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Dear Sirs

CP 16-17 – FCA Quarterly Consultation No.13

The City of London Law Society ("**CLLS**") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the **"Committee"**). The Regulatory Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

We are grateful for the opportunity to respond to this consultation.

Chapter 4 – Changes to the requirements in the Disclosure Rules and Transparency Rules

Q4.1 Do you agree with our proposal to introduce a revised Glossary definition of 'prescribed market' for the purpose of Chapter 5 of the DTRs?

We recognise the need to introduce a revised definition of "prescribed market" for the purposes of DTR 5, and agree in principle with the wording proposed. Since the Disclosure and Transparency Rules apply to the listed community rather than to regulated firms, it would

be helpful if the glossary could at least direct them (possibly as a note) to the register which contains the list of UK RIEs, or (ideally) provide the hyperlink for the relevant search.

Chapter 8 – A new 'pooled investment vehicle' definition for the marketing restriction rules on NMPIs

Q8.1: Do you have any comments on the proposed new 'pooled investment vehicle definition'?

Definition of 'special purpose vehicle' for the purpose of the NMPI definition

We agree with the FCA's observation that the definition of 'special purpose vehicle' is unnecessarily complex for the purposes of the NMPI rules and as a result creates confusion for firms.

As part of the original consultation process on the introduction of the marketing restriction rules on NMPIs, we raised our concerns on the use of the term "special purpose vehicle" and highlighted the fact that the term was uncertain and lacked clarity.

The rules have been in place now for over two years, and our members' experience of the rules is that not only is the NMPI definition difficult to apply (due to its complex nature), but also that it provides an opening to interpret the definition in a far narrower way that we consider was intended. This is at least in part due to the use of the term 'special purpose vehicle' as defined in the glossary to the FCA Handbook.

Whilst we welcome the FCA's proposal to remove uncertainty and complication from the definition of 'special purpose vehicle', we would ask that the FCA consider the following points as part of this process:

1) Care should be taken not to expand the perimeter of this limb of the definition of NMPI. The current definition of special purpose vehicle only applies to bodies corporate only. There are other elements to the definition of an NMPI (such as unregulated collective investment schemes, qualified investor schemes and traded life policies) which are not the subject of this consultation. In this regard, we note that the FCA proposes in its Option 1 to make express reference to paragraph 21 of the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Scheme) Order 2001 (the "CIS Order") to bring back into scope certain closed-ended bodies corporate. Any change to the existing elements of the definition of an NMPI should not extend the reach of the regime beyond that which was originally consulted upon unless the FCA has compelling evidence that the perimeter of this regime is currently being circumvented (beyond the narrow interpretations of the existing definition of special purpose vehicle being taken by some market participants or advisers identified in paragraph 8.8 of CP16/17).

2) Since the introduction of the NMPI rules in January 2014, the provisions on marketing in the UK of the EU Alternative Investment Fund Managers Directive 2011/61/EU ("AIFMD") have been implemented (following the expiry of the initial 12-month grandfathering period) as have new rules on non-readily realisable securities (ostensibly to address concerns around securities based crowd-funding opportunities but more broadly applied). In addition, firms will need to comply with new rules relating to packaged retail investment products and the product governance powers under the Markets in Financial Instruments Directive II. This all leads to an unnecessarily complicated matrix of overlapping requirements on firms, many of which relying on different definitions or application provisions. If the FCA is using Chapter 8 of CP16/17 as an opportunity to conduct a more wide-ranging investigation into the application of the NMPI regime and consumer protections in the investment

space more generally, we would ask that you consider reducing the levels of complication.

3) If an object of this review is to remove some of the complexity and scope for some firms and their compliance advisers to take an unduly narrow interpretation of the application of these rules, we would query whether the two options that were provided by the FCA will achieve this aim or would instead simply provide those firms with alternative subjective elements take advantage of within the new definition.

