will be required of them in order to finalise their proposition or indeed finalise their intention to provide a

depositary service to private equity firms. Such certainty is required as a matter of urgency.

<u>Scope of Article 6 of the Directive *(Conditions for taking up activities as AIFM)*</u>

7. We are concerned that there is even at this late stage no clarification in respect of Article 6 of the Directive. Article 6 of the Directive contains limitations on the activities which may be undertaken by an AIFM. We are not, however, clear as to: (i) how these limitations are to be implemented in the UK; or (ii) how they are to be interpreted. The industry needs to understand, as a matter of some urgency, how the UK authorities view the limitations set out in the Directive particularly as, depending on how the Treasury and the FSA interpret these limitations, firms may need to apply for new entities to be authorised to carry out activities which are currently carried out by the entity which will be an AIFM.

8. In particular, it would be helpful to understand whether the limitations set out in Article 6 of the Directive should be interpreted as restrictions on only the MiFID activities that an AIFM may perform, which we think is a likely interpretation given the fact that the limitation stems from a directive, or whether these limitations are to be interpreted more widely so that if a Member State, under its domestic law, regulates an activity, an AIFM may not also perform that activity unless it is part of collective portfolio management as defined in Annex 1 of the Directive. This issue is particularly acute in relation to the operation of an unregulated collective investment scheme (a "**UCIS**") (an entirely UK concept). A key issue for PE/VC firms is whether the limitations will prohibit an AIFM from managing a co-investment scheme (where such co-investment scheme is a collective investment scheme ("**CIS**") but not an AIF). We would expect the majority of UK AIFMs to need authorisation for both managing AIFs and operating UCIS. If two authorised firms are required this would be very serious and disruptive.

9. We do not, however, see this as a necessary result. We suggest that either: (i) the Directive's restrictions are interpreted as we suggest; and/or (ii) as such co-investment schemes are clearly related to the management of the AIF, they fall within Annex 1 to the Directive. Any authorisation could be subject to limitations to make this clear. As other Member States do not currently regulate the activity of "operating unregulated schemes", the issue will not arise elsewhere and we expect their firms will naturally continue to manage co-investment schemes without the issue arising as it does in the UK. We therefore strongly believe that any approach which requires a separate authorised firm would put UK firms at a disadvantage to their counterparts in other Member States. It was open to the UK authorities, when implementing the Directive, to remove the existing UK regulatory regime for UCIS and replace it with the Directive regime. Instead of taking this approach, the UK has decided to retain the current regime and apply the Directive regime as an additional layer of Regulation. It is only because of this policy that this issue

arises in such a form. We therefore think it is vital that the Treasury (and the FSA) urgently clarifies its approach to this very important issue.

10. There are a range of other open questions in relation to the impact of Article 6, including:

- Can an AIFM assist with the promotion of a fund managed by an affiliate if it does so by carrying on the receipt and transmission activity?

- Portfolio managers, at least on a UK interpretation, "execute" orders. We believe that in other parts of Europe execution is understood as inherent in the authorisation for fund management, whereas in the UK, because the permissions regime follows the Regulated Activities Order, the activities are split out on a permission. Since an AIFM may also carry on discretionary portfolio management we assume that any execution activity inherent in its discretionary portfolio management is permitted, otherwise the ability to carry on such management will be impossible. This is particularly so for private equity/venture capital, where there is no execution intermediary.

PART B: RESPONSES TO CONSULTATION QUESTIONS

Q.1 Do you agree with the proposed approach? What would the impact of this approach be on competitiveness and investor protection?

11. We do not agree that the approach to sub-threshold AIFMs which manage authorised funds is proportionate insofar as it imposes the Directive's onerous depositary requirements on such AIFMs. The Treasury is clearly gold-plating the Directive's requirements and we do not believe that this approach is appropriate, at least not until these provisions apply to UCITS. The fact is that the Directive does create different levels of investor protection depending on the status of the AIFM. We therefore consider that the Treasury should review its approach to the depositary requirements for sub-threshold AIFMs. Requiring a sub-threshold AIFM to appoint a depositary will increase costs for such an AIFM, create a non-level playing field for such AIFMs across the EU (given that it is unlikely that all Member States will gold-plate the Directive's requirements) and thereby undermine the competitiveness of the UK's asset management sector.

