

Asset Management & Funds Policy Team
Financial Conduct Authority
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By email: cp26-28@fca.org.uk

22 October 2026

Dear Asset Management & Funds Policy Team,

RE: UK Financial Conduct Authority Consultation Paper CP26/28: The UK AIFM Regime

UK Private Capital is the association of the UK private capital industry. We represent 600 firms including the wider ecosystem of professional advisers and investors. Private capital consists of private equity, venture capital and private credit, which make long-term investments to grow British businesses and build a better economy. Our members invested £25bn into the UK economy in 2025, with the industry now backing 13,000 UK businesses, 90% of which are SMEs. These companies together employ 2.5m people and contribute 7% to UK GDP. Private capital therefore plays an important role in supporting investment, employment and economic growth across the UK.

We welcome the opportunity to respond to this consultation outlining proposals to change the regulatory framework for alternative investment fund managers (AIFMs) in the UK. We believe that these proposals are a critical opportunity for the FCA to drive meaningful reform and enhance the UK's attractiveness as a leading international centre for private capital firms and investment.

The ambition to simplify the regime and enhance proportionality is commendable. The thresholds and detailed framework will ultimately determine whether those objectives are achieved. The key test across these reforms should be whether the overall result is simpler, more proportionate and more internationally competitive. In some key areas, the proposals currently fall short of this aim.

The major advantage of the EU AIFMD regime for private capital firms is the "passport". When AIFMD was introduced in 2013/2014, many international fund managers established full-scope AIFMs in the UK and used this passport to market their funds across the European Union. The passport was designed to be available only to AIFMs established and operating from within the EU. When the UK left the EU, the UK did not secure agreement to continue with its prior passporting rights. The UK remains one of the world's leading centres for private capital, but this change has created a specific competitive disadvantage. International firms seeking straightforward access to EU investors have had an incentive to establish or expand operations within the EU, meaning some new jobs, investment and expertise that might previously have been located in the UK are now being created elsewhere.

We recognise that the FCA does not have the ability to change that position: that can only be achieved by the UK government agreeing a new arrangement with the EU. However, it is important background for this review. Given that the major commercial benefit of this regime is not available to UK managers, the FCA needs to consider the impact of the new regime on the UK's competitiveness.

While several of the proposed changes are helpful, as set out in our responses to the specific questions in CP26/28 below, our overarching view is that the FCA's proposals do not go far enough to introduce

flexibility and reduce regulatory burdens. We welcome, for example, the more ambitious approach to simplification and proportionality reflected in the FCA's proposals on remuneration in CP26/27. We encourage the FCA to adopt a similarly ambitious approach to reforming the UK AIFM regime.

We believe the FCA could go further in taking this opportunity to evolve and improve the existing AIFM regime, derived from pre-Brexit EU rules, by removing unnecessary prescription and applying requirements more proportionately. We are also concerned that the FCA and HM Treasury appear to have different interpretations of the proposed changes to the definition of an AIF, potentially resulting in additional regulatory requirements, costs and uncertainty for firms (see point 1 below).

Many global private capital firms will continue to establish funds in the EU in order to utilise the passport and because they have built out post-Brexit infrastructure in the EU. Those firms might be incentivised to operate parallel fund manager entities in the UK if they can do so at little additional cost, in order to offer bespoke products to non-EU investors alongside their blind-pool product suite. Other firms will want to ensure that any UK offering can satisfy UK standards provided they meet EU requirements. We recognise some changes are being proposed to support this, but we believe the UK should go further.

While the FCA's current proposals do not specifically address the regulatory challenges faced by start-up and emerging venture capital firms, we welcome the FCA's announcement in April 2025 that it was considering bespoke regulatory arrangements for venture capital firms, in collaboration with HM Treasury. We look forward to further engagement on opportunities to develop a more proportionate framework that supports the establishment and growth of new firms.

A proportionate and predictable regulatory framework that avoids unnecessary costs and complexity and does not create friction with the position in the EU is important to the UK's ability to attract and retain private capital firms and the investment activity, expertise and professional services that support the wider economy.

Our main concerns and recommendations are:

1. **Definition of an AIF:** The FCA suggests that the proposed clarifications by HM Treasury to the definition of an AIF in The Alternative Investment Fund Managers Regulations 2026 (AIFM Regulations) will lead to more funds which are currently being treated as residual CIS being classified as AIFs. In contrast, HM Treasury refers to the same changes as being clarificatory in nature, putting some of what was previously FCA guidance onto a statutory footing. It is not clear why the FCA is of the view that the proposed changes mean that more funds which are currently being treated as residual CISs should therefore be classified as AIFs. We ask the FCA to explain this apparent inconsistency and clarify which arrangements it considers may need to be reclassified, bearing in mind the need for the UK to be a competitive place for international private capital firms to operate.

If the FCA believes that the proposed changes are substantive rather than clarificatory, we ask that firms are given adequate time to prepare for the challenges this could present (at least another 12-18 months from when the changes to the definition take effect). This will be necessary if a firm has to apply for a Variation of Permission with the FCA or otherwise change its operating model. It is also our view that grandfathering should be considered, where appropriate.

We note that the proposals will require some changes to the PERG Guidance on the Scope of the Alternative Investment Funds Regime (PERG 16), particularly in PERG 16.2 on the AIF perimeter. This is because HM Treasury is reworking the concept of "a defined investment policy" in the definition of an AIF, while PERG 16.2 includes guidance at Q2.13 on the meaning of a defined investment policy. We urge the FCA to consult on any changes to the PERG 16.2 guidance, given the importance of this to firms' assessment of the regulatory perimeter. The FCA should also make it clear in its final response that neither the AIF nor the CIS perimeter themselves are changing as a result of the proposals. See also our responses to Questions 3 and 37.

2. **Calculation and definition of leverage:** The FCA must also consider what policy position it intends to take on leverage, including whether the existing concepts in the AIFM Delegated Regulation which are heavily relied on by the private capital industry, such as Article 6(4) which allows certain covered borrowing arrangements to be excluded from the AIF's leverage calculation, should be incorporated into its new rules. We urge the FCA to preserve established interpretations of leverage and provide clarity on their application under the proposed regime, avoiding unintended consequences for the treatment of private capital structures and the introduction of friction with the position in the EU. See Questions 8, 10 and 11.
3. **De minimis leverage exemption:** We strongly support allowing AIFs to use a de minimis amount of leverage without becoming subject to the full risk management and liquidity risk management requirements. Applying these requirements to closed-ended AIFs with modest leverage would be disproportionate, and we urge the FCA to introduce an appropriately calibrated de minimis exemption. See Questions 10 and 13.
4. **Valuation independence:** While we support appropriate independence in the valuation process, the FCA should ensure that its proposed requirements do not unnecessarily restrict the involvement of portfolio management and investment professionals. Their knowledge of portfolio companies and underlying investments is essential to robust valuations, and their continued involvement should be permitted subject to arrangements to identify and manage conflicts of interest. See Question 7.
5. **Investor disclosures and reporting:** We note that the FCA's policy intention is to make investor disclosures more principles-based and less prescriptive where investors are professional investors. However, firms operating in both the UK and the EU may face additional costs from overlapping disclosure obligations. We therefore ask the FCA to recognise equivalent EU investor disclosures as satisfying the UK investor disclosure rules in ALTS 9 and 10, avoiding unnecessary duplication. See Questions 20 and 22.
6. **Preservation of existing guidance:** The FCA and HM Treasury should ensure that transferring existing concepts into AIFM Regulations or the FCA's Handbook does not inadvertently change their interpretation or application. The FCA should identify and consult on any substantive changes to existing guidance, as firms have relied on established interpretations for their structures and activities. See Questions 3 and 37.
7. **Medium AIFM threshold:** We welcome the FCA's proposal to set the threshold for medium UK AIFMs at a higher level than its original proposal in the 2025 Call for Input. Nevertheless, while