4) We note that both of the options provided make reference to FCA guidance in Chapter 16 of the Perimeter Guidance Manual ("PERG"). Whilst some pooled investment vehicles may meet the definition of being an alternative investment fund within the meaning of AIFMD, we would anticipate that many will not. As such, we would ask that a clear statement be provided in the reference to say that the FCA would consider such guidance to apply irrespective of whether or not the issuer in question is, or is not, an AIF. To ensure that firms can obtain sufficient comfort of this, we would also ask that reference is also expressly made to this in Chapter 4.12 of the Conduct of Business Sourcebook ("COBS") (for example, in a similar manner to the way in which the FCA incorporates reference to the Joint Money Laundering Steering Group Guidance in SYSC 6.3.5).

5) Given that the FCA is relying heavily on concepts used within AIFMD for its two proposed Options, we consider that there should also be reference to the holding company exclusion in article 2(3)(a) of AIFMD and the corresponding guidance in the responses to Questions 6.2 to 6.5 of PERG 16.6. We would note that "holding company" here should refer to the term as used in AIFMD rather than the existing defined Glossary term.

Option 1

We note that Option 1 as sets out in the draft instrument in Appendix 8 of CP16/17 is the FCA's current preferred option. However, we have a number of concerns about it.

First, the definition is of a "pooled investment vehicle" however there is no reference to, or requirement for it to relate to any form of corporate, trust, partnership or other vehicle. In the absence of any other guidance or definition, we would assume that the FCA would expect firms and market participants to interpret "arrangement" in the introductory working to the definition in the same way as it is used in the definition of "collective investment scheme" in section 235 FSMA. As you will be aware, recent case-law gives this a very wide application. This would both increase the uncertainty of the application of the NMPI regime and, potentially, significantly broaden it beyond the scope originally intended by the FCA when the NMPI regime was introduced. If Option 1 were to be adopted, therefore, we would recommend that the word "arrangement" be replaced with "body corporate" or, failing that, "an undertaking" (each using the current Glossary defined terms).

Second, we note that the definition includes arrangements that would be collective investment schemes but for paragraph 21 of the Schedule to the CIS Order. We note that the FCA, in paragraph 9.2.1 of PERG states its view that "The nature of many bodies corporate means that they will, in most if not all circumstances, come within the definition of collective investment scheme in section 235(1) to (3) of the Act". As such, we do not consider this to be a particularly helpful element of the definition of pooled investment vehicle.

Third, we consider that making reference to the arrangement not having "a general commercial or industrial purpose", even by including cross-references to questions in PERG 16.2, includes additional layers of complexity and uncertainty. We appreciate however that,

as AIFMD becomes more embedded within the UK regulatory system, there is likely to be a closer consensus within the market of what this means. Furthermore, we accept that, to achieve the purpose of the NMPI regime, the inclusion of a term such as this may be necessary.

Option 2

We note that Option 2 is similar to the interpretation given by the FCA in PERG 16.2 to 'collective investment undertaking' which in turn forms an element of the definition of an 'alternative investment fund' for the purposes of AIFMD.

It should be noted that "collective investment undertaking" is not itself a defined term within AIFMD. The elements provided in Option 2 derive, we assume, from ESMA's "Guidelines on Key Concepts of the AIFMD" (ESMA/2013/611) rather than from binding legislation. If the FCA were to adopt Option 2, we trust that the FCA will continue to monitor ESMA publications and relevant case-law and amend this definition if necessary to ensure that it remains aligned with the broader legislative and regulatory framework.

Whilst we note that the FCA has provided helpful guidance in PERG 16.2 on its interpretation of the concept of a collective investment undertaking within the meaning of AIFMD, we again note that there is considerable uncertainty within the three elements that are listed in paragraphs (a) to (c) of Option 2. Each of these elements is subjective and open to taking an unduly narrow interpretation. Although we accept that firms are increasingly familiar with the definition (having been required to apply the concepts for the purposes of the AIFMD) we do not believe that the FCA would achieve the required level of certainty through adopting this definition.

