Response to FCA CP26/28: The UK AIFM Regime (except Chapters 13, 14 and 16)

20 October 2026

Executive Summary

INREV[1] welcomes the FCA's direction of travel in reforming the UK AIFM regime and supports a more principles-based, proportionate and outcomes-focused framework. The proposals provide an opportunity to reduce unnecessary prescription while maintaining appropriate investor protection and market integrity. However, the final regime should reflect the diversity of AIFMs, fund structures and asset classes, rather than treating assets under management as the sole proxy for risk.

Proportionality

We support the proposed tiered regime, aggregate NAV methodology and transitional periods for firms moving between thresholds, subject to safeguards against double counting and clearer guidance on material changes. Proportionality should remain available to all AIFMs and should take account of fund structure, leverage, liquidity, asset class, investor base and operational complexity.

Competitiveness of the UK

One of the FCA's objectives is to facilitate the UK's international competitiveness and growth in the medium to long term. In relation to the UK AIFM Regime, the FCA should consider the impact on UK funds marketing in Europe, not only from the perspective of the AIFM itself but also in relation to their investors, and including from a tax point of view. Where possible, the FCA should also minimise divergence that creates duplicative UK and EU compliance and recognise equivalent EU standards where they deliver the same outcomes.

The reforms should avoid disadvantaging UK vehicles relative to offshore alternatives. In particular, the depositary requirements applying to Reserved Investor Funds (RIFs) operated by small AIFMs should be reconsidered so that RIFs can compete on a level playing field with Jersey, Guernsey and Isle of Man property vehicles and other unauthorised UK structures. We also ask for the FCA to consider an opt-in route to the AIFM regime, for example, for structures such as an LTAF or RIF with a single DC pension scheme investor,

AIF and CIS boundaries

Within our response we have suggested some changes to the definition of an AIF; we will include these in our response to the HM Treasury consultation too. However, we urge HM Treasury and the FCA to proceed cautiously when making changes to the AIF definition and the treatment of residual CIS. The FCA and HM Treasury should clarify which structures will be affected, preserve the

[1] INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe.

INREV currently has over 520 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds that provide critical income security for more than 172 million people, as well as investment banks, investment managers, fund-of-funds managers and advisors representing all facets of investing in non-listed real estate vehicles in Europe. Our investment manager members manage more than 500 non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors.

continued relevance of PERG guidance, consult on any changes to that guidance and coordinate with HMRC to avoid unintended tax consequences. INREV supports limited FRAME reporting to build the evidence base, but does not support extending binding SYSC, COBS or enhanced disclosure requirements across the residual CIS population before that evidence has been assessed. If reclassification is required, firms should receive an implementation period of at least 18 months, and appropriate grandfathering should be considered.

Valuations

We strongly welcome removal of unlimited statutory liability for external valuers and, this removal takes effect as soon as practicable. We support clear independence and competence standards applying to valuations.

Leverage

We support removing mandatory gross and commitment leverage calculations and allowing disclosure using the method most appropriate to the fund. The final rules must nevertheless preserve or clearly replace important Level 2 concepts, including the treatment of commitment-backed borrowing, investor loans, hedging and leverage within controlled structures. The private equity carve-out should be retained and extended appropriately to real estate and infrastructure funds.

Liquidity

We believe that liquidity obligations, look-through assessments and stress testing should be tailored to the actual risk profile and operational feasibility of each fund.

Delegation

We support the FCA's general approach to delegation, including removal of prior approval for delegation of portfolio or risk management and proportionate treatment of specialist unauthorised delegates.

Reporting and disclosures

Simplified annual reporting and investor disclosures are welcome, but the regime should avoid requiring duplicative UK-specific reports where EU AIFMD requirements have already been met. Information supplied in response to investor requests should be shared more widely only where it is of general relevance, not where it is bespoke, tax-specific or otherwise particular to one investor.

Prudential regime

The prudential framework should reflect the agency-based nature and generally simple balance sheets of fund managers. We favour base capital and fixed-overhead requirements over AUM-linked activity metrics, propose a £75,000 minimum capital requirement for external AIFMs, and oppose prescriptive liquidity requirements that exceed the risks presented. If a liquid assets requirement is retained, it should be no more onerous than the MIFIDPRU approach. Wind-down expectations should focus on practical transfer and continuity arrangements, professional indemnity insurance should remain a firm-level judgement rather than a mandatory requirement, and reporting should be streamlined to avoid overlap across prudential regimes.

Glossary definitions

We are concerned with some of the definitions in the revised FCA Handbook Glossary of definitions. Some of the definitions require revisions and do not always work coherently with one another and with other FCA rules and guidance, for example, PERG. Some of the definitions we would like the FCA to review include the residual CIS excepted vehicles and some leverage definitions.

Definition of open-ended and closed-ended AIFs

We would particular like there to be clarity regarding the definitions of open-ended and closed ended AIFs. As drafted, we believe the definition of "Open-Ended AIFs" (ALTS 2.2.1R (1)) could potentially capture funds that are generally understood by the market to be closed-ended, but which contain highly limited redemption mechanics.

The FCA's definition largely follows the current EU definition in Commission Delegated Regulation (EU) No 694/2014, that open-ended funds are those which:

i) repurchase or redeem shares/units,

ii) at the request of their investors,

iii) prior to liquidation,

iv) in the manner set out in its documents (subject to exclusions in relation to distributions and secondary market transfers).

This broadly mirrors the FCA's proposed definition using different wording.

On the face of it, the definition is quite restrictive, as the ordinary meaning implies that any ability of the AIF to repurchase or redeem shares, no matter the frequency, would be caught. However, we are aware that this is not how this definition is interpreted in the EU. In the initial text of AIFMD Level 1, it was explicitly stated that the frequency would need to be "at least annual" for an AIF to be open-ended. ESMA's 2013 opinion (ESMA/2013/1119) supported this, stating that requiring at least annual redemptions was a reasonable interpretation of the Directive, even if the Commission chose not to explicitly include a frequency test in the final Level 1 text in order to expedite AIFMD's adoption. In addition, certain home states have provided their own indication of what frequency of redemptions would be classed as open-ended. For instance, in Ireland, under the CBI's AIF Rulebook, any Irish Retail Investor AIF must allow redemptions at least monthly to be considered "open-ended". Those offering less frequent liquidity are categorized as "open-ended with limited liquidity". Similarly, a Qualifying Investor AIF (QIAIF) that does not provide at least quarterly redemptions is classified as "open-ended with limited liquidity" by the CBI.

Once the legislation is made in the UK in its own right, the ESMA opinion and related EU guidance will no longer be relevant to the interpretation of the definition. This matters as we are increasingly seeing private, closed-ended funds which have some mechanism for redemption. This can either be:

i) infrequent, time based, i.e. less than annually, or

ii) event based, i.e. if there should be an event causing underlying liquidity within the structure.

We further note that there are other regulations which point to redemptions of a frequency of less than 5 years being a trigger for less restrictive rules to apply, implying a difference in funds with this frequency of redemptions, for example, under AIFMD in relation to a "PE AIF depositary".

The definition of “Open-Ended AIF” matters here due to the proposed cliff edge consequences. We do not believe that it would be proportionate for a fund with extremely limited redemption rights to be classified as open-ended and for example be subject to the look-through requirements.

We would therefore request that either:

i) the definition of “open-ended AIF” be amended to exclude AIFs with an infrequent redemption frequency, or

ii) that, as in other jurisdictions, a further category be introduced of openended AIFs with limited liquidity, with less stringent applicable rules.

There is one other option the FCA may wish to consider. Closed-ended funds have to consider the liquidity of their underlying investments as they near the end of their life and have to realise those investments. Instead of having prescriptive definitions for open-ended and closed ended AIFs, there could be a rule that all AIFMs should consider the liquidity of underline investments in their AIFs in the context of their obligations to return capital to investors.

We urge the FCA to consult further on the definitions in the Glossary in the follow up consultation on the UK AIFM Regime.

Host AIFMs

We would welcome clarity whether there are changes in the regulations that apply to host AIFMs on account of implementing the proposals envisaged by CP26/28.

Ongoing engagement

We have appreciated the FCA’s willingness to engage with INREV and our members throughout the consultation period.

If the FCA would like to discuss any aspect of our response further, please contact Jeff Rupp, Public Affairs Director, INREV (jeff.rupp@inrev.org).

We look forward to contributing to the second consultation on reforms to the UK AIFM Regime.

Response to consultation questions

Please find below our response to the individual questions within the consultation.

We have included, as Annexes to this response, two position papers, Annex 1 on 'The UK Collective Investment Scheme (CIS) Regime in the context of UK AIFMD Reform' and Annex 2 on 'Leverage in the Context of UK AIFMD Reform. These papers have been shared with the FCA during the consultation period, and we would like to thank the FCA for giving us the opportunity to discuss their contents with them. We have included them in our response to provide more colour to our responses to the consultation questions.

Chapter 2 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 believe the proposed aggregate NAV calculation is a practical, proportionate and transparent measure of firm size that will support a more coherent regulatory framework while reducing unnecessary complexity.

However, when an AIFM is determining its size, by aggregating the NAV of all its AIFs, care must be taken in ensuring there no double counting when, for example, they manage associated feeder and master funds. We suggest that the FCA amend ALT 2.3 to reflect this.

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 support the FCA's proposals for firms moving between thresholds. We agree that they are more streamlined than the current regime.

The requirement for firms to notify the FCA of a change in classification using a firm SUP15 material change form. is a more proportionate and operationally efficient approach which reduces unnecessary administrative burdens while still providing the FCA with appropriate supervisory oversight.

We note that a firm will be required to calculate and determine its size whenever there is a material change to the value of its business which may impact its AIFM classification, and whenever there is a significant change in the value of assets being managed by the firm. We ask the FCA to provide guidance on what constitutes a material or significant change, ensuring that firms apply a consistent approach when determining whether they must recalculate their size.