we accept that there is a balance to be struck between risk and the need to encourage growth, we continue to urge the FCA to increase this from £750 million NAV to £1 billion NAV. This would provide additional headroom for growing firms before they become subject to more extensive regulatory requirements. An increased threshold would better support smaller managers without imposing disproportionate additional regulatory burdens, provide a greater runway for growth, make the UK regime more competitive and, therefore, attract more investment in the UK economy. See Questions 1 and 2.

- 8. Implementation:** Where a change removes or simplifies existing requirements, this should be brought in as soon as possible to enable firms to take advantage of its benefits. If the FCA decides to remove the business restriction (which we strongly support) then this could take effect immediately. Similarly, where requirements in respect of the depositary are removed, firms should also be able to make the corresponding changes as soon as possible. See Questions 18 and 27.

We urge the FCA to take a more ambitious approach to reform that supports the Government's growth and productivity agenda, reduces unnecessary regulatory burdens, and strengthens the UK's position as an internationally competitive centre for private capital firms, funds and investment.

We set out our responses to the questions in CP26/28 below, including recommendations to address the issues identified above. We would be happy to discuss this response with you in more detail.

Firm size thresholds

Question 1: Do you agree with our proposed size calculation, i.e. the aggregate NAV of all CIS and non-CIS AIFs and non-AIF CIS, managed by the AIFM?

We agree that the use of NAV rather than AuM will be easier in practice for firms.

We note that NAV is defined as "*the value of the assets of a fund, after the deduction of the fund's liabilities*" and is to be calculated based on the valuation methodology in ALTS 6.2.2R. Although we support carrying out the calculations on a consistent and transparent basis, we have concerns that a valuation at "fair value" may not, in all cases, correspond to the methodology used by firms. We discuss these concerns further in our response to Question 7 below.

We also think that it is important to ensure that there is no double counting. This is vitally important especially in the light of the fact that the NAV of CISs will be included in the calculation. We therefore ask the FCA to clarify that, where an AIFM manages both an investing fund and an underlying fund or pooling vehicle, the same underlying assets should not be counted twice for the purposes of determining the AIFM's regulatory classification.

As an example, a single fund structure will relatively commonly include an AIF that invests all its assets through a non-AIF CIS pooling vehicle, which may also aggregate investments in carried interest or co-investment structures. Calculating NAV at the level of both the AIF and the non-AIF pooling vehicle would clearly result in double counting. This could, in some cases, lead to the relevant AIFM being classified inappropriately and becoming subject to a higher level of regulation than its activities warrant. We therefore ask the FCA to clarify that, where a fund holds an interest in another fund managed by the same AIFM, the AIFM is required to include the NAV attributable to the underlying fund holding only once in its calculations.

Question 2: Do our proposals for firms moving between thresholds, including SUP15 notifications and a delayed application of new rules, remove the cliff edge effects in the current regime?

We think that it is important that firms are able to grow without being subjected to abrupt and disproportionate increases in regulatory obligations. It is possible that a firm may exceed a NAV threshold for a short period as a result of temporary fluctuations in the value of underlying assets. An AIFM should not have to comply with a more onerous regime where any increase in NAV is only short term. Therefore, it would be better for a change of AIFM classification to be triggered only where the threshold for the AIFM's current classification (as calculated under ALTS 2.3.19R) has been exceeded for two consecutive quarters. The FCA should also clarify when reclassification takes effect following satisfaction of this test and how temporary movements below a threshold would be treated. It should also be clarified that, for these purposes, a firm will not be required to carry out this assessment more than once a quarter.

The delayed application of the new rules for six (or 12) months and the removal of the requirement to apply for a Variation of Permission when crossing a threshold will be helpful in mitigating the impact as a result of an AIFM moving between thresholds. However, we do not think that these will mitigate the cliff edge effects associated with an AIFM moving between the tiers entirely.

We therefore urge the FCA to adopt a sufficiently flexible transitional framework to avoid requiring firms to make significant operational changes in response to temporary changes in NAV.

In particular, for the appointment of a depositary, we think that a period of 12 months may be too short given the level of due diligence required and the need to test that the depositary is able to perform the role effectively. We therefore think that a period of 18 months before the depositary requirements apply would be more practicable.

Residual CIS operators

Question 3: Do you foresee any challenges and practical issues because of HM Treasury's clarification of the definition of an AIF, and the potential for some non-AIF CISs to be reclassified as AIFs?

We have found the commentary from HM Treasury and the FCA on this point to be inconsistent. HM Treasury states that the revised definition is simply a clarification, whereas the FCA appears to consider that it will have a more significant impact and result in firms reclassifying a number of residual CISs as AIFs. It is not clear why the FCA considers that some CISs will need to be recategorised as AIFs. If the proposed changes are intended to be clarificatory, the FCA should explain the circumstances in which existing arrangements may nevertheless need to be reclassified and whether this reflects a change in legal scope or in the FCA's interpretation of the existing perimeter. We also ask the FCA to explain which types of vehicles it anticipates will fall within the definition of an AIF as a result of the changes. This is particularly important because firms already expend significant resources, including legal fees, assessing whether an arrangement is an AIF, a CIS or something else; the changes should not make that assessment more complicated, and consideration should be given to the detrimental impact changes could have on the competitiveness of UK AIFMs, when compared to their peers operating in the EU. Any uncertainty over the regulatory status of existing arrangements could result in additional legal and compliance costs, including potentially the need for new permissions or changes to existing structures. Any changes should be clearly identified and subject to appropriate consultation.

We note the FCA's proposed carve-out of carried interest vehicles, joint venture vehicles, and single investor vehicles from ALTS 9 and 10 requirements that otherwise apply to residual CISs. We welcome the FCA's recognition that certain residual CISs have characteristics that warrant different regulatory treatment. However, we think that applying the rules in this way to a subset of residual CIS and not others which have similar characteristics or purposes unnecessarily creates an artificial distinction and leads to uncertainty. We would encourage the FCA to first consider gathering information about the variety of CISs in the regulatory perimeter, to identify other vehicles with similar characteristics for which these disclosure requirements may be unnecessary. We consider it likely that there are other types of CISs where these disclosure requirements are unnecessary.

In particular, we think that it is important that single asset vehicles are also included in this carve-out. As with the other vehicles listed in the carve-out, single asset vehicles do not generally have the typical characteristics of a pooled investment vehicle. We also note that paragraph 3.7 of CP 26/28 refers to *"arrangements to enable interests in a specific, pre-determined asset to be held efficiently by multiple persons"* as an example of the type of vehicle which should not be subject to all the rules applicable to a residual CIS and we think that a single asset vehicle would fit this description.