An alternative, third, option

As noted above, we consider that there are difficulties with both of the options that have been suggested. Nonetheless, we accept that it may be necessary for there to be some uncertainty in whichever option is taken given the policy objective and the lack of suitable defined terms and concepts that are already familiarly to the market.

If the FCA is committed to making use of one or other of the two options suggested, our preference would be for Option 1 to be used (with the substitution of the word "arrangement" and adding reference to the AIFMD holding company exclusion each as referred to above) and strengthening the cross-references to PERG 16.2.

However, in our view a third option may be preferable. The option that we propose below is predicated on the basis that the concept of "pooled investment vehicle" can be drawn relatively widely provided that it is then restricted either within its own definition or in the list of "excluded securities". As such, the definition of pooled investment vehicle could be heavily based on the existing Glossary definition of "special purpose vehicle (except in PR)" already used, but with the deletion of the words "explicitly established for the purpose of securitising assets" and with the addition of a reference to not having a general commercial or industrial purpose, and also not being a holding company (each by reference to the existing PERG 16.2 guidance).

In case it is considered helpful, we suggest some drafting below for this alternative definition:

"pooled investment vehicle - a body corporate whose sole purpose (either generally or when acting in a particular capacity) is to carry out one or more of the following functions:

(a) issuing designated investments, other than life policies;

(b) redeeming or terminating or repurchasing (whether with a view to re-issue or to cancellation) an issue (in whole or part) of designated investments, other than life policies;

(c) entering into transactions or terminating transactions involving designated investments in connection with the issue, redemption, termination or re-purchase of designated investments, other than life policies,

where such body corporate:

(X) does not have a general commercial or industrial purpose; and

(Y) is not a holding company (within the meaning of article 3(3)(a) of AIFMD).

[Note: The FCA, when considering whether a body corporate has a general commercial or industrial purpose, will have regard to its guidance in PERG 16.2 as if they were to apply to the body corporate. When considering whether a body corporate is a holding company within the meaning of article 3(3)(a) of AIFMD, the FCA will have regard to its guidance in Questions 6.2 to 6.5 of PERG 16.6.]"

Additional comments

In responding to Chapter 8 of CP16/17, we would welcome the opportunity to bring another matter to the attention of the FCA which has become apparent since the implementation of the rules on NMPIs. In particular, we understand that some issuers have found that paragraph (d) of the definition of "excluded securities" (which forms part of the definition of paragraph (c) of the definition of NMPI) may be too restrictive for new funds entering the market and so could act to inhibit growth and development of the funds market in the UK.

Paragraph (d) of the definition of excluded securities excludes the following from the definition of an NMPI: "a share in a company resident outside the EEA, where that company would qualify for approval as an investment trust by the Commissioners for HM Revenue and Customs under sections 1158 and 1159 of the Corporation Tax Act 2010 if resident in the United Kingdom".

We do not set out here the elements of sections 1158 and 1159 of that Act, but wish to draw to the FCA's attention that, whilst certain of the elements have a forward looking status (such as the requirement not to retain more than 15% of the entity's income for any accounting period which is to be satisfied by the date of filing of the tax return), another key element is to be assessed as at the date the assessment. The element which has the potential to cause particular difficulty is the requirement not to be a close company. In the context of a new listed fund, it is likely that it will be a close company at the time the financial promotions are being made (and may even remain a close company for a short interim period following launch whilst shares are issued and distributed).

We do not believe the intention of paragraph (d) was to restrict access such that only already established listed overseas funds are eligible for this exclusion, not least of which because newly established vehicles are eligible to be listed on the LSE's Main Market under Chapter 15 of the Listing Rules.

We do not propose seeking to amend the relevant definitions within the Corporation Tax Act 2010, however we would ask the FCA to consider including guidance to state that this test should be met either (for pre-existing funds, for example, conducting secondary fund-raisings) at the time of the marketing or, for structures that are being marketed by the expiry of a period six months after completion of the first fund-raising.