Q.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?

12. Other than as described in our answer to Consultation Question 1, we have no further comments.

Q.3 What would be the impact of applying the full requirements of the Directive to AIFMs of sub-threshold authorised AIFs?

13. We have no particular comments save to note that this would clearly increase costs for affected AIFMs and would be a form of gold-plating.

Q.5 Do you agree with the proposed approach?

14. We agree that only a registration regime should be applied to internally managed investment companies. It is also important that the registration application does not in practice become akin to an authorisation application. As the Treasury notes at paragraph 2.14 of the Consultation Paper, such companies are already subject to the general requirements of company law and other rules and Regulations. We consider that the existing legislative framework provides for a very high standard of investor protection and we are not aware of any investor protection issues that have arisen which are not covered by this existing framework. As such, we do not consider that the Treasury's proposed approach could lead to any detriment to investor protection and agree that applying the Directive's requirements to such AIFMs would impose a significant cost burden without any commensurate benefits.

Q.7 Do you believe that the proposed approach could lead to any detriment to investor protection?

15. As noted in our answer to Consultation Question 5 above, we do not believe that the proposed approach could lead to any detriment to investor protection.

Q.11 Under what circumstances should we expect transposition to result in significant restructuring of external AIFM to become internally managed with an internal AIFM?

16. This is as likely to happen in reverse. The key practical issue either way relates to the need for a clear understanding as to the 'tipping' point at which an investment company will be said to be internally managed, given that the board of any company has to have some supervisory monitoring and control functions.

Q.12 Do you agree with the proposed approach?

17. We agree with the Treasury's proposed approach as regards sub-threshold AIFMs which manage UCIS.

Q.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?

18. Please see our answer to Question 25, we believe there is scope for more flexibility in relation to certain types of UCIS, particularly 'professional investor" UCIS.

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

19. No, in particular we see no reason for imposing any requirements in addition to those which currently exist.

Q.19 Do you agree with the proposed approach?

20. We agree with the Treasury's proposed approach as regards the application of the so-called "private equity provisions" to sub-threshold AIFMs. In particular, sub-threshold private equity AIFMs are likely to be making investments in smaller companies and we can see no reason to increase the burdens and costs associated with making such investments.

Q.23 Do you agree with the proposed approach?

21. We support the Treasury's proposal to exercise the derogation set out in Article 21(3) of the Directive. We believe that some fund administrators may be interested in acting as depositaries for 'private equity' AIFMs and we agree with the Treasury that exercising the derogation will help support a competitive depositary market for private equity AIFMs. Fund administrators already provide a very large element of the services which are comprised in the depositary function and, given the difficulties being experienced by our members in finding a willing depositary in the traditional custody sector, it is essential that the Treasury and the FCA actively encourage the establishment of these other providers.

Q.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)?

22. As noted in our answer to Consultation Question 23, we believe that some fund administrators may be interested in providing this service.

Q.25 Do you agree with the proposed approach?

23. We are concerned about the Treasury's proposed approach given that, by maintaining current UK concepts (such as CIS) and adding the concept of "AIF", the resulting legislation is hugely complex. We note the Treasury's statement at paragraph 5.4 of the Consultation Paper (i.e. that the Directive needs to be transposed in an extremely short

space of time and it is not realistic to carry out the work needed to overcome the difficulties in the time available) but the definition of "AIF" has been fixed for a long time and, although we appreciate that the publication of the Level 2 implementing measures was significantly delayed, this should not have prevented the Treasury from considering many of the relevant issues and developing a less complex legislative framework. In particular, whilst we understand that there may be policy reasons for preserving the CIS concept so far as unsophisticated retail investors are concerned, we see no reason to do so for funds where the investors are professional (including for this purpose high net worth and sophisticated investors). We would encourage the Treasury to review this issue, with a view to ensuring a simpler approach by July 2014.