We also strongly support the proposed implementation periods. Allowing firms six months to comply with new requirements following a change in classification, together with a twelve-month period to appoint a depositary where one becomes required, recognises the practical reality that many compliance, governance and operational changes cannot be implemented immediately. This is particularly important where

crossing a threshold may trigger significant organisational changes or require the establishment of new third-party relationships.

The proposal to delay the commencement of compliance periods where a firm crosses multiple thresholds within a calendar year is also sensible. It should help mitigate the effects of short-term fluctuations in asset values and reduce the risk of firms being required to repeatedly adjust their arrangements in response to temporary movements in NAV.

More broadly, the FCA's wider reforms to the threshold structure should also reduce cliff-edge effects. The move to a three-tier regime, the increase in the lower threshold to £750 million NAV, and the use of aggregate NAV as a simple size metric should create a more graduated and proportionate progression between regulatory categories. The FCA has expressly recognised concerns raised by industry regarding the current regime.

Overall, we consider that the proposed framework strikes an appropriate balance between regulatory oversight and proportionality. While some threshold effects will inevitably remain in any tiered regime, the FCA's proposals materially reduce the operational, compliance and authorisation burdens associated with moving between categories.

Chapter 3 Residual CIS operators

Please do refer to our position paper 'The UK Collective Investment Scheme (CIS) Regime in the context of UK AIFMD Reform' in Annex 1 when considering our responses to the proposals in the consultation paper regarding residual CIS.

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

We support the FCA's objective of ensuring that arrangements which should properly be classified as AIFs are brought within the AIFM regime. However, we believe there are significant practical challenges and risks that will need to be carefully managed if changes to the AIF definition result in the reclassification of certain non-AIF CISs.

First, there remains considerable uncertainty as to which specific categories of arrangements the FCA and HM Treasury consider would be newly brought within the scope of the AIF definition. While the proposed changes appear intended to clarify existing concepts, such as "raising capital" and "defined investment policy", it is not currently clear which structures are expected to be affected in practice. Greater clarity would help firms assess the implications of the reforms and determine whether changes to permissions, governance arrangements or operating models will be required.

Secondly, the boundary between AIFs, non-AIF CISs and arrangements that are neither AIFs nor CISs is complex and has developed over many years through legislation, FCA guidance and case law. Many legitimate commercial structures rely on the current interpretation of these boundaries, including co-investment vehicles, carried interest vehicles, funds-of-one, joint venture arrangements and other real estate

investment structures. Any changes that create fresh uncertainty around these distinctions may result in significant legal analysis costs for firms and could discourage the use of UK structures in favour of jurisdictions where the regulatory treatment is perceived to be more certain.

We are also concerned about the potential knock-on effects on related legislation, particularly tax legislation, where the concepts of AIFs and CISs are frequently incorporated directly or by reference. Even where regulatory changes are intended to be clarificatory, firms may be required to revisit the tax analysis of existing structures, creating additional cost and uncertainty. We therefore encourage continued coordination between the FCA, HM Treasury and HMRC to ensure that any regulatory changes do not produce unintended tax consequences.

If the FCA's expectation is correct that certain non-AIF CISs will need to be reclassified as AIFs, a significant transition period will be required. Affected firms may need to apply for variations to their Part 4A permissions, appoint depositaries, appoint or replace external AIFMs, amend documentation or implement new compliance arrangements. We therefore strongly support a transition period of at least 18 months and encourage the FCA to consider whether grandfathering relief would be appropriate for existing structures.

Finally, if HM Treasury's changes are intended merely to clarify the existing position rather than extend the scope of the regime, we would welcome confirmation that existing FCA guidance, including PERG 16, continues to apply. This guidance has been extensively relied upon by market participants and advisers and remains an important source of certainty in assessing whether arrangements constitute AIFs. Therefore, if required, we urge the FCA to consult prior to making any changes to PERG.

We encourage HM Treasury and the FCA to proceed cautiously with any changes to the AIF definition. The FCA should, provide greater clarity on the arrangements expected to be affected, and ensure that any transitional arrangements are sufficient to allow firms to adapt in an orderly and proportionate manner.

Our members would like more flexibility by there being the ability to opt-in to the UK AIFM Regime. For example, where AIFMs wish to have the ability to provide a managed account service, via an LTAF or RIF, for individual DC pension schemes. It may also be beneficial for excluded entities or residual CIS to be able to opt-up to become a residual CIS or AIF with the agreement of all participants. We would like to discuss with HM Treasury and FCA how the AIF definition could be adapted to enable ‘opt-in’.

As we mentioned in our response to the discussion chapter on Depositaries, smaller AIFM, operating a RIF, face disproportionate depositary requirements compared with an AIFM operating another type of unauthorised AIF. We believe that the policy intention was never intended to create a difference between the RIF and other unauthorised AIFs. The RIF Tax Regulations were (understandably at the time) drafted under an assumption that a depository was part of the structure. If this remains unchanged this would go against the stated policy intention in FCA CP 26/28 paragraph 13.16 to ensure a proportionate regime for small UK AIFMs. It would be helpful if, as part of the FCA work on the discussion chapter on Depositaries, the FCA

raises this concern with HM Treasury. There could be a simple solution to this by inserting the word "any" in the following wording within Regulation 6 of the RIF Tax Regulations 2025:

> "the operator and *any* depositary of the scheme are bodies corporate incorporated in the United Kingdom… and administer the scheme from the United Kingdom".

This would also enable small AIFMs to appoint a RIF depositary, if they so choose, in line with FCA CP26/28 paragraph 13.17.

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?**

We do not believe there is currently a sufficient evidential basis for applying the SYSC and COBS provisions that operate as guidance for residual CIS operators as binding rules. The FCA has acknowledged that the residual CIS population is highly diverse and encompasses a wide range of arrangements, many of which are not fund-like and serve very different commercial purposes. The CIS regime has developed over many decades, serves multiple distinct policy functions, and applies to a broad range of structures, including arrangements that are not closely associated with blind-pool fund management.

In our view, the FCA should first gather data on the nature, scale and activities of residual CIS operators before considering any wider extension of regulatory obligations. We support the limited annual reporting proposed under FRAME for residual CIS operators, as this would provide the FCA with a better understanding of the population of firms and arrangements involved and would create a more robust basis for any future policy decisions.

We are also concerned that imposing additional rules at this stage could create unnecessary burdens for a wide range of legitimate structures that are properly categorised as non-AIF CISs. The FCA's own consultation recognises that many residual CISs arise from historical and commercial circumstances and perform legitimate economic functions. The regulatory framework should therefore distinguish clearly between arrangements that have been wrongly categorised and should properly be regulated as AIFs, and arrangements that are correctly categorised as non-AIF CISs.

A further consideration is the complexity of the existing permissions landscape. The interaction between AIF permissions, CIS operator permissions and the rules that attach to them has historically been a source of uncertainty for firms and advisers. We would therefore be concerned if the extension of additional binding rules were to create further uncertainty about the permissions required for CIS-related activities or the conduct standards that apply to them.

Accordingly, we would favour a cautious and evidence-based approach. At this stage, we support the introduction of the limited reporting framework proposed in FRAME and would encourage the FCA to use the resulting data to assess

whether any categories of residual CIS operators present risks that justify additional regulatory requirements. Once that evidence base has been established, the FCA could then consider whether specific SYSC or COBS provisions should be applied to particular categories of residual CIS operators, rather than extending a broader set of rules across the residual CIS population as a whole.

In terms of additional rules, we do not currently identify any further provisions that should be applied to residual CIS operators beyond the limited reporting requirements proposed under FRAME. Before considering any expansion of the regime, we would encourage the FCA to undertake a dedicated workstream focused on the CIS regime as a whole, informed by the data collected through FRAME and by a better understanding of the variety of structures that fall within the residual CIS population.

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

We do not support extending the enhanced investor disclosure requirements in ALTS 9 and 10 to residual CIS operators at this stage. In our view, the FCA should first gather data on the residual CIS population through the proposed FRAME reporting regime and use that information to assess whether additional disclosure requirements are justified and, if so, which categories of residual CIS should be in scope. The FCA's proposed reporting requirements will provide a better understanding of the size, nature and activities of the residual CIS population, which we consider a necessary precursor to any broader reform of the regime.

More fundamentally, the residual CIS population is highly diverse and includes many arrangements that are not fund-like in nature. The CIS regime applies to a wide range of legitimate structures that serve important commercial functions, including carried interest vehicles, co-investment arrangements, funds-of-one, joint ventures, property development structures and other real estate investment vehicles. Applying enhanced disclosure requirements by default to all residual CISs, subject only to a list of exemptions, risks capturing many structures for which there is no clear policy justification for additional disclosure obligations.

We are concerned that the definitions, in the revised FCA Glossary, including the ones for the exempt vehicles are not fit for purpose. The FCA's proposed definitions require considerable revision and do not work coherently with one another – in some cases, the definitions do not fully reflect existing FCA guidance in PERG. We urge the FCA to revisit these definitions and consult further on them in the follow up consultation on the UK AIFM Regime.

If the FCA ultimately concludes that additional disclosure requirements are appropriate, we believe a more targeted approach would be preferable. Rather than defining a broad population of residual CISs and carving out exempt categories, the FCA should positively identify the specific characteristics of those residual CISs that create a need for additional investor disclosure and apply the requirements only to those arrangements. This would provide greater clarity and

avoid bringing within scope structures where the benefits of additional disclosure are limited or non-existent.

We are also concerned that the proposed exemptions are not yet workable. As highlighted in our comments on the proposed definitions (in the Appendix of Annex 1 to our response), concepts such as "joint venture vehicle", "single investor vehicle" and "carried interest vehicle" are difficult to define and, in several cases, the proposed definitions do not align fully with existing FCA guidance or market practice. There is a significant risk that the current drafting could create uncertainty, require complex legal analysis and inadvertently bring into scope structures that the FCA intends to exclude.