More broadly, we would also ask the FCA to consider why only investment trusts (and their equivalent) are considered to be within scope for being excluded securities under paragraphs (c) and (d). If the FCA wished to undertake a more general review of the scope of the NMPI regime (and the types of vehicle to be taken outside the regime), we would be grateful if the FCA could consider whether a broader category of investment fund can be included within the scope of excluded securities (particularly if the entity concerned meets all of the criteria other than admission of the Official List), such as those with shares admitted to trading on AIM. For example, given that the FCA will be required to implement the provisions of MiFID II and will shortly be publishing a consultation on the amendments to the Conduct of Business Sourcebook, we would suggest that financial instruments that are non-complex (including as a result of article 57 of the proposed delegated regulation supplementing MiFID II as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive could be used as an alternative or additional benchmark for measuring whether a financial instrument should constitute an NMPI (with an additional items in the existing list of items that are excluded securities or otherwise outside the definition of being an NMPI.

Chapter 10 – Transparency reporting requirements for AIFMs

We have considerable concern over the proposals in Chapter 10 for the extension of reporting requirements for AIFMs beyond those actually required under the AIFMD, although its restriction to those AIFMs who are required to report quarterly is welcome. Our principal reasons for concern over the proposed extensions are that:

- in our experience AIFMs have had, and are having, considerable difficulty with reporting under the AIFMD and the extent of that reporting is a significant factor for non-EEA AIFM considering whether to market their AIFs in the EEA at all;

- notwithstanding the extensive guidance given by both ESMA and the FCA on reporting there are considerable ongoing uncertainties over the data required, and basic definitions such as the definition of leverage, with a consequential risk that the data being filed is inconsistent and potentially unreliable;

- in the context of the recent referendum vote in favour of the UK leaving the European Union even more careful consideration than has been the case hitherto should be given and caution exercised before "*goldplating*" the requirements of EU Directives. There are significant systems implications for AIFMs with each incremental change to reporting obligations and we suggest that any extension of the reporting requirements beyond those actually required by the AIFMD should be considered only in the light of the FCA's general consideration of the AIFMD regime in the context of Brexit.

It is not clear to us, nor set out in any detail in the Consultation Paper, how the benefit brought to the pursuit of the FCA's objectives in gathering additional information beyond that required under the AIFMD for the very broad range of different types of AIF will be sufficient to justify the additional reporting burden on UK AIFM and on non-EEA AIFM marketing to professional investors (and the very limited range of permitted other investors) in the UK.

We welcome the restriction to those managers who report quarterly but note that some of the AIFs managed by such managers are small in size and that management or marketing in the UK does not mean that the relevant AIF either has assets in the UK or trades on UK markets. It is not clear to us that it is appropriate to extend the already extremely extensive reporting requirements to add detailed additional reporting for each such AIF in the manner proposed.

Q 10.1 Do you have any comments on our proposal for certain full-scope UK AIFMs to report on their non-EEA AIFs where those AIFs are not marketed in the EEA?

For the reasons given above it is not clear to us that this extension is justifiable, though we welcome its restriction to those managers who report quarterly.

We note that the "*goldplating*" involved goes not only beyond the AIFMD's requirements but also beyond the recommendations of ESMA for additional information which national competent authorities may wish, but are not obliged, to gather. We also note that some of the funds managed by UK AIFMs but not marketed in the UK will also not involve any UK assets or trading on UK markets (e.g. the fund concerned may invest in real estate outside the EU).

Q 10.2 Do you have any comments on our proposal for an above threshold non-EEA AIFM to report on its master AIFs not marketed in UK, if the relevant feeder is marketed in the UK?

For the reasons given above it is not clear to us that this extension is justifiable, though we welcome its restriction to those managers who report quarterly.