As regards co-investment vehicles, the FCA, in Q2.52 of PERG 16, takes the position that a typical co-investment vehicle would not be considered an AIF. However, given the uncertainty around what types of vehicles the FCA considers should be reclassified as AIFs, the fact that co-investment vehicles are not included as an example of a residual CIS in paragraph 3.7 of CP 26/28 and the uncertainty around the future status of PERG 16, the status of co-investment vehicles needs to be made clearer. We therefore ask the FCA to clarify formally that, in its view, it would not consider a co-investment vehicle to be an AIF under the revised definition. We also think that a co-investment vehicle should be included in the carve-out for residual CIS.

We also note that PERG 16 includes additional guidance on the definition of an AIF, some of which is heavily relied upon by the private capital industry. PERG 16 is important for the industry, and we ask that the FCA consults with the industry before making changes to PERG 16. Any changes to PERG 16, particularly if they result in a more restrictive or less helpful position, would add cost and complexity for fund managers and therefore it is important that any changes are made cautiously and do not disadvantage the UK's competitiveness.

We also ask the FCA to identify which existing interpretations it intends to preserve and to consult on any proposed changes to that guidance. Where existing arrangements could be brought into scope because of a change in regulatory interpretation, appropriate transitional or grandfathering provisions should be considered.

A few specific points that are important:

- HM Treasury's new definition of an AIF will require changes to PERG 16.2. For example, Question 2.13 in PERG 16.2 sets out what the FCA considers to be a defined investment policy. However, the concept of a defined investment policy is being reworked by HM Treasury in the definition of an AIF. Given the importance of this guidance to the industry, we urge the FCA to consult with the industry about changes to PERG 16.2 before making any changes.

- The FCA has proposed a new concept of a "carried interest vehicle" which includes a residual CIS which is available *exclusively* to employees or former employees of an AIFM in which its employees invest only a nominal amount of capital to share in the profits of the AIFM as compensation for the management and operation of the AIF. However, it is not clear whether the FCA guidance in Q2.34 of PERG 16.2, which provides that the term "employee" is not limited to the technical definition in UK law but, in the FCA's view, includes personnel who work in the business of the undertaking concerned, contributing their skills and time, including partners, directors and consultants, will continue to apply. Similarly, Q2.35 of PERG 16.2 provides that carried interest vehicles are generally not AIFs because the employee participation scheme exemption will often apply. We think that it is important for commercial and legal certainty that this guidance continues in force, and we ask that the FCA makes a clear link to the existing guidance in PERG 16.2.
- The FCA has also proposed, in ALTS 2.2.1R, a definition of "open-ended AIF" which is in similar but not identical terms to that in the UK version of Commission Delegated Regulation (EU) No 694/2014. It would be helpful for the FCA to confirm that no substantive changes are intended to the concept of open-ended AIF under the new regime, noting that differences versus the EU regime in this area could be particularly challenging given the recent implementation of EU AIFMD II.

Question 4: Do you think that the SYSC and COBS rules that currently serve as guidance should be applied as rules to residual CIS operators? Please explain why or why not. Are there any other rules that you think we should consider applying to residual CIS operators?

In the private capital industry, funds which fall within the scope of residual CIS tend to be established for a specific, bespoke purpose for a limited number of investors. We therefore do not think that, in many respects, a "one size fits all" regime would be appropriate. Instead, it would be preferable to continue to allow residual CIS operators to apply the rules in SYSC and COBS as guidance which would permit some limited flexibility within defined guardrails for those firms.

Question 5: Do you have any comments on our proposal to apply enhanced investor disclosure requirements to some categories of residual CIS?

We agree that the rules in ALTS 9 and 10 are not appropriate for all residual CIS and welcome the FCA's proposal to exempt certain types of residual CIS (e.g., carried interest vehicles, joint venture vehicles, single investor vehicles and excluded entities). However, we think it would be simpler and more proportionate, given the nature of residual CIS vehicles, for the FCA to exempt all types of residual CIS from the requirements in ALTS 9 and 10. If this is not possible then, as discussed in our response to Question 3, the FCA should identify other residual CIS for which the disclosure and reporting requirements are also inappropriate. This should include, as a minimum, single asset vehicles and co-investment vehicles.

Valuation

Question 6: Should AIFMs only appoint an independent valuer subject to certain conditions? If so, do you agree with the conditions that we have proposed?

We welcome the removal of the statutory strict liability of external valuers which has previously limited the number of firms willing to perform this role. We think that the proposed criteria applicable to appointed third-party valuers look broadly appropriate.

Question 7: Do the baseline rules we propose represent an appropriate standard to set for all AIFMs?

Under the proposed rules, large UK AIFMs must ensure that the valuation of AIF assets and liabilities is carried out independently from the portfolio management function. The FCA appears to consider that this requires more than mere separateness. It is currently unclear what would be sufficiently independent for these purposes, and we would welcome additional FCA guidance. However, an AIFM's portfolio managers are an integral part of the valuation process and should not be excluded from participating in that process. We ask the FCA to confirm that the proposed independence requirements do not preclude appropriate involvement in the valuation process by front-office and portfolio management professionals, whose knowledge of portfolio companies and underlying investments is important to robust valuations, provided that effective arrangements are in place to identify and manage conflicts of interest. The FCA should also ensure that it does not adopt a more restrictive position or impose requirements beyond those set out in the findings of its Private Markets Valuations Review.

We would also welcome clarification that there is no requirement or preference for AIFMs to make use of independent valuers.

We understand that the FCA's definition of fair value in ALTS 6.2 is intended to align with the IFRS accounting definition: the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. However, the proposed requirements could lead to differences between the FCA's valuation rules and IFRS. We would therefore welcome clarification on how the proposed fair value requirements are intended to interact with established valuation methodologies, including the treatment of liquidity and marketability considerations under applicable accounting standards and the IPEV Guidelines. The proposed fair value criteria would also be inconsistent with some valuation methodologies currently used by certain AIFs. For example, under IFRS 9, some debt funds may use amortised cost rather than fair value. The rules also do not make sufficiently clear that the ALTS 6.2 valuation requirements apply to the AIF's portfolio assets, rather than to every item that might appear in its accounts. Carried interest arrangements, for instance, are commonly reflected in fund accounts and valued on an accruals basis.

Therefore, in our view the better course would be to preserve the current position, under which AIF assets are valued "fairly and appropriately" in accordance either with applicable GAAP or with the methodology set out in fund documentation. We consider that this would provide an appropriate and proportionate framework, while recognising the accounting standards, investment strategies and valuation methodologies used across private capital funds. Accounting standards are technically complex and introducing a prescriptive FCA definition of fair value would require many AIFMs to revisit their existing valuation processes, potentially triggering a full revaluation of fund assets. It would also likely necessitate amendments to fund documentation, investor notifications, and in some cases formal investor consent. It may also introduce inconsistent valuation methodologies across a fund structure (for example, where the UK AIFM is managing one vehicle in the fund structure alongside other vehicles managed by an AIFM in the EU).