More generally, any reforms should recognise the legitimate role of non-AIF CISs in the UK economy. The CIS regime is not merely a residual framework but a long-established regime that serves a number of distinct policy functions and supports a range of commercially important structures, particularly in the real estate sector. The FCA should therefore be cautious about increasing the regulatory burden on residual CISs in a way that could discourage firms from establishing and operating such structures in the UK.

Accordingly, we would encourage the FCA not to extend the enhanced investor disclosure requirements at this stage. Instead, the FCA should proceed with the proposed FRAME reporting, analyse the resulting data, and, if necessary, develop a more targeted disclosure regime based on clearly identified categories of residual CIS that present investor protection concerns.

Chapter 4 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 strongly welcome the removal of the statutory provision for unlimited liability for external valuers, and this removal takes effect as soon as practicable. We have been campaigning for this change ever since AIFMD came into force. Professional valuers have been unable to accept appointments as external valuers by an AIFM because they are not able to obtain insurance to cover them for unlimited liability. It is important that AIFMs, of AIFs investing in real estate, are able to obtain independent valuations from valuers with the appropriate experience in valuing real estate. This gives investors in the fund comfort with the value of the fund itself.

We agree with the FCA's proposal that AIFMs only appoint an independent valuer if it meets the following criteria:

> 6.2.11R (2) The AIFM must ensure that the third-party valuer is independent of the AIFM and that, throughout the period of its appointment, the valuer:
>
> (a) has the knowledge, skills and experience to value the relevant assets and (if applicable) liabilities;
>
> (b) has sufficient personnel and technical resources;
>
> (c) is able to act independently of the AIFM; and

(d) has procedures to safeguard the performance of a proper and independent valuation.

For consistency with the above criteria and to reinforce the need for independence from the AIFM we suggest the following minor changes to the prosed ALTS:

6.1.3G (3) An AIFM may conduct the valuation itself, or it may appoint an ~~independent~~ third-party valuer (who must be independent of the AIFM) to assist the AIFM in carrying out its obligations. Where an AIFM uses a third-party valuer to carry out or assist it with carrying out a valuation, the AIFM remains responsible for ensuring compliance with the regulatory requirements relating to valuation.

6.2.10 R A large UK AIFM must ensure that:

(1) a valuation of an AIF's assets and liabilities is carried out by a third-party valuer or independently of the AIFM's portfolio management function;

In addition, we believe that "regulatory requirements relating to valuation" (ALTS 6.1.3G (3)) should be defined. It is unclear whether this refers only to FCA requirements or extends to requirements from other entities like RICS and Financial Reporting Council.

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

We agree that the general rules for valuing AIFs as set out in ALTS 6.2 should apply to all authorised UK AIFM regardless of their size. We support a clear baseline of proportionate organisational and conduct standards for all AIFMs. Baseline rules should establish essential outcomes without reproducing requirements designed for the largest or most complex firms. We suggest additional obligations should be focused in view of relevant items like risks, fund structure, leverage, liquidity, assets and investor base.

Chapter 5 Leverage calculations

Please do also, refer to our position paper 'Leverage in the Context of UK AIFMD Reform' in Annex 2 when considering our responses to the proposals in the consultation paper regarding leverage.

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 support the FCA's requirement to remove the mandatory requirement for AIFMs to calculate leverage using the commitment and/or gross method. Please refer to our response to Question 11 for our concerns relating to how leverage is to be defined under the FCA's proposals.

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 agree with a hedging exemption for closed ended AIFs that solely use leverage only for hedging purposes. Such an exemption is a proportionate way of tailoring risk management and liquidity requirements to the actual risks posed by a fund. It ensures that closed ended AIFs that only utilise leverage embedded in derivates for currency and interest rate hedging purposes are not subject to disproportionate risk management and liquidity requirements.

We note that the concept of using leverage "for investment purposes" is not defined, though SUP 16 Annex 63.2(6)(d) provides a negative confirmation that leverage used for foreign exchange and interest rate hedging purposes should not be regarded as leverage used for "investment purposes". However, the Glossary definition of an "unleveraged closed-ended AIF" seems to be narrower insofar as it provides that an AIF will be unleveraged where it only employs leverage embedded in derivatives used for currency and interest rate hedging purposes where the derivatives:

(a) do not aim to generate a return;
(b) offset specific risks; and
(c) result in a verifiable reduction of market risk for the AIF.

We urge the FCA to ensure that the concepts of "leverage", "hedging", "unleveraged closed-ended AIF" and leverage used "for investment purposes" are used consistently throughout the rules. If different formulations are intended to produce different outcomes, these distinctions should be clearly explained in the rules and supporting guidance.

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 the FCA's proposal to allow AIFs to undertake a de-minimis amount of leverage. We believe this is a proportionate way of tailoring the rules and distinguishing between AIFs that use leverage for incidental purposes and highly leveraged AIFs. We suggest that the FCA set the de minimis leverage cap at 15% of NAV.

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 welcome the FCA's proposal to allow AIFMs to calculate and disclose a fund's leverage based on the method that is deemed to be most suited to the AIFs and for the purposes of reporting under FRAME and investor disclosure, so long as the basis of the calculation is adequately disclosed, we think the proposal makes sense.

However, we envisage that challenges may arise when using the "leverage" concept because, in addition to our concerns noted in our response to question 9, the way "leverage" is proposed to be defined leaves areas of uncertainty.

In particular, we note the FCA is proposing to retain the existing EU AIFMD definition of leverage (i.e., any method by which an 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) without including the concepts/ boundaries that are contained in the EU's AIFM

Delegated Regulation into ALTS. This is an important omission as the contents of the EU AIFM Delegated Regulation play an important role in defining leverage and have been relied upon by market participants, albeit we recognise they operate somewhat imperfectly. Two important clarifications within those rules (but by no means all) are that temporary borrowing arrangements are excluded from the leverage calculation (Article 6(4)) and the position on look through (Article (6(3)).

As such, if the FCA intends to retain the AIFMD's concept of leverage in ALTS it should ensure that the rules/concepts that inform this definition are also replicated in ALTS. In particular, the FCA should replicate Article 6(4) that excludes temporary borrowing arrangements, that are fully covered by capital commitments from investors, from the leverage calculation. Without these rules being transposed into ALTS, firms would technically be free to take a number of positions within the broad umbrella definition of leverage.

We also urge the FCA to consider how it can improve upon the EU's definition of leverage and create a regime that better reflects the commercial reality of how real estate funds use leverage. We suggest that the FCA retain the Article 6(3) AIFM Delegated Regulation carveout for leverage at the level of non-listed companies and issuers for AIF's whose core investment policy is to acquire control of such issuers/non-listed companies and to explicitly clarify that this extends to funds whose core investment policy is to acquire control of real estate.

An alternative approach would be to delink the more flexible interpretation of “leverage” proposed for reporting under FRAME and investor disclosure purposes, from the classification of AIFs (i.e., whether an AIF is an “unleveraged closed-ended AIF”) for risk management purposes for which greater clarity would be welcome. We’d be happy to discuss how this could work with the FCA.

Chapter 6 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?**

We agree with having baseline requirements for all AIFMs to carry appropriate research and due diligence when selecting investments. We welcome the FCA not bringing across from Level 2 Regulation prescriptive rules around investment due diligence. However, guidance would be useful to assist AIFMs in understanding the level

of research and due diligence expected when selecting different types of investments.

We note that under the current rules, AIFMs are able to apply the risk management rules on a proportionate basis. However, under the FCA's proposals the ability to apply the rules in a proportionate manner would be strictly limited to small UK AIFMs only. Medium and Large UK AIFMs would not be able to avail use of proportionality to tailor the risk management rules. This

appears to have been a policy choice informed by the idea that there is a direct correlation between the risks that an AIFM is exposed to and the quantum of NAV it manages. We do not think this is correct. The risks that AIFMs are exposed to may correlate to a variety of factors e.g., the asset class that AIFs invest in or the geography of those investments etc. We therefore urge the FCA to reinstate the ability for all AIFMs, irrespective of size, to apply proportionality when implementing the risk management rules. Please refer to our answer to Question 14.

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 broadly agree with the FCA's proposal. In our view, closed ended unleveraged AIFs pose a lower level of risk to the financial system and should only be subject to baseline risk management requirements.

Please refer to our earlier comments on the definition of leverage in our response to Question 11. These are relevant in respect of how the concept of an 'unleveraged closed-ended AIF' is defined.

Question 14 **Should the largest firms 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?**

Currently all AIFMs irrespective of their size are able to apply the risk management requirements on a proportionate basis. More specifically, the requirement for an AIFM to "functionally and hierarchically" separate the functions of risk management from the portfolio management function (and other operating units) is, under Article 15(1) AIFMD, subject to the principle of proportionality. Some large/medium AIFMs apply this principle to switch off this requirement provided that they can demonstrate compliance with the broader rules on safeguards against conflicts of interest that allow for the independent performance of risk management (under Article 43 of the AIFMD Level 2 Regulation) and that the risk management process is consistently effective. This is instead of meeting the requirements for full functional and hierarchical separation in Article 42 of Level 2.

Under the FCA's proposed rules, this ability to apply proportionality will be limited to small UK AIFMs only and so large/medium AIFMs will be in a materially worse position under the proposed rules than they are today.

In proposals which are meant to be business friendly, it is not clear why the FCA is increasing the obligations on the risk management of AIFMs in this manner. Specifically, many cross-border asset management enterprises do employ independent risk management specialist professionals, who contribute to enterprise-wide portfolio risk management functions. However, if they employ them in (say) Luxembourg or the US, they should not be required to make an additional duplicative hire in the UK in order to meet local independence requirements more onerous than EU AIFMD (or current UK law).

Chapter 7 Liquidity risk management

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

We note that the rules for small UK AIFMs' liquidity risk management are in ALTS 7.2 and these apply when small UK AIFMs are managing any unauthorised AIF other than an unleveraged closed-ended AIF. Therefore, initially an AIFM will need to establish if the AIF is leveraged or not. As we have mentioned before, clarification is required from the FCA on what constitutes leverage to be able to establish which funds meet the definition of a closed-ended, unleveraged AIFs.