Q.26 Do you agree with the proposed approach?

24. We question whether activities which would otherwise be unregulated activities need to be treated as regulated activities as a matter of UK Regulation. They clearly need to be covered by the passport to implement AIFMD, but we do not see the need to go further. These additional activities are expressly not included in the Directive definition of "managing" and so do not need to be regulated activities, to make them so is a form of "gold-plating".

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

25. Broadly speaking, we welcome the Government's overall approach to transposing EU legislation on a "copy-out" basis in order to minimise the regulatory burden on UK firms. There are, however, a number of parts of the Directive in respect of which it may be more appropriate for the Treasury not to apply a strict copy-out approach but instead provide clarification for UK firms. In addition, as we note below, in important areas a "copy –out" approach has not been taken, e.g. in relation to the definition of "marketing", which then causes "gold –plating". In addition the specific regimes for sub-threshold AIF and registration for private placement are not required by the Directive.

Q.28 Do the draft Regulations adequately implement the Directive?

26. Whilst we consider that the Draft Regulations largely implement the Directive adequately (other than in respect of those issues detailed in our response), we believe that firms would benefit from clarification in respect of those areas where there is overlap between the Draft Regulations and the FCA rules (e.g. regarding delegated management).

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PART C: COMMENTS ON THE DRAFT REGULATIONS

Regulation 3 (Meaning of "AIF")

27. Regulation 3 defines "AIF" but neither it nor Schedule 7 addresses the other aspects mentioned in recital 8 of the Directive, notably securitisation special purpose vehicles, insurance contracts ,joint ventures and family offices. It would be helpful if the Treasury could explain how these aspects will be addressed.

Regulation 4 (Meaning of "AIFM", "external AIFM" and "internal AIFM")

28. We are concerned about the drafting of Regulation 4(1) which provides that an AIFM is a, "*... legal person that performs risk management <u>or</u> portfolio management for an AIF*" (emphasis added). We appreciate that the Directive's definition of "*managing AIFs*" is very poorly drafted. Article 4(1)(w) of the Directive provides that, "*managing AIFs means performing at least investment management functions referred to in point 1(a) <u>or</u> (b) of Annex 1..*" (emphasis added). Annex 1, in turn, provides, "*Investment management functions which an AIFM shall at least perform when managing an AIF: (a) portfolio management; (b) risk management*". Article 6(5) of the Directive, however, makes clear that an AIFM cannot be authorised to provide only one of the services of portfolio management or risk management.

29. The ambiguity in the Directive arises because of the use of the word "*or*" in the definition of "*managing AIFs*". This ambiguity is reflected in Regulation 4(1) where the words, "*performs risk management or portfolio management*" appear, which is in part copy-out (we note that this language also appears in the related amendments to the FSMA (Regulated Activities) Order 2001 (new article 51ZC (*Managing an AIF*)). We think that the Draft Regulations (and the new article 51ZC) need to reflect Article 6(5) and, in doing so, eliminate the ambiguity. This is particularly important as a literal approach to the current definition in the Draft Regulations produces the possibility of there being two AIFMs for a single AIF. This could arise in instances where an AIFM carries on the activity of portfolio management but delegates the activity of risk management to a separate entity. In such instances, given that, as currently drafted, Regulation 4(1) provides that an AIFM is the "*legal person that performs risk management or portfolio management*", there could be two entities deemed to be the AIFM. This is an issue for two reasons: (i) it is not permitted by the Directive (Article 5 of the Directive provides that, "*Member States shall ensure that each AIF managed within the scope of this Directive shall have a single AIFM...*"); and (ii) the FCA will be able to refuse permission to manage an AIF if the AIFM would not be the only AIFM of each AIF it manages (Regulation 5(2)(b)). This is an area where we think the Treasury should avoid taking a literal approach to copy-out and instead provide clarification for firms.