Another approach could be to introduce a limited set of high-level valuation principles applicable only to unauthorised AIFs that are open to retail investors. We do not consider that any such additional layer of prescription would be warranted for professional investor funds, whose investors are sophisticated enough to assess and negotiate valuation terms for themselves.

Should the FCA nonetheless decide to proceed with its fair value criteria, we would ask that it introduce adequate transitional and grandfathering arrangements. This is particularly important in the light of the investor-facing consequences outlined above, where the absence of appropriate transitional protection could give rise to real investor detriment. Any transitional arrangements should take account of the potential need to amend fund documentation, valuation policies and, where applicable, existing contractual arrangements with investors.

For private equity, it is important that the FCA's proposed valuation requirements remain compatible with the International Private Equity and Venture Capital Valuation (IPEV) Guidelines which are widely used by the industry.

Under ALTS 6.2.7R, the NAV per unit would need to be made available to an AIF's investors as often as it is calculated. We assume that this means when it is calculated in accordance with the terms of the AIF and not whenever an informal, internal calculation is carried out. We request that the FCA clarifies this.

Leverage calculations

Question 8: Should we remove the gross and/or commitment method calculations or would you prefer the regime to retain an adjusted version of the calculations?

We agree with the proposal to remove the mandatory requirement for firms to calculate leverage by reference to the gross and/or commitment method.

Question 9: Does a hedging exemption for closed-ended AIFs that use leverage only for hedging purposes work well to tailor our risk management and liquidity rules? If so, how should hedging be defined?

We support having a hedging exemption but do not think that it should be limited to leverage in derivatives used for currency and interest rate hedging purposes which meet specific criteria. Instead, given the various hedging structures which could legitimately be used, we think that there should be a more general, purposive definition, for example, any transaction concluded with the aim of offsetting a risk linked to another position in the portfolio.

Question 10: Should we allow AIFs to undertake a de minimis level of leverage (for investment purposes)? If so, how should the de minimis level be calculated? What is the appropriate threshold?

We support allowing AIFs to use a de minimis amount of leverage and not be considered leveraged. While the hedging exemption is useful, it will only be of limited benefit to most firms. A de minimis exemption could be used to distinguish modest use of leverage or gearing in a closed-ended vehicle from highly leveraged or open-ended structures and would avoid such entities being subject to more detailed risk and liquidity requirements which would be disproportionate. We suggest that this could be set at 15% NAV.

For the purposes of determining eligibility for this exemption, we suggest that the FCA consider a calculation based on net debt as a percentage of the AIF's NAV, excluding arrangements used for genuine hedging purposes and borrowing facilities backed by investor commitments that are not used to increase investment exposure. This would provide a relatively straightforward and proportionate means of identifying AIFs using modest levels of investment leverage, without requiring firms to undertake more detailed leverage calculations. The precise methodology would need to be appropriately defined to ensure consistent application.

This raises the question of how leverage is to be defined. We note that HM Treasury and the FCA are retaining the AIFMD definition of leverage, i.e. any method by which the AIFM increases the exposure of

an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means, and that the concepts of leverage and unleveraged are used as definitional terms when assessing the application of certain rules, e.g. risk management and FRAME reporting. It does not appear that the FCA is intending to retain further detail on the definition of leverage contained in the AIFMD Level 2 Regulation as onshored into UK legislation. We would recommend that the FCA takes a thoughtful approach to this. Please see further our thinking on this in response to Question 11 below.

Question 11: Can you foresee any benefits or challenges in allowing firms to disclose to a fund's investors a leverage method that is best suited to the AIF?

We strongly welcome the proposal to allow firms to disclose leverage based on the method that is best suited to the AIF. We think that this is a practical and proportionate approach.

We think that there is a key question on how leverage is defined. HM Treasury and the FCA are retaining the AIFMD definition of leverage, i.e. any method by which the AIFM increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means. However, it does not currently appear that either HM Treasury or the FCA intend to transpose existing concepts as set out in the AIFM Delegated Regulation into the Regulation or ALTS.

The existing concepts are important in informing private capital managers on the meaning of leverage and will need to be considered carefully as the market has reached widely understood positions on these. Any changes may have a significant impact. We therefore ask the FCA to confirm that established interpretations under the AIFM Delegated Regulation, including the treatment of portfolio-company exposures and borrowing arrangements, will be preserved unless the FCA expressly consults on proposed changes.

Changes could also create a very different concept of leverage to that currently used by UK firms (and which will continue to be used in the EU thereby introducing complexity for cross-border arrangements). For legal and commercial certainty, we therefore encourage the FCA to retain these interpretative provisions.

Also, certain provisions in the AIFM Delegated Regulation which private capital firms have historically relied on to carve certain investments out of leverage are not currently addressed. If the FCA adopts the requirement that exposures in SPVs are deemed to be exposures of the AIF then these should also be retained. For example:

- Article 6(3) which provides that for AIFs whose core investment policy is to acquire control of non-listed companies or issuers, the AIFM should exclude in the calculation of the leverage any exposure that exists at the level of those non-listed companies and issuers provided that the AIF or the AIFM acting on behalf of the AIF does not have to bear potential losses beyond its investment in the respective company or issuer. This is an important provision for private capital.
- Article 6(4) which provides that temporary borrowing arrangements that are fully covered by capital commitments from investors are to be excluded from the leverage calculation. We also think that the word "temporary" has created uncertainty and there is no policy rationale for making a distinction between temporary and other borrowing that is fully covered by capital commitments from investors. This would also ensure consistency with the approach taken in the recent EU AIFMD II reforms under which the exemption for exposures as a result of borrowing covered by

investor commitments for the purposes of the leverage cap is not limited to "temporary" borrowing but includes *any* borrowing arrangements.

Accordingly, we urge the FCA to maintain the existing treatment of portfolio-company exposures and borrowing arrangements, and to consult on any proposed departure from established interpretations.

Risk management

Question 12: Should all AIFMs be subject to baseline standards, with additional requirements applying according to the type of AIF managed and the size of the firm? If not, what alternative approach would you suggest?

Currently, all AIFMs can apply the risk management requirements on a proportionate basis, which works well for private capital firms. Under the proposed rules, this ability would be limited to small UK AIFMs. However, the risks associated with a particular AIFM do not always correlate with its size; other factors, including its investment strategy, will also be relevant. We therefore think that the ability to apply the requirements proportionally should be extended to medium and large UK AIFMs. The application of risk management requirements should reflect the nature, scale and complexity of the activities undertaken, the investment strategies pursued and the risks presented by the AIFs, rather than the size of the AIFM alone.

This will be particularly important if no de minimis level of leverage is permitted. The underlying rules should also be neutral as to how the requirements are met. This would enable firms to implement effective diligence practices, ensuring that the requirement is applied on a meaningful basis rather than as a box-ticking exercise. It would also allow for firms operating on a cross-border basis to have the flexibility to make use of international teams rather than requiring a UK-specific team in order to meet prescriptive UK requirements.