We urge the FCA to revisit the proposed requirement for small AIFMs to have regard to COLL 6 Annex 5 (guidance on good liquidity risk management practices published in PS26/17 Enhancing fund liquidity risk management). We appreciate that this is intended to bring a degree of consistency between authorised funds and unauthorised AIFs when designing and implementing a liquidity risk management framework. However, we think it is misguided that AIFs would need to have regard to guidance that is principally designed to apply to UCITS and NURS funds.

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?**

It is not clear how medium and large AIFMs should consider the liquidity of the assets held in open-ended funds that their open-ended AIFs have invested in. Will AIFMs be expected to assess the liquidity of the individual assets held by the underlying fund or should the assessment be based upon the type of assets the underlying fund invests in? If the assessment should be asset by asset this will be operationally challenging. It would require the AIFM, of the AIF investing in other open-ended funds, to have access to granular information about the underlying AIF's portfolio. The managers of the underlying fund may not wish to divulge such in depth details about the assets especially as it could be burdensome for them to prepare this information. Given that the definition of open-ended AIF potentially includes funds that consider themselves to be closed ended but in fact fall within the definition as a result of a liquidity window or similar, the underlying funds may not consider disclosure appropriate. In addition, the AIFM would need to know which assets the underlying fund planned to sell to meet redemptions, which is likely to be highly commercially sensitive information. We would suggest that the obligation for AIFMs covered by this rule could be to seek a look through to the portfolio where possible but not to be in breach if that would be disproportionate to the potential benefit of investors.

Also, we note that there is no mention of the expected frequency of 'look through' assessments. We are concerned that the requirement for these assessments could be operationally complex and burdensome for AIFMs.

We ask that where that the current industry guidelines for liquidity risk management, namely the ESMAs Guidelines and Q&As for AIFMD, remain relevant, this is stated in ALTS.

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 welcome the FCA's proposed rule in ALTS 7.3.5R(2) that would allow AIFMs to tailor their liquidity risk management framework to their risk profile.

We urge the FCA to consider how it might enable medium UK AIFMs of open ended and leveraged closed-ended AIFs tailor the requirements relating to annual stress testing (ALTS 7.3.14R). While we understand the benefits of stress-testing, we believe that these requirements should be tailored such that medium UK AIFMs can apply some (or all) of these measures where they are appropriate to the risk profile of the fund in question.

Chapter 8 Delegation

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

We support the FCA's general approach to delegation - in particular we support HM Treasury's proposed removal of the requirement for AIFMs to seek FCA approval for the delegation of the risk or portfolio management function. We agree that the existing framework has generally worked well and support the FCA's proposal to retain the core principles, including the requirement that the AIFM remains responsible for the delegated activities and maintains appropriate oversight and substance.

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 consider the FCA's proposals, on the delegation of investment management activities to entities that are not authorised or supervised for that activity, to be pragmatic and proportionate. This is particularly beneficial for the real estate sector, where access to specialist expertise can be important to the effective management of investments. We welcome the guidance in ALTS 4.3.11G, which provides helpful clarification on the types of entities that are considered authorised or registered for these purposes. These provide greater certainty and consistency in the application of the rules.

Chapter 9 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 support the FCA's broad approach to annual investor disclosure obligations and welcome the FCA's desire to make these more principles based. Section 9.10 of the consultation paper states that the FCA do not propose to retain all the detailed measures in articles 103 and 104 of the UK's Level 2 AIFM Regulations. These articles originate from Article 22(2)(a) to (e) of the EU's AIFMD. The FCA's policy decision raises the spectre that firms operating cross-border would need to prepare two sets of annual reports and would therefore have to bear the complexity and costs of preparing two similar but not identical reports. Consequently, if an AIF, marketed in the EU and the UK, and is complying with the annual requirements in the EU's AIFMD Article 22, it should

be regarded as satisfying the UK reporting requirements. We urge the FCA to acknowledge that AIFs complying with the EU's AIFMD Article 22 would be accepted as complying with the UK's requirements for an AIFs' annual reporting without the need to prepare a largely duplicative UK-specific report.

We note that, guidance, in ALTS 10.2, sets out that the methodology and terminology adopted in a fund's annual report (in relation to the balance sheet, statement of assets and liabilities, and the income and expenditure account) should be consistent over consecutive financial years. We wonder if the FCA have taken into consideration that when the AIFM of an AIF changes, the new AIFM may have a good reason to make a change, such as where it does not agree with the prior AIFM's interpretation of applicable accounting standards. In such a circumstance, a change should be permitted provided there is a clear explanation to investors of the reasons and the effect of the change compared to prior methodology and terminology. This should be reflected in the guidance.

We also have concerns regarding the proposed requirement, as set out in section 9.22 of the consultation paper and in ALTS 9.2.4R and ALTS 10.2.5R, that, where an investor makes a reasonable request for further information about the activities of the fund the AIFM must provide this to them and make it available to all other investors.

While we support appropriate transparency for investors, we do not believe that it will always be appropriate or proportionate to share all information requests and responses more widely. In practice, investors often request information that is tailored to their own circumstances and does not have relevance to other investors. For example, investors frequently ask AIFMs to complete bespoke ESG questionnaires or reporting templates to meet their own internal reporting requirements. It would not be appropriate to require every completed template to be distributed to all investors in the fund. Similarly, investors may request tax information that is specific to their jurisdiction, tax status or internal compliance obligations, and which would be of limited or no relevance to other investors.

Fair treatment of investors doesn't necessarily mean that they must all receive the same information. We therefore encourage the FCA to clarify that the requirement to make information available to other investors should apply only where the information is of general relevance to investors as a whole, rather than to investor-specific requests or bespoke reporting. This would better balance transparency with practical operational considerations and avoid unnecessary disclosure obligations.

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

In section 9.25 of the consultation paper and in ALTS 10.3.7R (2) it says for small AIFM, where an investor makes a reasonable request for further information, firms must make this available to other investors in the AIF. We have the same concerns with this as stated in our response to Question 20.

There is an assumption that 'in scope residual CIS' will not be carried interest vehicles, excluded entities, joint venture vehicles, or single investor vehicles. We believe this definition should be based upon the outcome of the consultation on Residual CIS operators in Chapter 3. Please see our response to Question 5.

Chapter 10 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 welcome simplification of investor disclosures. However, by proposing significant changes to the investor disclosure requirements this will lead to AIFMs that market their funds in both the UK and EU having to disclose different information depending upon where their investors are located. This will create extra cost for cross-border business.

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?**

We have no objections to the approach being proposed for AIFM retail disclosures.

Last December the FCA published a consultation paper on Client categorisation and conflicts of interest (CP25/36). We note that the FCA have not yet published their feedback and possible policy statement for this consultation. In answering this question, it would be useful to see any new standards from the FCA for assessing whether clients meet the threshold of professional clients and which clients require the benefit of retail protections.

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?**

We do not have a response to this question.

Chapter 11 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?**

We agree that the FCA has appropriately considered the distinct roles of the company board and the AIFM within its proposals. The proposed framework recognises the existing allocation of

responsibilities between these parties and appropriately reflects this split in the revised AIFM rules. We consider this to be a
proportionate approach that provides clarity on accountability while avoiding unnecessary duplication of obligations. We welcome the guidance provided in ALTS 1.4.3 clarifying that where a CEIC is managed by an external AIFM, the external AIFM remains responsible for compliance with applicable requirements in the ALTS sourcebook.

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 agree that the proposed disapplication of the AIFM investor disclosure, reporting and notification requirements for closed-ended investment companies admitted to trading on a UK regulated market appropriately reflects the fact that equivalent outcomes are already delivered through existing UK listing, market disclosure and transparency obligations. Removing these overlapping requirements should help reduce unnecessary regulatory duplication and compliance costs, while maintaining an appropriate level of investor protection and access to information. The proposal therefore represents a proportionate and pragmatic approach to regulation.

Chapter 12 NPPR and cross-border marketing

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

We believe that ALTS 14.1.1G(1) currently does not reflect the intent that the NPPR will apply to authorised UK AIFM and a full-scope Gibraltar AIFMs marketing non-UK and non-Gibraltar AIFs in the UK.
We believe 'non-UK AIFM' should be replaced with 'third country AIF'.

14.1.1 G This chapter applies to an authorised UK AIFM and a full-scope Gibraltar AIFM which intends to market in the UK:

(1) ~~a non-UK AIFM~~ a third country AIF; or

(2) a feeder AIF that is a UK AIF or a Gibraltar AIF, the master AIF of which is either:

(a) *managed by an AIFM that is not an authorised UK AIFM or a full-scope Gibraltar AIFM; or*

(b) *a third country AIF.*

Chapter 15 Consequential changes: operating conditions

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

We do not have a response to this question.

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

We do not have a response to this question.

Chapter 17 Discussion chapter: Reviewing the prudential regime for fund managers

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 believe that activity-based metrics are not appropriate for reflecting the scale and nature of fund managers activities. We have explained our reasoning on this in response to Question 40. Therefore, we support that the baseline financial resources requirements for AIFMs should be determined using the base capital and fixed overheads requirements.

We acknowledge that base capital requirements are not risk sensitive and therefore can be out of line with the scale and nature of firm's activities. However, we can see the benefits of applying a minimum level of capital requirements. Although, these should be proportionate, so they are not a barrier to new entrants.

Under MIFIDPRU the minimum capital requirement for agency portfolio managers, who do not hold client assets and do not deal on their own account, starts at £75,000. Given the broad similarities between the risks associated with segregated portfolio management and collective portfolio management, we believe the minimum capital requirements for externally managed AIFMs should be lowered from EUR 125,000 to £75,000.