30. In addition the definition of an AIFM under Regulation 4(1) should incorporate the Directive "regular business" concept.

Regulation 11

31. We understand that where a manager manages funds some of which are of the kind referred to in Article 61(3) and (4), then these funds are not included in the threshold calculation as to funds under management for the purposes of the Directive. This is a key issue for smaller firms for whom it could make a significant difference and clarity on the face of the Regulations or alternatively some form of guidance would be helpful.

Regulation 16

32. This needs to incorporate the temporary breach concession.

Regulations 21 (Application of FCA rules to small authorised UK AIFMs managing an authorised AIFs) and 22 (Application of FCA rules to small authorised UK AIFMs managing unauthorised AIFs)

33. We would be interested to understand why the derogations for small AIFMs in Regulations 21 and 22 appear to expire on 22 July 2015. As a very minor point, we also note that "an" should be deleted from the heading of Regulation 21.

Regulation 29

Regulation 29(2) should reflect or refer to the concept of loss in Article 100 of the Level 2 Regulation

Regulation 37 (Ways of acquiring control or shares)

34. We believe Regulation 37(2) goes further than the Directive requires. Article 26(1) of the Directive clearly requires "control" to be assessed on a joint/concert party basis, as reflected in Regulation 37(1). However, our understanding is that Article 27(1) of the Directive, which requires notifications to be made when an AIF acquires, disposes of or holds shares in a non-listed company, is intended to apply on a single entity basis. For this reason, Article 27(2) imposes a separate notification when control is acquired on a joint/concert party basis. However, Regulation 37(2), in conjunction with Regulation 40, would appear to require these notifications to be made on a joint/concert party basis, rather than on a single entity basis. We believe this is gold-plating that would result in an increased administrative burden for AIFM.

35. The word "of" appears to be missing in Regulation 37(2)(a).

Regulation 38 (Meaning of "control")

36. We believe the concepts described in Regulations 38(2) and 38(3) are equally relevant to determining the proportion of voting rights held by an AIF for the purposes of Regulation 40(1). Should both provisions therefore apply for the purposes of "this Part" as a whole?

Regulation 40 (Notification of the acquisition or disposal of major holdings and control of non-listed companies)

37. There are two apparent cross-referencing errors - should paragraph (3) reference "paragraph (2)" and paragraph (4) reference "paragraph (3)"?

Regulation 41 (Disclosure in case of acquisition of control)

38. Both the Regulations and the Directive use the terms "non-listed company" and "issuer" distinctly. For consistency and clarity, we suggest it would be helpful to refer to "the company or issuer" throughout Regulation 41 (although we note and accept that the Directive is worded in the same way as the draft Regulations). From a practical perspective, it would also be helpful to copy out the Directive definitions of "non-listed company" and "issuer" in Regulation 2.

39. In addition, we believe the obligation pro-actively to "provide" the prescribed information to the persons listed in Regulation 41(1) is more onerous than the corresponding obligation in Article 28 of the Directive to "make the information available" to those persons, which we consider could reasonably be interpreted as an obligation to provide that information on request and/or to make the information available through a medium such as a website where those persons can access the information if they wish to. We understand that the words "make ... available" were specifically used in the Directive (in preference to the word "provide", or equivalent used in one of the earlier drafts) in response to concerns raised that some investors may prefer not to receive certain information. For example, some investors are subject to laws and Regulations which make it hard for them to preserve the confidentiality that is required for some reports, and the ability to make information available through a website or similar (rather than sending a copy to the investor) is viewed by many AIFM as a valuable tool for ensuring that confidentiality is preserved.

40. If the obligation to "provide" the information is retained, it would be helpful to specify the timeframe within which the disclosure must be made. We would suggest 20 working days.