ALTS 5.3.4R would introduce a new requirement for all authorised AIFMs to identify, monitor and manage risks to market integrity arising from the management of each AIF and from their other activities. This would impose an additional burden on AIFMs and could place them in conflict with their obligations to investors, for example when deciding whether it is appropriate to sell a particular investment. AIFMs will not necessarily interpret consistently what constitutes a risk to market integrity, particularly because the risks they present will differ according to factors such as investment strategy, size and investor base. It is therefore unclear why proposals intended to be business-friendly would increase AIFMs' risk management obligations in this way.

Question 13: Should firms managing only closed-ended, unleveraged AIFs be subject only to baseline risk management requirements? If not, what alternative approach would better reflect the risks posed by those firms?

We agree with the FCA's proposals only to apply baseline risk management requirements to closed-ended, unleveraged AIFs. We think that this is a proportionate approach for AIFs which pose lower risks to investors and the financial system more broadly.

However, we also think that this should be extended to closed-ended, leveraged AIFs using modest levels (<15% NAV) of leverage. Closed-ended AIFs with modest leverage and no investor redemption rights should not be subject to the full risk management requirements solely because they use modest leverage. It would be disproportionate to subject such AIFs to the same risk management rules as highly leveraged and/or open-ended funds with real liquidity or redemption risks.

As we discuss in our response to Question 12, there are a number of factors which affect the risk level of an AIF. The use of a modest amount of leverage should not, in itself, trigger the full risk management requirements. This could be achieved through the FCA's proposal to adopt a de minimis amount of leverage below which an AIF would not be considered leveraged (see Question 10).

Question 14: Should the largest firms should remain subject to a more detailed framework that preserves the substantive standards of the current regime, while simplifying the drafting where possible? If not, why not?

We think that it would be appropriate for the largest firms to be subject to some higher standards but with the option to apply these on a more proportionate basis where the firm is large but otherwise lower risk. This would apply, for example, in the case of AIFMs managing private capital funds where a small number of large investments are held for the long term and subject to extensive due diligence prior to investment.

Liquidity risk management

As with the risk management rules, we agree with the FCA's proposals not to apply liquidity risk management requirements to closed-ended, unleveraged AIFs. However, as discussed above, we think that this should also be extended to closed-ended, leveraged AIFs with modest levels of leverage (we suggest below 15% NAV). Closed-ended AIFs with modest leverage have a very different risk profile to open-ended funds and therefore it would not be proportionate to apply the full liquidity management regime (including the onerous stress testing requirements) to such AIFs. Where the regulatory concern is margin pressure in leveraged closed-ended vehicles due to the use of derivatives for investment purposes, the requirements should be targeted at that risk and the FCA should not apply a broader redemption-based liquidity framework where no such risk arises.

Question 15: Should small AIFMs should be required to comply with new, simplified liquidity risk management rules?

If small AIFMs are required to comply with new liquidity risk management rules, there should be an appropriate grandfathering period before liquidity management tools are required to be included.

Question 16: We propose that medium and large UK AIFMs of open-ended AIFs that invest in other open-ended funds should be required to 'look through' to the portfolio of those other funds to better assess the liquidity risk. Can you foresee any issues that we should be aware of?

Although it is comparatively rare for private capital funds to invest in open-ended funds, we are concerned about the ability of funds more generally to obtain sufficient information to carry out this assessment and the level of granularity of information that they would be required to seek.

Question 17: Are there any rules that are unnecessary for medium AIFMs or areas in which medium AIFMs should not be subject to the same level of prescription as large AIFMs?

We think that it is helpful that the FCA proposes in ALTS 7.3.5R(2) that the liquidity risk management framework should be "*appropriate to the AIF's size, investment policy and strategy, liquidity profile and investor base*" as this should allow AIFMs to tailor their liquidity risk management to their risk profile. It would be helpful to extend this to all the liquidity risk management rules to allow for a more proportionate approach to be taken by firms.

The detailed requirements on stress testing will be a significant burden for medium UK AIFMs with little corresponding benefit in many cases, and we suggest that these requirements be modified to allow

medium UK AIFMs to apply some or all of these measures only where appropriate to the risk profile of the AIF.

Delegation

Question 18: Do you have any comments on our general approach to delegation?

We support HM Treasury's removal of the requirement for FCA approval for a delegation of risk or portfolio management. We also support the FCA's new approach of applying reduced obligations for the delegation of certain ancillary functions which will allow firms to focus on those delegations which are of greatest importance to their business. However, we would welcome formal confirmation from the FCA that the proposed changes are not intended to change the current scope of what is considered to be a delegation.

Question 19: Do you agree with our proposals on delegation of investment management activities to entities that are not authorised or supervised for that activity?

We agree that this is a sensible approach which will facilitate, in particular, cross-border arrangements which are important to the private capital industry.

Annual reporting to investors

Question 20: Do you agree with the proposed changes to the requirements applying to an AIF's annual report? If not, please explain.

We welcome the general direction of travel of the FCA in making annual investor disclosure obligations more principles-based and less prescriptive. However, we think that, for professional investors, the better approach would be to require AIFMs to comply with high-level principles, such as ensuring that information is fair, clear and not misleading, without imposing specific detailed disclosure requirements. The specific information to be disclosed would be as agreed between the investor and the AIFM. This would allow AIFMs with a more sophisticated investor base not to comply with information requirements which the investors do not require and to provide more meaningful and targeted information instead.

This is particularly relevant for single asset vehicles. As discussed in our response to Question 3, we consider that single asset vehicles should be included in the full residual CIS carve-out. However, if this suggestion is not accepted, we think that there should be a specific exemption from the requirement to provide financial statements for single asset investments. Such a requirement would add no value for investors in a single asset private equity investment, as there is no or minimal activity to account for from initial investment to exit.

If the FCA does not wish to adopt this approach, it is important to note that many private capital firms will have international business which means that they would also have to continue complying with EU AIFMD disclosure obligations. As an alternative, we think that it would be sensible to allow compliance with EU AIFMD Article 22 disclosure requirements to satisfy the new ALTS 10 disclosure requirements. This would help prevent duplication and unnecessary additional obligations which do not result in any real benefit for investors and may dissuade firms from operating in the UK and reduce the range of products available to UK investors.

Without this recognition, some well-intended simplifications could inadvertently increase the reporting burden for private capital managers who also operate in the EU. For example, we welcome the FCA's decision to reduce the amount of remuneration information that must be provided in the annual report in relation to an AIF managed by a medium UK AIFM or a large UK AIFM, including limiting remuneration

disclosures under ALTS 10.2.3R(4) to the AIFM's material risk takers (in contrast to previous EU-derived rules that required remuneration disclosures relating to the AIFM's staff generally). However, it would be unhelpful if an AIFM, which is also required to make an annual report available under EU AIFMD, had to prepare different remuneration calculations, one covering all staff and another for material risk takers. In this instance, we see no reason why it would not be acceptable for the AIFM to provide the information set out in EU AIFMD Article 22, rather than be required to prepare a tailored UK-specific report.

For some AIFMs with simple investment strategies, such as a small AIFM with a single asset transitioning to a medium AIFM, it would be excessive to require that the annual report includes audited financial statements. Therefore, we think that the requirement for medium and large AIFMs' financial statements to be audited should not apply where it is not proportionate to do so.

Question 21: What are your views on requiring small UK AIFMs and certain operators of residual CISs to prepare an annual summary for its investors?