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?**

We do not agree that compensation for investors in relation to operational or conduct risks, such as errors, negligence or misconduct, necessarily increase in line with assets under management. These risks, and any associated financial impact, do not depend solely on assets under management but are shaped by a range of factors. These Include the complexity of the fund's investment strategy, the robustness of the AIFM's systems and controls, the training and expertise of its staff, and the specific responsibilities assumed by the manager in relation to the fund and its investors.

Basing baseline capital requirements on the assumption that operational or conduct risks increase in proportion to AUM, would not adequately reflect the underlying drivers of risk. It will unfairly penalise well-managed firms whose AUM has grown as a result of strong investment performance, despite having robust systems and controls in place. For managers of funds marketed to professional, sophisticated and high-net-worth investors, maintaining investor confidence, protecting long-term relationships and securing future fundraising opportunities provide powerful incentives for effective oversight and governance.

Operational and conduct risks are often difficult to measure in financial terms. Historical evidence is typically limited, as losses arising from operational failings, negligence or misconduct tend to occur infrequently. This creates a weak evidential foundation for calibrating capital requirements in a reliable and proportionate manner.

The financial consequences of operational errors will also depend on the contractual arrangements governing the fund. In many cases, indemnities and limitations of liability mean that, except in instances of gross negligence, wilful default or bad faith, the economic impact of operational failures is borne by the fund rather than the manager. As a result, the circumstances in which routine operational errors give rise to material legal liability for the manager are relatively limited, and the resulting threat to the manager's financial resilience and ongoing viability is generally modest.

For these reasons, we do not believe it would be appropriate to introduce additional prudential requirements based on these perceived risks. There is no clear or reliable basis on which such requirements could be calibrated, and in many instances the actual financial exposure of the manager is likely to be limited.

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?**

Firm-level liabilities and wind-down costs are generally limited for AIFMs and do not justify the current liquid assets requirement. As agency asset managers, AIFMs do not take proprietary positions and the assets of the funds they manage are held by the funds themselves, or their depositaries, rather than on the AIFM's own balance sheet. Consequently, AIFMs typically have relatively simple balance sheets and would not ordinarily face the complexities associated with unwinding trading positions or returning client assets. Their liabilities are often predictable and operational in nature, such as employee costs, rent and supplier contracts, rather than significant third-party financial exposures.

The process of winding down an AIFM is also generally less complex than for many other regulated firms that have larger and more diverse client bases. In practice, a wind-down of an AIFM is likely to be anticipated well in advance, allowing firms to plan and manage liabilities in an orderly manner. As a result, AIFMs pose limited risks to the wider market in a wind-down scenario.

Against this background, we do not consider a prescriptive basic liquid assets requirement to be necessary or proportionate. We believe the current requirement for full-scope UK AIFMs is excessive and can restrict firms' ability to invest in their operations, systems and controls by requiring substantial resources to be held in low-yield cash or cash-equivalent assets. A more appropriate approach would be a principles-based requirement under which firms take reasonable steps to ensure that they can meet liabilities as they fall due, taking into account the nature and timing of expected cash inflows and outflows.

If the FCA concludes that a specific liquid assets requirement remains necessary, it should be calibrated more proportionately and aligned with the approach under MIFIDPRU. This would require liquid assets to be capped at one-third of a firm's fixed overheads requirement. This would better reflect the limited wind-down risks presented by AIFMs and help ensure a more level playing field with MiFID investment firms undertaking broadly comparable portfolio management activities.

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?**

We consider that capital and liquidity requirements serve different prudential objectives and should not be too closely linked. Capital requirements are designed to ensure firms have sufficient financial resources to absorb losses and support an orderly wind-down over a longer time horizon, whereas liquidity requirements are concerned with a firm's ability to meet obligations as they fall due. As a result, liquidity is inherently more dynamic and dependent on the

timing of cash inflows and outflows than regulatory capital. Linking liquidity directly to capital requirements, as under the current approach, can lead to firms holding substantially more liquid assets than is necessary to meet their actual liquidity needs.

AIFMs generally have simple balance sheets, which are separate from those of the funds they manage, and do not involve proprietary trading positions or significant firm-level financial exposures. Their principal cash outflows tend to be predictable and recurring, such as salaries, rent, taxes and fees payable to service providers. Given these characteristics, there is limited evidence of a strong prudential rationale for requiring capital and liquidity requirements to interact in the same way as they do for firms exposed to more complex liquidity risks, such as banks, investment banks or proprietary trading firms.

Accordingly, we do not consider that there is an obvious need for a standardised relationship between capital and liquidity requirements for fund managers. A more proportionate approach would focus on ensuring that firms maintain sufficient resources to meet liabilities as they fall due, taking account of the nature and predictability of their cash flows, rather than imposing a rigid linkage between capital and liquidity metrics.

However, if the FCA concludes that a link should be retained, any liquidity requirement should be calibrated no less favourably than under MIFIDPRU or COREPRU. In particular, any basic liquid assets requirement should be limited to one-third of the firm's fixed overheads requirement. Requiring AIFMs to hold significantly more liquid assets than firms conducting broadly comparable MiFID portfolio management activities is difficult to justify and risks creating an uneven competitive environment.

Similarly, any standards relating to the quality of own funds and liquid assets should reflect the typically simple nature of fund managers' balance sheets and business models. Requirements should be proportionate to the limited liquidity risks presented by agency asset managers and should avoid unnecessarily constraining firms' ability to invest in their operations, systems and controls by forcing excessive holdings of low-yield liquid assets.

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?**

We agree that fund managers should be subject to appropriate risk management and wind-down planning expectations. However, those expectations should be proportionate to the nature of their business model and the risks they pose. In particular, AIFMs differ from many other regulated firms because fund assets are held separately by the fund and do not form part of the manager's balance sheet or insolvency estate. AIFMs also typically have limited balance-sheet exposures and do not engage in proprietary trading activities. As a result, the risks associated with an AIFM failure are generally less complex than those associated with firms that hold client assets, maintain trading books or incur significant third-party liabilities.

Against this background, we do not consider that highly prescriptive wind-down planning requirements, detailed stress testing exercises, or extensive capital and liquidity modelling over hypothetical winddown periods are appropriate for AIFMs. Similar requirements under MIFIDPRU can be onerous and

disproportionate to the underlying risks, particularly for firms with relatively simple business models. In the context of AIFMs, the decision to wind down is also typically identified well in advance and is rarely triggered by sudden market events. This allows firms to plan for an orderly transition and reduces the need for complex wind-down analysis.

We believe the focus should be on practical and operational planning. AIFMs should maintain robust but proportionate plans for the orderly transfer of fund management responsibilities to a replacement manager, including arrangements for retaining sufficient skilled staff during any transition period and ensuring continuity of portfolio management and oversight. This addresses the key risk relevant to fund management, namely the potential disruption to the management of fund portfolios during a change of manager.

Any requirements should therefore be calibrated according to the size, complexity and risk profile of the firm. Smaller firms with straightforward business models and a limited number of funds should face relatively simple planning expectations, while larger or more complex managers may require more detailed documented arrangements. However, proportionality should remain a central principle, and requirements should focus on operational transition planning rather than detailed solvency, liquidity and stress-testing exercises. We do not consider that additional capital or liquidity requirements are necessary to support such planning.

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

The principal risks faced by agency asset managers are operational in nature and may, in certain circumstances, give rise to legal liability arising from negligence or default in the performance of their duties. However, the extent of that liability will often depend on the contractual arrangements agreed with investors. In many cases, fund documentation limits a manager's liability to instances of gross negligence, wilful default or bad faith and may provide indemnification for liabilities arising in other circumstances. As a result, the scale and nature of potential exposures can vary significantly across firms. Therefore, PII can be a useful risk management tool for some fund managers, but we do not believe it should form part of a mandatory prudential framework.

A compulsory requirement could impose disproportionate costs and practical difficulties, particularly during periods when PII capacity is limited and cover is expensive or difficult to obtain. In such circumstances, firms may face a seller's market with limited choice of providers and pricing that bears little relation to the actual risks being insured.

We believe that PII should be regarded as one of a range of risk management tools available to fund managers rather than as a mandatory prudential requirement. Firms should be required to consider whether PII is appropriate in light of their specific circumstances. The decision whether to obtain cover, and the terms of that cover, should remain a matter for the firm's own reasonable judgement. If they do decide to obtain PII, they should be able to determine the appropriate scope, limits and exclusions of cover having regard to the firm’s business model, the nature of its obligations to investors, and its broader risk management framework. This approach would better reflect the diversity of business models and contractual arrangements across the fund management sector while avoiding unnecessary costs and regulatory burdens.

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 support the FCA's objective of streamlining the collection of data from firms. For firms that are subject to multiple prudential regimes, overlapping and duplicative reporting requirements can be a significant burden, particularly where similar information must be reported in different formats or on different reporting schedules. We therefore encourage the FCA to develop integrated reporting templates that allow firms to report relevant data once, in a consistent manner, across multiple prudential frameworks. Simplifying and harmonising reporting requirements would reduce compliance costs, improve data quality and provide the FCA with more coherent and comparable information.

As regards indicators of potential or realised harm, we consider that the most useful reporting would focus on material operational and conduct events that provide meaningful supervisory insight. This could include significant operational errors, material redress events, breaches that affect investors, and near-misses that reveal weaknesses in key systems and controls. However, reporting should remain proportionate and focused on events that are genuinely relevant to investor protection or market integrity. Excessively detailed or frequent reporting of minor incidents risks generating large volumes of data with limited supervisory value.

More generally, the design of any reporting framework should reflect the relatively simple balance sheets and business models of agency fund managers, whose activities present lower prudential risks than firms that hold client assets, undertake proprietary trading activities or incur significant balance-sheet exposures. A streamlined and proportionate reporting regime would therefore be consistent with both the FCA's objective of reducing unnecessary regulatory burdens and the underlying risk profile of the fund management sector.

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?**

We do not believe that additional periodic prudential reporting is necessary to identify potential or realised harm to fund investors or other market participants. The FCA already has access to material information through existing event-driven notification regimes.