Moreover, in relation specifically to the position of non-EEA AIFM, it is not clear to us that the FCA is able to re-interpret regulation 59(3) of the Alternative Investment Fund Managers Regulations 2013 in order to achieve the change proposed.

We appreciate the FCA's concern that information about the activities of a feeder fund is of relatively little value by comparison with information about the master fund into which it feeds. However, regulation 59(3) relates to above threshold non-EEA AIFMs who have given notification to market an AIF in the UK and provides that they are required to comply with "the implementing provisions applicable to full scope AIFMs which relate to the provisions of Articles 22 to 24 of the directive in so far as such provisions are relevant to the AIFM and the AIF". Although the precise "different interpretation" proposed by the FCA is not stated in the Consultation Paper it is not clear to us that an alternative interpretation of that regulation is possible, nor that if it were possible the restrictions proposed by the FCA would apply. This is a very serious consideration since a change of interpretation could mean that non-EEA AIFM have been in breach of the regulations in the past.

In our view the previous interpretation was the correct one. Compliance with reporting requirements under regulation 59(3) must be in relation to both the AIFM and the AIF in relation to which the marketing notification was given, not in relation to another AIF in relation to which a marketing notification was not given and which is not being marketed in the UK, even if that other AIF is the master AIF to a feeder AIF which is being so marketed.

To seek to expand the application of regulation 59(3) beyond its natural reading in circumstances where a number of non-EEA AIFMs have taken decisions on the marketing of feeder funds and acquisition of investors in the UK on the basis of the original, natural interpretation that reporting would only be required in relation to the feeder fund which is marketed in the UK, has a significant retrospective effect for such AIFMs by requiring them to provide extensive and detailed information relating to their master funds and, arguable, since the proposed amendment to FUND 10.5.11B is just guidance interpreting regulation 59(3), to have provided such information in past filings. Had such obligations been known at the time the non-EEA AIFM might have decided not to market a feeder fund in the UK.

If it were possible to read regulation 59(3) as applying also to a different AIF (i.e. the underlying master AIF), which we do not believe is the case, then there does not appear to us to be a reason for dividing up the application of regulation 59(3)(a) applying the new reading only to quarterly reporting obligations under FUND 3.4 implementing Article 24 on reporting to the FCA and not to all those provisions and also to the provisions of FUND 3.2 (implementing Article 22 on investor information) and FUND 3.3 (implementing the provisions

of FUND 3.3 on the provision of an annual report). There might even be uncertainty over whether the provisions of Part 5 might be regarded as applicable. We note also that the extension to master AIFs which are not managed by the same AIFM goes beyond matters which are relevant to the AIFM which is subject to the reporting obligations and is also broader than the provisions

For the reasons given above the proposed change for non-EEA AIFMs therefore appears to us to be outside the powers of the FCA under the Alternative Investment Fund Managers Regulations 2013 as well as undesirable in policy terms by its retrospective and potentially wide reaching effect.

We note that the cost benefit analysis refers to potential obligations of relevant AIFM already to file information with the SEC and/or with the NCAs of Belgium, Luxembourg and the Republic of Ireland and suggestion that this means that it is likely that a number of those affected are already filing an equivalent article 24 return with another NCA. In our experience AIFMs do regard the incremental costs of filing with more than one regulator and technical difficulties with reformatting information to meet the detailed filing process for each regulator very seriously and it can affect their willingness to market at all.

In addition, in our experience, although we would agree that it is common for non-EEA AIFMs to market in more than one EU jurisdiction if they decide to market in the EU at all, there has been a very significant restriction of the states in which marketing (in the sense defined under the AIFMD) is undertaken since the implementation of the AIFMD. Belgium, Luxembourg and the Republic of Ireland are not high on the list of states chosen when marketing is limited to selected EU states. On the other hand the UK is quite commonly chosen as the sole EU member state in which marketing is undertaken.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours faithfully

Karen Anderson
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
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