We agree in principle that small UK AIFMs and residual CIS operators should be required to provide some information to investors and agree with the FCA's proposals to limit this to information that an investor would reasonably require to understand any material changes to the merits, risks and costs of investing in the fund. We do not think that any more detailed information would be necessary.

However, we do have some concerns around the proposed requirement to provide further information in ALTS 10.3.7R, which we discuss below in our response to Question 22. The same analysis applies here.

Investor disclosures

Question 22: Have we struck the right balance between removing prescription from the disclosures to professional investors and ensuring that those investors can access the information they need? Are there areas of the rules that could be made more or less prescriptive?

We think that having less prescriptive disclosures for professional investors would be a positive development and more closely reflect commercial realities. As discussed above in the context of annual reports, we think that AIFMs dealing with professional investors should instead be required to comply with high-level principles with any other disclosures as agreed between the investor and the AIFM.

If this approach is not taken forward, as discussed above in our response to Question 20, given the cross-border activities of many firms, particularly in the private capital space, we think that it would be appropriate to allow firms to satisfy the new ALTS 9 disclosure requirements through compliance with the EU AIFMD Article 23 disclosure requirements.

If the more prescriptive disclosures are retained, we also think that there is merit in tailoring these disclosures further and note that there are a number of areas where the rules appear to require more detailed obligations, such as in respect of investment techniques and additional information on feeder AIFs. We do not see any justification for these, as additional disclosures go against the intention of the reforms. Given that these changes are intended to reduce the burden for firms dealing with professional investors who are already sophisticated investors who are able to seek any information that they need and given that there is a general overarching obligation in ALTS 9.3.2R to provide appropriate pre-contractual information, the disclosure requirements should not be broader than absolutely necessary.

Further, ALTS 9.3.4G(8) requires firms to disclose the risks associated with the fund, including investment risks and operational risks. This goes further than the existing disclosure requirements where risks

associated with the investment techniques only need to be disclosed. In practice, we think that it will put more pressure on firms to include longer risk factors in fund documentation and expose them to potential regulatory sanction risk where an undisclosed risk crystallises. We think that this should be subject to a materiality qualification.

ALTS 9.2.4R and ALTS 10.2.5R also provide that, where an investor in a fund makes a “reasonable” request for further information about the fund, the manager must provide that information and make it available to other investors. This could impose significant additional burdens on managers, which would need to assess both whether a request is reasonable and whether the information can be disclosed, including where it is confidential or commercially sensitive. It may also create difficult investor relations issues. This would run counter to the intended aim of the reforms, and it is unclear what information the FCA considers is not currently being provided to investors. We understand the FCA’s objective of ensuring that investors are treated fairly. However, particularly for professional investors, fair treatment does not require every investor to receive exactly the same information. In any event, the general overarching obligations concerning the provision of appropriate information to investors already address this issue.

Question 23: Do you agree with our approach for AIFM retail disclosures? Do you think it is proportionate to the risks posed by these products?

No comment.

Question 24: Do you agree with our proposal to disapply the COBS 16.3 periodic reporting rules and rely on our proposed disclosure rules instead?

Yes, we agree that this is a sensible approach. This should avoid duplication of some of the reporting requirements on AIFMs which would otherwise impose additional administrative and cost burdens without a corresponding benefit.

As a general matter we support proposals to simplify and rationalise the rules.

Closed-ended investment funds trading on UK markets and internally managed investment companies

Question 25: Have we adequately taken account of the differences between the company board and the AIFM and reflected the split of responsibilities in the AIFM rules?

Listed CEICs are already subject to significant board-level risk management and governance requirements. Therefore, we think that additional AIFM requirements should apply only where there is a material residual risk not already addressed. We also do not think that it is always the case that the external AIFM is necessarily responsible for the day-to-day operation of the vehicle. For example, in some structures, the listed company may have its own board, CEO, employees and operating functions, with the AIFM performing a narrower regulatory role.

Question 26: Does our proposal to disapply the AIFM investor disclosure, and reporting and notification to investor rules for closed-ended investment companies admitted to trading on a UK regulated market, fully account for equivalent outcomes that are delivered through other requirements?

We have not considered the full detail of these proposals but, as a general matter, we support disapplying duplicative requirements.

NPPR and cross-border marketing

Question 27: Do you have any comments on our proposed guidance on the NPPR?

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We support broadly retaining the NPPR regime in its current form as we think that, in general, it has been functioning well. Given that many funds marketing under the NPPR will be marketing in the EU, the FCA should allow the annual report and investor disclosure requirements in ALTS 9 and 10 to be met by compliance with the Article 22 and Article 23 requirements.

Also, while not relevant to NPPR, we welcome the removal of the requirement for UK AIFMs to provide 20 working days' notice to the FCA before marketing a fund. This will be a significant benefit for firms seeking to launch new products quickly.

However, we do have concerns about the FCA's power to maintain registers of notified, suspended or revoked AIFs. If information on AIFs which have been suspended or revoked is made public, this risks creating adverse publicity for those AIFMs and AIFs even where this is not justified. We recognise that publication may be appropriate where necessary to address genuine investor protection concerns. However, the FCA should distinguish those circumstances from administrative or other matters where publication could create a misleading impression of regulatory wrongdoing. We therefore suggest that the better approach would be for the FCA not to make publicly available information on AIFs that have had their entitlement to market suspended or revoked unless publication is necessary to address an identified risk to investors or the public. It is also possible that publishing information on AIFs notified for marketing could inadvertently breach securities offering laws in other jurisdictions and we therefore urge the FCA not to publish more information than is strictly necessary and to ensure that this risk is avoided.

Consequential changes: operating conditions

Question 36: Do you agree with our approach to consequential in these sourcebooks? If not, what do you disagree with and what alternative approach would you suggest?

Under the new COBS 18.5A.5R(2), where a firm is required to provide information to, or obtain consent from, a customer or client, it must ensure that the information is provided to, or the consent obtained from, an investor or potential investor in the fund. We consider this provision to be drafted too broadly and likely to produce unintended consequences, particularly because it includes potential investors and extends to requirements to obtain consent. Where a disclosure is relevant to an investor or potential investor, it should already be covered by the pre-contractual disclosure requirements. For example, ALTS 9.4.2R(4) requires information on research and inducements to be provided as a pre-contractual disclosure to retail investors. The current approach of extending a rule on a case-by-case basis where appropriate should therefore be retained, and the proposed provision should be deleted.

Question 37: Are there areas of the asset management regime we should consider first to ensure consistency and remove unnecessary differences in our rules?

The references to professional investor and retail investor in the draft AIFM Regulations cross-refer to the FCA's definition of professional client within the meaning of section 3.5 of the Conduct of Business sourcebook. In order to try and limit the number of regulatory changes that a firm needs to implement, the FCA's proposed changes to the professional client definition (as discussed in CP25/36: Client categorisation and conflicts of interest) should come into effect no later than the AIFM Regulations.

More generally, we also have some comments on a few other changes in the AIFM Regulations which affect the FCA and its rules.

- The provisions setting out the information to be provided in an application for authorisation have been removed in the AIFM Regulations. It would be helpful if the FCA could confirm that it will

not require more information to be provided by an applicant than is currently required under existing legislation.

