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Investment Funds Team
Conduct Business Unit
Financial Services Authority
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1 February 2013

Dear Sirs

Re: CLLS Regulatory Law Committee Response to FSA Consultation Paper CP12/32: Implementation of the Alternative Investment Fund Managers Directive

The City of London Law Society ("**CLLS**") represents approximately 14,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world.

This paper has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). Members of the Committee advise a wide range of firms in the financial markets, including alternative investment fund managers specialising in numerous strategies and asset classes such as hedge, private equity, real estate, listed equities and fixed income, as well as service providers such as depositaries/custodians, prime brokers and fund administrators.

1) General Concerns

a) Applications for Authorisation as an AIFM

We are deeply concerned by the proposal in relation to the time at which the FCA will accept applications for authorisation as an AIFM. We appreciate that, until the Level 2 Regulation was published, there were some areas where the UK authorities could not finalise their proposals, but this was not the case in a number of important areas, including this one. It is a matter of great concern to us and our clients that it was only at the end of last year that it became apparent that the UK authorities were not planning to be in a position to process applications for AIFM status until 22 July. This is a huge commercial issue and potentially very damaging to UK firms. There will be many who will

already be engaged in marketing in the EEA or who will want to commence marketing in the summer who will be unable to do so because there appears to be no mechanism under which a UK firm which qualifies as an AIFM can market in other EEA States without being authorised as such. The draft Regulations appear to confirm this. It is essential that a mechanism is developed which enables such firms to be given an authorisation effective on 22 July 2013. Otherwise the bizarre result is that third country firms will be able to market their funds more easily in the rest of Europe than a UK firm. Marketing is not an optional aspect of a business activity for fund managers. For many of the largest firms teams of people are constantly engaged in marketing of some kind, it is the lifeblood of their business.

b) Scope of Article 6 of the Directive

This is also an issue on which clarification is urgently required. Article 6 of the Directive contains limitations on what an AIFM can do, but we are not clear as to how these limitations are to be implemented in the UK, nor as to how they are interpreted. This is an urgent issue for many firms who may need to apply for new entities to be authorised, depending on how the FSA interprets this provision. For example, it appears from the Directive that even if a firm only wants to provide the additional activity of advice, that it must be authorised also to provide discretionary asset management. What is the position if it does not wish to provide a management service in practice? Is the FSA prepared to grant authorisation for both activities? Are the Directive restrictions to be interpreted as restrictions on only the MiFID activities that an AIFM may perform, which we think is a possible interpretation, or is the FSA going to take the approach that an AIFM may not also operate a collective investment scheme (an entirely UK concept) or provide insurance intermediation? If so many firms will need to establish and authorise new entities to carry on these activities.

The Directive clearly allows an AIFM to provide discretionary portfolio management and we understand that in other Member States, this concept is understood as including the execution of transactions in that capacity. It will be necessary that this is reflected in the authorisations regime.

2) Responses to Specific Consultation Questions

Q1: Although we will return to this issue in a later consultation, once ESMA has completed its work on types of AIFM, do you have any concerns or questions regarding our approach to AIFMD scope described in this chapter?

Generally we agree with the approach and in particular welcome the comments in paragraphs 3.14 and 3.15 on property investment firms and joint ventures. We do think that there is scope to say more in relation to joint ventures, in particular we would welcome an express reference to Article 9 of the Schedule to the FSMA (Collective Investment Schemes Order), as it seems to us that arrangements that fall within that provision (entitled "schemes entered into for commercial purposes related to existing business") should not be AIF, in the light of the ESMA and FSA comments.

We are grateful that the FSA has attempted to address the potential ambiguities in the meaning of "AIF" and "AIFM". We understand FSA's comment in Section 3.7, in that it cannot make definitive statements in this CP. However, we do think it would be useful if the FSA could confirm its view on one general point. We agree with the FSA's view that

the definition of AIF does not contain any significant extension to the current definition of a Collective Investment Scheme as set out in Section 235 FSMA, with the exception of the loss of the closed-ended company exemption contained in Article 21 of the FSMA 2000 (Collective Investment Schemes) Order 2001 (the "**Order**"). As a result we consider that schemes that are currently exempt because they are entered into for commercial purposes wholly or mainly related to existing business (Article 9 of the Order) will not be AIF. We note that Recital 8 of AIFMD also refers to joint ventures. We think it would be helpful if FSA could insert an express reference to this.

Q2: Do you agree with our proposed approach to the capital and PII requirements for CPM firms and internally managed AIFs?

We agree with the proposals for internally managed AIF and, whilst we agree that the AIFMD is not entirely clear, we have also always understood the FSA proposal to be the intended policy outcome and we also believe it to be the correct legal reading of the Directive. This also seems to us to be appropriate in policy terms. In the case of an internally managed AIF (which in the UK is most likely to be an investment trust or similar) any additional capital is in effect taken directly from shareholders, and then can only be invested in liquid assets, which may not reflect the investment strategy of the vehicle itself. The position is different with an external manager which will usually be responsible for providing its own capital.