In particular, the operational incident reporting framework introduced under PS26/2 requires FCA-authorised firms to notify the FCA of serious operational incidents that meet specified reporting thresholds, including incidents that may affect the safety and soundness of the firm. These requirements should already provide the FCA with timely information about operational failures that are sufficiently significant to disrupt a firm's activities or its ability to provide services to the funds it manages.

In addition, under SUP 15.3, firms are expected to notify the FCA of events that may cause serious detriment to customers. This includes circumstances that could adversely affect a significant proportion of customers or generate a comparatively high volume of complaints. These requirements already provide a mechanism through which the FCA can receive information about material redress events and other significant conduct-related issues.

The most reliable indicators of potential or realised harm are likely to be material operational incidents, significant customer detriment events, substantial redress

exercises, and other incidents that trigger existing FCA notification requirements. We do not consider that minor day-to-day operational errors or isolated near misses should be subject to detailed prudential reporting, as this would generate large volumes of information with limited supervisory value and could distract attention from genuinely significant risks.

Instead, we believe the FCA should continue to rely primarily on its existing event-driven reporting framework, which enables firms to notify material issues promptly when they arise. This approach provides more meaningful and timely supervisory information than introducing additional periodic reporting requirements and is consistent with the FCA's objective of reducing unnecessary regulatory burdens while maintaining appropriate oversight of investor protection and operational resilience risks.

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

We consider that the prudential framework for CPMIs should better reflect the predominantly agency-based nature of their activities. The current approach, which treats CPMIs as MIFIDPRU investment firms and applies firm-wide requirements such as ICARA, risk management and governance obligations, can be disproportionate where fund management activities constitute a substantial part of the firm's business.

A more proportionate approach would be to rely on the fixed overheads requirement to capture the risks arising from both fund management and agency MiFID activities, such as segregated portfolio management, investment advice, and reception and transmission of orders. Any increase in activity and expenditure would automatically be reflected in the fixed overheads requirement, without the need for additional complex prudential requirements. This would also address the key prudential concern in the fund management context, namely ensuring sufficient resources are available to facilitate an orderly transfer of mandates to a replacement manager.

The FCA should also seek to simplify the interaction between AIFM and MIFIDPRU requirements, which currently creates unnecessary complexity and can place UK CPMIs at a competitive disadvantage relative to firms in some EU jurisdictions.

If, in future, AIFMs are permitted to undertake proprietary trading or other balance-sheet risk-taking activities, a differentiated approach may be appropriate. However, any regime should clearly distinguish between agency-only CPMIs and firms that assume proprietary risks, with more extensive prudential requirements applying only to the latter. This would ensure that prudential obligations remain proportionate to the underlying risk profile of the firm.

ANNEX 1

Position Paper:
The UK Collective Investment Scheme Regime in the context of UK AIFMD Reform

1. EXECUTIVE SUMMARY

1.1 This Position Paper is being submitted to the UK Financial Conduct Authority ("FCA") in advance of any formal consultation response by INREV or other interested parties to the FCA's Consultation Paper on the UK AIFM Regime (CP 26/28).

1.2 INREV welcomes the FCA's proposals to reform the UK AIFM Regime and supports the FCA's objective to streamline and update the regime. This Position Paper addresses a specific aspect of the FCA's proposals, namely the treatment of collective investment schemes ("CIS") that are not alternative investment funds. In due course, INREV may append this Position Paper to a broader consultation response submitted. This is a topic of particular interest to our members and the UK real estate industry more broadly.

1.3 INREV believes that:

1.3.1 The FCA should proceed cautiously with any reform of the CIS Regime. Any such reforms should be the result of a targeted workstream based on data about the nature and scale of the population of firms that would be affected by any reforms. We believe that the regulatory reporting contemplated by the FRAME consultation (CP 26/26) would be helpful in this regard.

1.3.2 We are particularly concerned that HMT and the FCA's proposals to revise the definition of an Alternative Investment Fund ("AIF") may have unintended consequences (e.g., by bringing arrangements which are neither a CIS nor an AIF into scope). We urge the FCA to provide clarity on which arrangements they consider are likely to be caught by the revised AIF definition which are not today, and to clarify the intention behind the change. We also urge the FCA to consider the knock-on impact of any changes to the AIF definition and the boundary between an AIF and CIS with tax legislation. As a general observation, we note that if the market perceives that there is fresh uncertainty in the boundary between an AIF and CIS triggered by HMT and the FCA's proposals, this may have deleterious implications including encouraging firms to set up

structures outside the UK (e.g., in the UK) where there is more certainty about the regulatory classification of vehicles.

1.3.3 The FCA's language in Chapter 3 of CP 26/28 implies that the CIS Regime is inherently sub-standard and that it fails to recognise the legitimate and important role that non-AIF CIS' play in the UK economy.

1.3.4 The limited reporting proposals set out in CP 26/26 for CIS operators are proportionate and we would support their introduction.

1.3.5 If the FCA's contention is correct that the changes to the AIF definition will result in firms needing to reclassify certain non-AIF CIS arrangements as AIFs is correct, we strongly urge the FCA to introduce a transition period. Firms must be given an adequate period of at least 18 months to consider and implement any changes prompted by the FCA's proposals (including if relevant, to apply for a Variation in their Part 4A permissions and to implement other necessary changes e.g., the appointment of a depositary or even a third party AIFM). We also urge the FCA to consider whether grandfathering relief is appropriate.

1.3.6 In relation to the FCA's proposal to extend the investor disclosure rules in ALTS 9 and 10 to certain categories of residual CIS, while exempting other vehicles (as those are defined in the revised FCA Glossary), we are concerned that the definitions proposed by the FCA are not fit for purpose. The FCA's proposed definitions require considerable revision and do not work coherently with one another – in some cases, the definitions do not fully reflect existing FCA guidance in PERG.

2. INTRODUCTION AND CONTEXT

2.1 INREV welcomes the limited proposals set out in Chapter 3 of CP26/28 and the Fund Reporting for Asset Management Entities (FRAME) (CP 26/26) consultation papers insofar as they relate to residual CIS operators. In particular, INREV is supportive of the proposal in CP 26/26 to introduce limited annual regulatory reporting for firms that hold the permission of establishing, operating or winding up a CIS. We believe this reporting to be proportionate to the FCA's aim of building the data it needs to understand this population of firms and the arrangements they operate.

2.2 However, we urge the FCA to be cognisant of the impact of its proposals in relation to the CIS Regime. As outlined in section 3, we note that the CIS Regime has developed incrementally over several decades, serves multiple distinct policy functions and applies to a wide variety of arrangements. In our view, while Chapter 3 of CP26/28, represents a reasonable starting point for the FCA, is not sufficient to support a comprehensive reform of the CIS Regime.

2.3 If the FCA intends to reform the CIS Regime, INREV would support the inception of a separate, dedicated workstream to consider the CIS Regime in the round. In our view, it would be helpful for this workstream to be informed by the data the FCA gathers on the population of firms that would be impacted by any changes to the CIS Regime, including through the proposed FRAME reporting, to inform the nature, scope and boundaries of that exercise.

2.4 In the interim, INREV believes that the FCA should exercise caution about introducing changes that may have unintended consequences for existing CIS arrangements or create new areas of uncertainty for residual CIS operators and their advisers, particularly in relation to permissions required by such firms and the application of the FCA's conduct rules.

3. THE HISTORY AND POLICY FUNCTIONS OF THE CIS REGIME

3.1 The CIS Regime has a long legislative history and pre-dates the implementation of the EU's Alternative Investment Fund Directive (Directive 2011/61 EU, "EU AIFMD") into UK law. The modern statutory definition of a CIS is contained in section 235 of the Financial Services and Markets Act 2000 ("FSMA 2000"), but the broad functional concept of a CIS is significantly older.

3.2 Section 235 of FSMA replicated and refined section 75 of the Financial Services Act 1986 which first introduced the concept of a CIS as a discrete statutory category of arrangement into UK statute. However, the regulation of certain forms of pooled investment vehicles (e.g., unit trusts) can be traced beyond the Financial Services Act 1986 to the Prevention of Fraud (Investments) Act 1958, though this legislation was narrower in scope.

3.3 The modern CIS Regime under FSMA 2000 comprises several distinct and complementary layers of primary legislation, secondary legislation (e.g., statutory instruments), FCA Handbook rules and guidance as well as judicial decisions which have considered, refined and clarified the concept of a CIS. At its core, the modern CIS Regime comprises:

3.3.1 the statutory definition of a CIS under section 235 FSMA 2000;

3.3.2 The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062) (the CIS Order), which exempts certain type of arrangement from constituting a CIS;

3.3.3 The promotion regime under section 238 FSMA and the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (SI 2001/1060);

3.3.4 FCA Rules set out in COBS 18.5A, certain provisions of CASS, and COBS 4; and

3.3.5 Additional perimeter guidance in PERG 9 and PERG 16.

3.4 The CIS Regime has historically served, and continues to serve, at least six distinct policy functions. Any proposal to reform the CIS Regime beyond the introduction of proportionate reporting for residual CIS operators must, at the very least, have due regard to these policy functions.

Regulation of blind-pool investment funds (now largely superseded by AIFMD)

3.5 Prior to the implementation of the EU's AIFMD, the CIS Regime was the principal UK regulatory framework governing blind-pool funds. Since the implementation of EU AIFMD into UK law, this function has now been subsumed.

3.6 The concepts of an AIF and a CIS frequently overlap. However, owing to the subtly different definitions of an AIF and a CIS and the application of relevant exemptions, it is also possible for a CIS to be a non-AIF or for an AIF to not be a CIS (non-CIS AIFs include AIFs which are bodies corporate other than OEICs). Non-AIF CIS are governed by the CIS Regime alone. For

example, the FCA's rules in COBS 18.5A rules relating to investor eligibility and operational requirements are a legacy of this function of the CIS Regime. It is in this respect that the CIS Regime is frequently described by market participants as "residual". Though as will become clear in the subsequent sections of this Position Paper, the CIS Regime continues to play a central role in UK financial services regulation for other reasons.