- The FCA will have the power under regulation 41(6) of the AIFM Regulations to make rules specifying when a planned change is a material change. If the FCA intends to bring in new rules or guidance on this, it would be helpful if it could do so as part of the UK AIFM review so that AIFMs can implement any necessary changes as part of this wider project.
- The definition of AIF in regulation 3(1) replaces the concept of "investment compartments" with "sub-fund". We note that the FCA does not perceive a distinction in practice between these concepts and states in Question 2.61 of PERG 16 that "*An investment compartment is similar to, and corresponds with, the Glossary term sub-fund*". However, there is also some further guidance on the concept of investment compartment in Questions 2.62 to 2.65. As with other aspects of its PERG 16 guidance, the FCA should ensure that interpretations on which the market has historically relied are not lost and therefore the FCA should consider retaining this guidance (and other PERG 16 guidance more broadly) as part of its review.

Discussion chapter: Reviewing the prudential regime for fund managers

Prudential requirements protect the integrity of the UK financial system, but they also impose significant costs on firms by requiring substantial sums to be held in reserve rather than deployed productively in the real economy. Against this backdrop, we strongly disagree with the FCA's proposal to bring AIFMs within the COREPRU framework. The proposal does not, in our view, sufficiently recognise that the risks arising from fund management activities are typically more predictable (and significantly lower) than those arising from inherently riskier activities, such as proprietary trading. We also strongly disagree with extending any ICARA (MIFIDPRU) or ORA (COREPRU) requirement to AIFMs. The time, cost and resources required to produce, maintain and review such documents would be disproportionate to any resulting risk management benefits, and the nature of fund management activities does not justify such an onerous framework. In summary, the proposed approach is likely to be a significant deterrent to firms considering establishing an AIFM in the UK, undermining UK competitiveness.

We consider that the FCA should instead develop a prudential framework that reflects the particular risks and liabilities of a private capital business, recognising that the assets and liabilities of the fund are separate from those of the AIFM.

We also think that it is important to note that private capital funds operate differently from some other types of funds with different types of risks against which capital needs to be held. For example, although the AuM of a private capital fund may be very large, there may only be a limited number of transactions which are heavily due diligenced and negotiated. Similarly, there may be relatively limited fluctuation in a private capital fund's NAV or AuM. This is materially different to some other fund types, e.g. a hedge fund.

Question 39: Do base capital requirements, activity-based requirements and fixed overhead requirements appropriately reflect the scale and nature of fund managers' activities and, if you think they do, how should they be calibrated?

We support the application of a base capital requirement and a fixed overhead requirement to AIFMs. We do not believe that an activities-based requirement is an appropriate tool to capture the risks that are associated with the management of funds. An AIFM's capital requirement should be the higher of a base

capital requirement and the fixed overheads requirement and we encourage the FCA to consider lowering the current fixed overheads requirement (bearing in mind the inherently low risk associated with the prudential position of private capital firms) which acts as a barrier to entry and dissuades new market entrants.

Activities-based requirements:

Activity-based prudential requirements are often justified on the basis that they reflect the level of risk that arises from the underlying activity to which they relate. The current rules for full-scope UK AIFMs apply a funds under management approach (FuM) which is predicated on the view that risks increase proportionately as an AIFM's AuM increases over time.

However, this approach is misguided because the risks arising from fund management do not increase in a linear fashion. As a successful AIFM's FuM increases, its FuM requirement under IPRU-INV 11.3.2R will increase correspondingly, even though in many cases there will be no equivalent increase in risk. In the fund management context, operational and conduct-related risks arise from a range of factors, including the complexity of an AIFM's business model and investment strategy and the quality and robustness of its systems and controls. These factors are not necessarily related to the AIFM's FuM (or AuM).

As a result, the FCA should not carry forward an activity-based requirement as this is very rarely relevant and inaccurately models how risks arise in the context of fund management business.

Instead, the FCA should seek to establish clear minimum financial resources requirements and risk management obligations, without introducing additional calculations that do not reliably reflect the risks faced by private capital firms.

Fixed overheads requirements:

Most UK Private Capital members' current capital requirements under IPRU-INV are driven by the fixed overheads requirement. We believe that an appropriately calibrated fixed overheads requirement is generally a more coherent basis for determining an AIFM's capital requirement. This is because, given that a fixed overheads requirement is based on an AIFM's actual expenditure, it better addresses the principal risk that arises from fund management activities, i.e. the need for an AIFM to provide capital to cover arrangements to transfer the management of any funds to a new entity or run off those funds in the event that an AIFM needs to wind down its operations.

Fixed overheads requirements are conceptually well understood by UK AIFMs (given that they are part of the existing IPRU-INV rules) and would provide a degree of consistency across prudential requirements for different types of regulated firms (as both COREPRU and MIFIDPRU also contain the concept). However, we would strongly urge that any fixed overheads requirements for UK AIFMs should be tailored and reflect the three new categories of authorised UK AIFMs. In our view, the FCA should introduce a ramp-up mechanism scaling fixed overheads requirements across the three tiers of AIFM until the requirement reaches the current requirement for a large UK AIFM (three months' relevant expenditure).

Base capital requirements:

Base capital requirements are fixed and so are not responsive to an increase in the risks associated with a UK AIFM's fund management business. However, base capital requirements effectively set a minimum amount of capital that an AIFM needs to hold in order to become FCA authorised as a fund manager and so play an important role. In our view, the current baseline capital requirement of €125,000 for external

full-scope authorised UK AIFMs sets the barrier to new fund managers too high and should be reduced. We suggest setting the base capital requirement at £75,000 instead as this reflects the base capital requirement for portfolio management firms under MIFIDPRU that do not undertake proprietary trading or hold client assets/money.

Question 40: To what extent should the risk of compensating investors for errors, negligence or misconduct, which can scale with assets under management, inform the design of activity-based metrics for fund managers?

In UK Private Capital's view, the risk of compensating investors for errors, negligence or misconduct does not necessarily scale by reference to an AIFM's AuM. Instead, and as explained in our response to Question 39, the relevant risks associated with fund management business arise from several variables that are unrelated to an AIFM's AuM. We also note that depending on the contractual terms governing the relationship between a fund and its AIFM, the financial impact of an operational error may well be principally or exclusively borne by a fund (and not the AIFM). This is typical in cases other than gross negligence or bad faith actions by the AIFM. As a result, the risk to an AIFM's financial viability arising from, for example, simple errors or omissions is limited and therefore calibrating any capital requirement by reference to such errors or omissions is counterintuitive.

For completeness, we note that AIFMs of private capital funds are typically subject to extensive due diligence by professional investors investing in the funds an AIFM manages. Typically, such diligence will cover an AIFM's systems and controls framework and so AIFMs seek to maintain robust and effective risk management systems irrespective of their AuM. AIFMs of private capital funds typically raise capital from a comparatively small number of long-standing professional investors and so AIFMs are heavily incentivised to ensure that errors, misconduct and negligence do not occur as any lapse could impact these longstanding investor relationships and jeopardise the ability of the AIFM to raise capital for its funds.