Q3: Do you agree that we should treat an AIFM that also undertakes MiFID services as a BIPRU limited licence firm (subject to the additional requirements of the Directive)?

We do think there is scope for an alternative reading of the Directive in relation to capital requirements, i.e. it is not clear that the effect of the AIFMD is to require an AIFM that also undertakes MiFID services to be treated as a BIPRU limited licence firm, although we recognise that this is how the FSA applies UCITS. On that basis we think it is important that there is a common approach across ESMA members on this, otherwise AIFMD/MiFID UK firms will be subject to more onerous capital requirements than firms in other EEA Member States.

Q5: Do you agree with our intention to apply the liquid assets requirement also to UCITS management companies that do not manage any AIFs?

We consider this is a policy question as it is gold plating the Directive. The Treasury has indicated in its Consultation Paper that gold plating must be supported by strong justification. We do not see any such justification for the FSA applying a liquid assets requirement to a UCITS management company that does not manage any AIFs. This goes beyond the UCITS requirements and we do not believe there is any reason to make this change unless and until the UCITS laws are changed, to do so puts UK UCITS managers in a very different position to those in the rest of Europe.

Q6: Do you agree with the proposed changes to SUP 16.12 and that the proposed new forms and guidance notes will provide us with sufficient information to assess whether firms are complying with the capital and PII requirements?

As lawyers we are not best placed to assess the adequacy of the forms and notes, either from the perspective of the FCA or that of the firms who must complete them. However we are very familiar with the difficulties experienced by different types of firm in completing various forms required by the FSA and so we would strongly recommend that a pilot user group of a cross section of firms is established to test the proposals.

Q7: Do you agree with our proposal for aligning the existing requirements under the FSA Remuneration Code with the new AIFMD remuneration rules? Do you have any specific concerns regarding:

- **Our proposed treatment of AIFMs which are part of a banking group?**
- **AIFMs doing MiFID investment business?**

We support the principle that the alignment of the requirements must make implementation as smooth as possible and for that reason agree that the rules should all be in the same location in SYSC.

Q9: Do you agree with our approach permitting authorised professional firms and other suitably qualified firms to be authorised to carry on the activity of acting as a PE AIF depositary?

We agree with the proposed approach. We understand the use of the term "*PE AIF depositary*" as a shorthand description of this particular type of depositary, but it is important (as is acknowledged in the consultation paper) that the use of this language does not influence the application of the approach, as this provision could apply to some other types of AIF, such as some real estate AIF.

Q11: Do you agree that it may be necessary or desirable for PE AIF depositaries to be able to hold financial assets in custody?

We do agree that it is necessary if this provision is to be of any use, given the lack of clarity in the final definition in the Level 2 Regulation of "*assets which must be held in custody*".

Q13: Should such depositaries be subject to different requirements, depending on whether or not they may hold financial instruments in custody? If so, what type of requirement would be most appropriate for these higher-risk firms: more own funds, an expenditure-based requirement, or some other method of calculation (please specify)?

We do not think that such depositaries should be subject to different requirements, depending on whether they may hold financial instruments in custody. A firm may only appoint such a depositary where its investment policy is (i) either generally not to invest in assets that must be held in custody, which suggest that any such assets will be fairly minimal or (ii) to invest in issuers or non-listed companies in order to acquire control. In the second case the notion of "losing" investments to the detriment of the AIF when the AIF controls the investee is unreal. For these reasons we do not think that any additional requirement is necessary and, given our comment in relation to Question 11, we expect that every one of these depositaries will need to be able to hold assets in

custody. In our experience private equity and similar firms are already finding it very difficult to locate a depositary and we do not think that any further disincentives to providers should be introduced.

Q14: Do you agree with our approach permitting AIF depositaries to be in the same group as the AIFM so long as Directive requirements are met?

Yes, we agree with the approach and do not think that any other approach would be practicable. This should be so for all depositaries, including "PE AIF depositaries".

Q15: What additional safeguards, if any, should there be to ensure effective management of conflicts of interest, especially in relation to custody of AIF assets?

Given the extremely wide ranging requirements in the Directive in relation to conflicts and in relation to custody of assets we consider that any additional safeguards would be superfluous and represent gold plating. No additional safeguards are required.

Q16: Do you agree with our approach requiring UK firms providing depositary services under Article 36 to hold a Part IV permission to be an AIF depositary?

We consider this needs further thought and do not agree that firms should be expected to seek Part IV permission in order to provide unregulated services.

Q17: Do you agree that EEA credit institutions should be allowed to act as depositary to UK AIFs? If you expect to be an AIFM of UK AIFs from 2013, would you consider using such a firm as depositary?

We agree that this should be allowed.

If the FSA would find it helpful to discuss any of these comments then we would be happy to do so. Please contact me in the first instance by telephone on +44 (0) 20 7295 3233 or by email at margaret.chamberlain@traverssmith.com.

Yours faithfully

Margaret Ch

Margaret Chamberlain
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
REGULATORY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

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