Regulation 42

41. As for Regulation 41, we believe it would be helpful to specify the timeframe within which the disclosure must be made. We would suggest 20 working days.

Regulation 43 (Sensitive information)

42. There is an apparent cross-referencing error - should the reference be to Regulation 40(4), not Regulation 40(5)?

Regulation 45 (Asset stripping)

43. For clarity, we believe it would be helpful if Regulation 45(2) were to state explicitly that "A distribution to shareholders falls within paragraph (1) if and only if". Likewise for Regulation 45(3).

44. For the purposes of Article 30 of the Directive, we believe that share redemptions should be viewed as a form of acquisition of own shares, and should therefore be prohibited or permitted in the same circumstances as acquisitions of own shares (i.e. a share redemption should be prohibited if and only if it reduces the company's net assets below the amount referenced in Regulation 45(2)(a)). However, as share redemptions are not specifically referenced in Regulation 45(3), Regulation 45(1) appears to operate as a blanket prohibition on all share redemptions. We do not believe this was the intention of Article 30, and it seems perverse that a company would be permitted to buy back redeemable shares but not to redeem those same shares.

45. We find the inclusion (and re-ordering) of the words "to the extent that acquisitions of own shares are permitted" in Regulation 45(3) confusing. We understand this wording in Article 30 itself to mean "to the extent that acquisitions of own shares are otherwise permitted under applicable law in the relevant Member State", and hence not to require transposition. We are not clear what meaning these words carry in Regulation 45(3) as drafted, especially given that Regulation 45(1) prima facie prohibits all acquisitions of own shares, and query whether they should be deleted (or clarified).

46. In addition to the above we also raised in discussion a number of general issues about the practical application of some of the asset stripping provisions of the Directive, and whilst these may not be appropriate for clarification in the Regulations we may write separately to ensure that there is a common understanding as to how they apply to some common situations.

Regulation 47 (Meaning of "markets an AIF" and "able to promote an AIF")

47. We are extremely concerned about the way in which the Treasury has transposed the Directive's definition of "marketing". The Directive's definition (Article 4(1)(x) of the Directive) is, "*a direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the Union*" (emphasis added). It is extremely concerning that the words "*at the initiative of the AIFM or on behalf of the AIFM*" do not appear in Regulation 47(1). We are concerned that the absence of this language could create issues in the secondary markets as, in effect, Regulation 47(1) (as currently drafted) could prohibit secondary marketing of existing fund interests (and, potentially, secondary trading in shares of listed funds) by any person, including the current holder or investor, unless marketing is permitted by Regulations 49 to 53.

48. Furthermore, unless the fund is a UCIS managed by a small AIFM (whereby the Draft Regulations permit interests to be marketed by anyone, subject to the existing financial promotion regime), Regulation 53 appears to impose restrictions which go beyond the Directive. It is in any event difficult to construe. On one reading it would appear to permit an existing investor to offer its fund interest to a UK investor only if the fund was originally distributed in the UK under an AIFMD approval. We doubt this is intended. A critical issue relates to the secondary market in limited partnership interests, a market which is an investor based market, not a manager one. Article 6 (8) of the Directive (on which we assume Regulation 53 is based) has to be seen in the context of the Directive as a whole and we consider relates to the position where MiFID firms are distributors for an AIFM, not when they are involved in secondary transactions for investors. In any event Regulation 53 goes beyond Article 6 (8) which relates specifically to marketing by MiFID firms as Regulation 53 applies to all 'persons' and so is a much wider prohibition. The policy behind Regulation 53 needs further thought as in its present form it is confusing and gold-plates the Directive.

49. We also note that the current definition is inconsistent with the definition of "marketing" in the draft FCA rules. This is important because whether or not a non-EU fund managed by a UK AIFM requires a depositary turns on whether the fund has been "marketed" in the UK (see proposed FUND 3.1.1G).