Anti-fraud / perimeter enforcement

3.7 The CIS definition also serves as an anti-fraud measure. It has frequently provided the basis for regulatory enforcement action against the operators of Ponzi schemes, land-banking arrangements, syndicate betting schemes and similar fraudulent or quasi-fraudulent arrangements. There is a substantial body of FCA enforcement action and case

law[2] illustrating this function. The critical feature of these enforcement actions is that the relevant schemes are being operated *in breach of* the CIS Regime — no operator running such a scheme would be doing so compliantly.

Definitional building block for other vehicle types

3.8 Section 235 forms a constituent element of the definition of other regulated vehicle types. The concept of a CIS is relevant to, among others: open-ended investment companies (section 236 FSMA 2000), and through that definition, unit trust schemes (section 237 FSMA 2000) and other authorised fund structures. Any reform of the CIS definition would invariably have cascading and potentially unintended effects on these definitions.

Regulation of arrangements complementary to AIF management

3.9 Far from being residual, the CIS Regime also provides the principal regulatory framework for certain arrangements that are not themselves AIFs but that are established and operated in connection with the management of AIFs. These arrangements include, but are not limited to:

3.9.1 Carried interest vehicles – these vehicles are typically exempt from the AIF definition as employee participation schemes, but potentially satisfy the CIS definition;

3.9.2 Deal-specific co-investment vehicles – where a specific asset has been identified and a vehicle is formed to enable co-investors to participate alongside a fund, depending on the facts at hand, the vehicle may be exempt from the AIF definition;

3.9.3 Funds-of-one – economically equivalent to segregated managed accounts, but structured (for example) as limited partnerships with a single investor limited partner and a sponsor co-investor or carried interest partner.

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[2] See for example *Financial Conduct Authority v Asset Land Investment Inc* [2016] UKSC 17; *Financial Conduct Authority v Capital Alternatives*

Ltd [2014] EWHC 144 (Ch); *Financial Conduct Authority v Robin Forster* [2023] EWHC 1973 (Ch), the FCA's action against Paradigm

Consultancy S.A. (press release) and most recently the FCA's actions against Concept Capital Group (press release)

Regulation of investment arrangements not closely associated with blind-pool fund management

3.10 Importantly, the CIS Regime also governs certain arrangements that are *not* closely associated with blind-pool fund management, including but not limited to:

3.10.1 Multi-investor co-investment programmes (as distinct from deal-specific co-investment);

3.10.2 Property development financing arrangements and, certain "joint venture" vehicles — including arrangements where an FCA-authorised firm acts as operator;

3.10.3 Reserved Investor Funds (RIF);

3.10.4 Certain other miscellaneous arrangements.

Arrangements carved out from CIS by the CIS Order

3.11 Finally, there are arrangements that would otherwise satisfy the section 235 FSMA 2000 definition of a CIS but are excluded by the CIS Order. These include arrangements of particular relevance to the real estate industry including certain real estate joint ventures, certain group arrangements, and (notably) closed-ended bodies corporate other than limited liability partnerships[3]. Each of these exemptions serve specific policy purposes and may be relied upon by market participants for a variety of reasons.

4. FCA'S APPROACH AND INTENDED POLICY AIMS

4.1 Paragraph 3.3 of the CP 26/28 states that operators of CIS that are not AIFs "*do not have to comply with the same regulatory requirements as AIFMs, resulting in less transparency, with risks to market integrity and investor protection*." From this, we understand that the FCA's decision to amend the definition of an AIF appears to be animated by a concern that certain arrangements that *should* have properly been categorised as AIFs have not been.

4.2 However, the framing of Chapter 3 of CP 26/28 does not fully reflect this concern or the complexity and nuance of the CIS Regime. It could be read as suggesting that operating a CIS — as opposed to an AIF — is inherently problematic or that CIS operators are subject to inadequate regulation. We do not consider this to be an accurate characterisation of the CIS Regime as it applies to properly categorised non-AIF CIS. As set out above, the CIS Regime has developed over a number of decades and serves several distinct policy functions.

4.3 Moreover, the arrangements described in section 3 above are legitimate, well-understood commercial structures that serve important economic functions, particularly in the real estate

[3] Please refer to Schedule 1, the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 for a full list of arrangements that are carved out of the definition of a CIS.

sector. It is in the interests of the UK economy that such structures are established and operated onshore, rather than in competing jurisdictions. The FCA's regulatory regime, and importantly the signals it sends to market participants about proportionate regulation, are relevant to these structuring decisions.

4.4 We encourage the FCA to frame its proposals in a manner that recognises the legitimate role of non-AIF CIS and distinguish clearly between:

4.4.1 arrangements that have been wrongly categorised solely as CISs when they should also be AIFs (which is a matter of compliance with the AIF Regime);

4.4.2 arrangements that are properly categorised as non-AIF CIS; and

4.4.3 arrangements which are legitimately neither AIFs nor CIS.

4.5 The stated aim of the FCA's consultation is to ensure that the FCA's rules are proportionate and support firms to enter, grown, compete, innovate and operate internationally. With this in mind, we urge the FCA to be mindful of the implications of increasing the regulatory burden on non-AIF CIS vehicles. Whilst we are supportive of the regulatory reporting contemplated under the FRAME consultation, we are mindful that any increase in the regulatory burden on unregulated CIS in the UK vis-à-vis similar structures in the UK, may result in making the UK a less attractive destination for firms to set up and operate their structures.

5. HMT'S PROPOSED CHANGES TO THE AIF DEFINITION

5.1 HM Treasury's draft AIFM Regulations 2026 propose changes to the statutory definition of AIF, including clarifying that a "*defined investment policy*" can be implicit, and that the "*raising capital*" criterion is satisfied where capital has been raised in the past or is intended to be raised in the future.

5.2 We are confident that these clarifications broadly reflect existing FCA perimeter guidance[4] and should not, in practice, bring within the AIF definition arrangements that are *properly* categorised as non-AIF CIS under existing guidance. In particular, we do not consider that deal-specific co-investment arrangements which do not set out with a commercial

endeavour to raise external capital, and which do not exhibit the characteristic of "pooled return from pooled risk", should be affected.

5.3 We note that the FCA has published a template for CIS reporting as part of CP 26/26. This template lists various types of CIS including employee participation schemes; employee saving schemes (i.e., carried interest vehicles); securitisation special purpose entities; holding companies; joint ventures; co-investment vehicles; family office vehicles and other vehicles. We agree that these vehicles may typically qualify as non-AIF CIS, though we note that this

[4] See for example Question 2.10 and Question 2.13 in PERG 16

list does not perfectly align with the list of non-AIF CIS' included in paragraph 3.7 of CP 26/28 (for example, the reporting template for CIS reporting lists co-invest vehicles as a category of non-AIF CIS whereas paragraph 3.7 does not). As a result, we would welcome clarity from HM Treasury and the FCA as to which *specific* categories of arrangement they consider will be newly caught by the revised definition of an AIF particularly as the FCA has indicated that it may engage with firms[5] to determine how the firms will respond to the changed definition of AIF and whether this will impact their permission profile. We encourage the FCA to consider whether grandfathering would be appropriate.

5.4 We note the FCA's expectation that the HMT will allow "*reasonable time*"[6] for affected firms to take any necessary steps under transitional arrangements. We are supportive of a transitional period of at least 18 months though the appropriate transition period will, in part, depend on the final shape of the FCA's proposals (and on the proposed changes to the definition of AIF). For example, if it is necessary for a firm to prepare and file a Variation of Permission application or to appoint external AIFMs or depositaries, this will have significant timing implications.

5.5 If HMT's contention is correct and the changes are merely clarificatory, we urge the FCA to clarify whether the existing guidance in PERG 16 continues to apply. For example, PERG 16.2.13 (which deals with the criteria for whether an arrangement has a defined investment policy) remains relevant despite the changed definition of an AIF. PERG 16.2.13 has been an important source of guidance to the real estate (and indeed wider asset management) industry.

6. INTRODUCTION OF REGULATORY REPORTING FOR RESIDUAL CIS OPERATORS

6.1 The FCA's FRAME consultation (CP 26/26) proposes limited annual reporting by residual CIS operators, comprising: the number of residual CIS operated; the gross notional value; and the purpose of each vehicle. We are supportive of the introduction of this limited reporting by residual CIS operators.

6.2 In our view, the data fields are proportionate and should not impose a significant burden. This reporting will also put the FCA in a materially better position to understand the population of CIS operators and the nature of their activities, which is a necessary precondition for any future, more considered reform of the CIS Regime.

6.3 We note that, in order to prevent the possibility for regulatory arbitrage, this reporting should apply to all CIS (including those offshore unit trusts that qualify as offshore CIS for the purposes of TCGA 1992 Schedule 5AAA.

[5] Paragraph 3.6, CP 26.28

[6] Paragraph 3.6, CP 26/28

6.4 We do however note the risk of double counting in relation to the reporting of aggregate NAV under FRAME for all residual CIS (for example where the residual CIS is feeding into, or sitting below, other residual CIS or AIFs) and suggest this is expressly catered for.

7. PERMISSIONS AND ASSOCIATED RULES

7.1 The permissions and rules landscape for CIS operators is complex and has been the source of significant uncertainty and, at times, disruption for firms. We note this as context for the FCA's proposals, and we wish to flag the importance of the FCA not creating fresh difficulties in this area.

7.2 At present, there are broadly three permutations of FCA permission relevant to CIS operation:

7.2.1 Firms with permission to manage AIFs, which may also establish and operate CIS "in connection with or for the purposes of" managing those AIFs, pursuant to article 51ZC of the Regulated Activities Order 2001;

7.2.2 Firms with Part 4A permission to establish, operate and wind up a collective investment scheme; and

7.2.3 Firms with CIS operator permission together with other permissions historically considered necessary to manage pooled funds (e.g. managing investments, dealing as agent, arranging deals, safeguarding and administering investments).