Question 41: To what extent are firm-level liabilities and the costs of wind-down significant for fund managers, and should they be subject to a basic liquid asset requirement; if so, how should this requirement be calibrated?

We do not believe that AIFMs should be subject to a basic liquid assets requirement as UK AIFMs typically have minimal wind-down costs, stable income under a predictable management fee, a right to reimbursement of expenses reasonably and properly incurred in connection with their management of the fund(s), and limited firm-level liabilities.

A full-scope authorised UK AIFM cannot undertake proprietary trading or similar activities. AIFM balance sheets are therefore typically comparatively light, and wind-down costs do not need to cover the liquidation of proprietary trading positions or the verification and return of client assets. In most cases, the principal liabilities of a full-scope authorised UK AIFM will be to group affiliates under intragroup agreements or to its employees; these liabilities are predictable and short-term in nature. An AIFM will also typically have a very small number of regulatory clients—the AIFs it manages—compared with an investment bank, which may have thousands. An AIFM can therefore usually wind down more quickly than an investment bank. Where an alternative AIFM needs to be appointed, that process can also be completed more quickly because of the relatively small number of AIFs under management at any one time.

Instead, we would suggest that the FCA impose a principles-based requirement for an AIFM to ensure that it takes reasonable steps to meet its liabilities as they fall due.

Question 42: How should capital and liquidity requirements interact for fund managers, and should a consistent standard for the quality of own funds and liquid assets apply, taking account of the typically simple nature of fund managers' firm-level balance sheets?

As noted in our answer to Question 41, AIFMs typically face limited capital and liquidity risks when compared with deposit-taking banks and firms that trade on their own account. As a result, there is not an obvious interaction between an AIFM's capital and liquidity requirements.

An AIFM's balance sheet must be separate from those of the AIFs that it manages, and its own obligations must be separate from any obligations that it incurs on behalf of those AIFs. As a result, the principal expenditures incurred by AIFMs tend to be stable and predictable, such as employee salaries and bonuses, taxes and fees paid to third-party service providers. Given that these are comparatively simple and predictable outflows, we do not think that there is a strong policy rationale to link capital and liquidity in the same way as the MIFIDPRU and IPRU-INV 11 regimes currently do.

Should the FCA nonetheless choose to link an AIFM's fixed overheads requirement with any retained basic liquid assets requirement, we would urge the FCA to ensure that the liquidity requirements applicable to UK AIFMs are on similar terms to the requirements under COREPRU or MIFIDPRU.

Question 43: To what extent should structured risk management and wind-down planning expectations apply to fund managers, given that fund assets are held separately from the manager and do not count towards insolvency, and how should any such expectations be calibrated proportionately across firms of different sizes, complexity and risk profiles?

As noted in the question, AIFMs structurally separate their assets from the assets of the funds they manage. As a result, in our view, structured and detailed wind-down planning expectations and/or requirements to conduct detailed stress testing for liquidity and capital are not appropriate for AIFMs. In contrast to a firm that conducts proprietary trades or an investment bank, where potential market risks and volatility pose a more immediate threat to the firm's viability, AIFMs typically derive their revenue from the management fees paid by their small number of regulatory clients (i.e., the funds under management). This revenue stream is inherently stable and any threat to an AIFM's viability is likely to be identified at a far earlier stage. In a wind-down context, the key practical and operational consideration should be to ensure that an AIFM in wind-down is either able to run off its existing fund investments or (if applicable) to hand over the management of any funds to an incoming manager. This can be achieved through a principles-based requirement for an AIFM to maintain appropriate and robust practical wind-down plans relating to how an AIFM would transition its funds to a replacement manager and/or run off existing fund investments. Such plans should be proportionate to the firm's activities and the arrangements governing its funds, without automatically requiring detailed capital or liquidity stress testing.

Question 44: What role should PII play within a prudential framework for fund managers?

In our view, the current requirements under IPRU-INV 11 for full-scope UK AIFMs to hold additional funds to cover the risk of professional negligence or to hold a combination of additional own funds and PII to cover this risk should be reformed. We do not believe that there should be any requirement for AIFMs to mandatorily hold PII. There are several reasons for this. Typically, the terms of the arrangements between AIFMs and the funds under management either wholly exclude liability to the funds (or indeed investors) or provide that an AIFM will be indemnified for liabilities unless an AIFM's actions constitute gross negligence or wilful default or are otherwise in bad faith. As a result, we do not see the rationale behind imposing mandatory PII requirements on AIFMs. However, as the duties owed by an AIFM to the fund(s)

it manages are heavily dependent on the terms agreed with investors and the funds, we believe that AIFMs should be free to adopt PII if the AIFM believes doing so would be an appropriate tool to help manage risk.

Question 45: How could our data collection be improved, and where firms are subject to multiple prudential regimes, how significant are overlapping or duplicative reporting requirements?

We welcome the FCA's aim to reduce regulatory reporting burdens on firms. In general, if the FCA chooses to proceed with our proposal that AIFMs are subject only to a fixed overheads requirement and/or base capital requirement, we believe that the FCA could monitor AIFMs' prudential health through periodically filed financial statements without requiring additional time- and resource-intensive reporting. To the extent that the FCA requires data on a specific firm, the FCA can always make specific ad hoc data requests.

Question 46: What types of reporting would provide reliable indicators of potential or realised harm to fund investors or other market participants, including operational errors, redress events and near-misses?

The FCA has already introduced extensive operational incident reporting requirements that would require AIFMs to notify the FCA of any serious operational incidents. Importantly, such incidents include any incidents which pose a threat to the viability and soundness of a firm. Additional notification requirements already apply to AIFMs (for example the requirements in SUP 15.3.1R for regulated firms to report any event which could result in serious detriment to a firm's customers) and under Principle 11.

As a result, in our view, the FCA should already be receiving all the necessary information to determine whether there are any operational errors, redress events and near misses. There is no need to introduce additional duplicative notification/reporting requirements.

Question 47: How could the prudential framework for CPIMs be designed to better reflect the nature of their combined fund management and MiFID investment activities?

In our view, the current prudential framework for UK CPIMs places them at a considerable disadvantage to their EU peers. The FCA's current rules treat CPIM firms as MIFIDPRU investment firms and so extend requirements such as the obligation to produce an ICARA to such firms. This contrasts with the position in a number of EU jurisdictions and places a significant burden on CPIM AIFMs. Moreover, subjecting CPIM firms to MIFIDPRU requirements introduces a significant degree of complexity for these firms as firms have to navigate a variety of overlapping requirements, some of which apply to the firm as a whole whereas others will apply only to specific business lines.

We consider that, so long as a CPIM AIFM's activities are agency-only (such as segregated portfolio management or reception and transmission of orders), a fixed overheads requirement under the AIFM prudential regime should cover these activities. If the AIFM business restriction is removed and AIFMs are permitted to undertake proprietary trading, this position may need to be revisited.

If you have any questions or there are points it would be helpful to discuss further, please contact Nick Chipperfield (nchipperfield@ukprivatecapital.co.uk) and Tom Taylor (ttaylor@ukprivatecapital.co.uk).

Yours faithfully,



Tim Lewis
Chair, UK Private Capital Regulatory Committee