Regulation 48 (Prohibition on marketing)

50. It needs to be clarified whether, during the one year transitional period permitted by Article 61 of the Directive, an EEA (non-UK) AIFM which has not been authorised for the purposes of the Directive would be permitted to continue to market into the UK on a private placement basis. Regulation 48 seems to imply that this is not permitted. We believe some other Member States will be allowing non-authorised EEA AIFMs to market

during the transitional year. It is important that there is common agreement amongst Member States as to the position.

Regulation 51 (Marketing with consent from FCA or other competent authority)

51. We believe that marketing in accordance with Regulation 51(a) needs to be expressly carved out of section 238 of FSMA, or added to the FSMA (Promotion of Collective Investment Schemes) (Exemptions) Order 2001, in order to prevent the financial promotion regime from applying to harmonised AIFMs (which we do not think the Directive permits). We cannot see any necessary carve-out in the Draft Regulations.

52. We are also concerned that, as currently drafted, Regulations 51(b) and 56(1)(a) and (b) are not effective for an AIF managed by a UK AIFM that will be distributed to retail investors only (i.e. without also being distributed to professional investors). Regulation 56 applies only if the AIFM is "*seeking to market to professional investors*". We consider that the word "*professional*" should be deleted from Regulations 56(1)(a) and (b).

Regulation 56 (4)

We believe that a six month period for marketing approval is excessive and should be no more than three months, which itself is a long period in the context of marketing activity. Marketing approval should not involve anything like a full authorisation for which six months is also the maximum.

Regulations 58 -67

53. These provisions are unnecessarily onerous and give the impression that the UK is not open for business with the wider world. One of the UK's strengths in the financial services context has been that it has not closed its borders to third country firms doing business on a professional basis. They represent a fundamental change to the current private placement rules and put the UK on a footing with other Member States who have traditionally been much more bureaucratic and restrictive in this area. We suggest that the most that is required is a notification to the FCA.

Regulations 70 (Closed-ended AIFs that make no additional investments) and 71 (Closed-ended AIFs whose subscription period has closed)

54. The Treasury has, perhaps inadvertently, gold-plated the transitional provisions of Articles 61(3) and (4) of the Directive. Article 61(3) of the Directive provides that AIFMs *in so far as they manage* AIFs of the closed-ended type before 22 July 2013 and which make no additional investments after 22 July 2013, may continue to manage such AIFs without authorisation under the Directive. Article 61(4) of the Directive sets out a similar

exemption in respect of AIFMs *in so far as they manage* AIFs of the closed-ended type whose subscription period has closed prior to the entry into force of the Directive and are constituted for a period which expires at the latest three years after 22 July 2013.

55. We have two key concerns about the Treasury's approach to transposition of Articles 61(3) and (4) of the Directive. Firstly, Regulations 70 and 71 do not use the critical words "*in so far as they manage*" but instead use the word "*all*". We think that the intention of the Directive is to provide that, if an AIFM has some funds which meet the conditions of these Articles, then it does not need an authorisation to cover the management of those funds and need only comply with the specified parts of the Directive. It may, however, manage other funds for which authorisation as an AIFM, and full compliance with the Directive, is required. Many PE/VC firms manage funds nearing the end of their life and which it will be both expensive and unnecessary to bring within the scope of the Directive, particularly as we do not consider that the Directive requires this. This is not only a drafting issue – it will have significant cost implications for UK firms.

56. Secondly, we fail to understand why the transitional exemptions in Regulations 70 and 71 are mutually exclusive (that is, as currently drafted, each exemption is available only if all AIFs managed by an AIFM are closed-ended and of a type specified in either Regulation 70 <u>or</u> 71). This means, in practice, that an AIFM managing a combination of the two types of closed-ended AIF (and an AIFM managing some AIFs of that type but also some which do not qualify for the transitional provisions in either Regulation) cannot rely on the transitional provisions. We do not consider this to be the correct approach and have the same concerns about this gold-plating as set out above.