7.3 The FCA has indicated that it intends to consult further on this restriction. We note that FUND 1.4.6G currently provides that, in the FCA's view, the restriction permits an AIFM "to carry out AIFM management functions for a collective investment undertaking which is neither an AIF nor a UCITS."

7.4 If the business restriction is removed (as the FCA proposes), this guidance will become otiose, but the underlying question of how CIS operation relates to a firm's AIFM permission will remain.

7.5 The interaction between these permission profiles and the applicable FCA rules has been the subject of extensive correspondence between regulated firms and FCA supervision teams over several years. Most recently, we are aware that the FCA reached out to certain regulated firms directly in late December 2023 asking them to submit a Variation of Permission application via Connect to remove the "establishing, operating or winding up *unregulated* collective investment scheme" permission.

7.6 We do not think that it is necessary that the FCA should attempt to resolve all of these complexities in the present consultation. However, we would ask that the FCA: (a) does not, in the course of these reforms, inadvertently generate fresh uncertainty as to the Part 4A permissions required for CIS-related activities or the rules that attach to them; and (b) considers, in due course, whether a rationalisation or clarification exercise would be valuable, ideally in the context of the broader future workstream on reforming the CIS Regime.

8. DISCLOSURE REQUIREMENTS FOR RESIDUAL CIS

8.1 We note the FCA's proposal to extend the investor disclosure rules in Chapters 9 and 10 of the proposed ALTS sourcebook to certain categories of residual CIS, while exempting carried interest vehicles, joint venture vehicles, single investor vehicles and excluded entities (in each case as defined in the revised FCA Glossary).

8.2 As a general comment on approach, given the challenges we outline below we would encourage the FCA not to extend the investor disclosure requirements at this stage, pending further data received following the introduction of the FRAME regime. Once informed by that data, if the FCA identifies material categories of residual CIS to which the ALTS 9/10 disclosures should apply then we would encourage the FCA to define the

universe of residual CIS that should be subject to these requirements positively, by reference to the characteristics of those CIS that mean that additional disclosure is required - rather than applying these requirements strictly to all residual CISs except a specifically exempted sub-set. It would be very helpful to the industry for the FCA to give concrete examples of the types of residual CIS that it believes should be caught by the additional disclosure requirements and why that is the case.

8.3 The issues with the approach as proposed are that:

8.3.1 As noted earlier, the CIS definition is very broad and capable of catching a variety of structures that are not really fund-like – the result is that the proposed approach would pick up the more unusual “outlier” structures irrespective of whether there is any objective reason for them to be included[7];

8.3.2 The sub-set of residual CIS that would be exempted includes a majority of the structures that market participants would consider to be CIS but not AIFs anyway – and the risk of trying to define these negatively is that some of these concepts like “joint venture“ are notoriously hard to define and the current definitions proposed in the CP would, in our view, require considerable reworking to make sure that they both capture adequately the relevant types of vehicle that should be excluded and work coherently with each other and the existing CIS definition (we have specifically commented on those in the Appendix);

8.3.3 As well as avoiding increasing disclosure burden for structures that do not justify this, the FCA’s approach here should seek to minimise creation of distinctions that require complex legal analysis (and related costs) for firms.

[7] For example, the following could be caught where they satisfy the CIS definition: investment conduits / pooling vehicles that are not treated as AIFs because they deploy capital raised by another fund vehicle; other vehicles that deploy capital not raised from investors – e.g. raised from the sale of a family business (PERG16 Q2.27); family offices or investment vehicles for other “pre-existing groups”; employee co-investment vehicles (depending on whether or not they fall within the proposed excluded entities definition); vehicles which were originally wholly owned by one investor but add a second investor by secondary sale of existing interests rather than by raising capital; vehicles with a commercial or industrial purpose that are formed as e.g. LLPs.

9. OPERATING CONDITIONS

9.1 The FCA asks (Question 4) whether SYSC and COBS rules that currently serve only as guidance for CIS operators should be applied as binding rules.

10. INTERACTION WITH TAX LEGISLATION

10.1 The definitions of AIF and CIS are not only both relevant building blocks in financial services legislation but are also extensively incorporated, either directly or by cross-reference, in various provisions of UK tax legislation.

10.2 Consequently, we are concerned that any changes to the regulatory definition of an AIF, its interpretation, or the boundary between AIF and non-AIF CIS could have unintended tax consequences for non-AIF CIS and require market participants to invest time and resources to re-assess the tax treatment of their structures. We urge the FCA to ensure that it carefully coordinates with HMT and HMRC to consider the impact of any changes and ensure they are consistent with HMT's fiscal policy.

11. CASE LAW AND REGULATORY GUIDANCE

11.1 The scope and application of the CIS definition has been the subject of significant judicial and regulatory consideration over many years. By way of an illustrative example of just two of these cases:

11.1.1 FCA v Asset Land Investment plc: the Supreme Court clarified that the concept of "arrangements" in section 235 FSMA 2000 ought to be interpreted objectively at the point in time when the arrangements were made. As a result, it is the substance of arrangements and not their legal form that is determinative[8].

11.1.2 Financial Conduct Authority v Capital Alternatives Ltd: the Court of Appeal clarified that the concept of "pooling" for the purposes of section 235(3)(a) is satisfied where a scheme participant had a separate identifiable plot of land – ultimately the Court of Appeal held that it is the functional reality of arrangements that is determinative – so even where each scheme participant was entitled to the profits derived from a particular defined plot of land, where the operator of the scheme manages properties as a whole, the arrangements may amount to a CIS. Similarly, when determining whether property is "managed as a whole by or on behalf of the operator of the scheme" for the purposes of section 235(3)(b), it

[8] The Supreme Court also clarified the nature of the "day-to-day" control test for the purposes of section 235(2) FSMA 2000.

is enough that any economic return depends on the operator's management activities as a whole.

11.2 Furthermore, the FSA and FCA's General Counsel Division has provided bilateral guidance to market participants and advisers on a number of perimeter questions on the meaning of "establishing" or "operating" a CIS.

12. THE LLP QUESTION

12.1 We note that the FCA and HMT's proposals to revise the definition of an AIF and the boundary between an AIF and a non-AIF CIF raises several difficult connected questions. For example, whether professional services firms established as limited liability partnerships may constitute collective investment schemes.

12.2 LLPs are not excluded from the CIS definition by the CIS Order (unlike bodies corporate other than LLPs [9]).

12.3 This question would become directly relevant if the FCA were to undertake a broader reform of the CIS definition or the exclusions and would merit detailed consideration.

[9] Paragraph 21(2), Schedule 1, the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001

APPENDIX

Comments on the proposed exempt vehicle definitions:

1. **"CARRIED INTEREST VEHICLE"**

1.1 Limb (a) of the definition [10] is redundant, as "employee participation schemes" and "employee savings schemes" are already included in the definition of "excluded entity".

1.2 PERG 16.2 questions 2.34 and 2.35 discuss the concepts of "employee participation schemes" and "employee savings schemes", noting a wider application to individuals who are not just strictly "employees", and we suggest that this interpretation remains.

1.3 The definition assumes the persons are employees of an "AIFM", however we also suggest this encompasses the residual CIS operator itself plus wider sponsor group entities, to accurately capture the scope of persons who may be allocated carried interest.

1.4 Limiting the definition to vehicles available "exclusively" to employees excludes those carried interest vehicles in which sponsor entities participate as well as participants who are founders with director or partner roles but who may not be employees. Similarly, some industry participants use the same vehicle for carried interest and employee or house co-investment for operational convenience.

1.5 Limb (b) also doesn't enhance the definition, because a vehicle with these characteristics would likely be an "employee participation scheme" per the existing guidance in PERG anyway.

1.6 Limb (b) also requires that the carried interest recipients are sharing in "profits of an AIFM as compensation for the management and operation of the AIF", however this mischaracterises the nature of carry (it is sharing in investment profits of an AIF or residual CIS, not profits of an AIFM/residual CIS operator) and more broadly could have tax implications if that were the case. In addition, the reference to AIF at the end of that sentence should also include a residual CIS.

1.7 Carried interest is not always invested at a nominal amount.

1.8 We urge the FCA to consider whether, in circumstances where a carried interest vehicle only ever invests in one or more AIFs (as may well be the case), and the FCA receives reporting

[10] A vehicle that is a residual CIS which:

(a) is an employee participation scheme or employee savings scheme available exclusively to employees or former employees of an AIFM; or

(b) 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.

on those AIFs, would requiring reporting at the level of the carried interest vehicle add material relevant information?

2. "JOINT VENTURE VEHICLE"

2.1 As noted earlier, attempting to define a joint venture is notoriously hard. An attempt was made to do so in paragraph 9 of the Schedule to the CIS Order [*Schemes entered into for commercial purposes wholly or mainly related to existing business*], and those joint ventures which fit within that exemption are not CIS in the first place. However, there is a category of joint ventures which cannot meet the very technical requirements of that exemption (highlighting the challenging nature of defining such arrangements), and those are characterised as CIS. Applying a further definition to such arrangements adds to the complexity, and the proposed definition[11] does not work.

2.2 It is also essential to make clear that the definition of "joint venture vehicle" is not relevant to the concept of a joint venture as regards whether or not a joint venture is an AIF, and that this definition does not add confusion to the FCA's guidance in PERG on the latter subject.

2.3 The use of the word "participant" in the definition is confusing given it is unclear whether this is being used in a technical CIS sense (i.e., section 235(2) FSMA 2000), and more generally it is not clear when AIFMD-type concepts are being applied and when CIS terminology is being used, noting they somewhat overlap but not entirely, and there is a body of case law on the CIS concepts (as discussed further in section 11 of this note).

2.4 We presume limb (a) is attempting to encompass where there is no "external capital raising" as contemplated by PERG, but it isn't that clear (for example, limbs (a)(ii) and (a)(iii) seem to exclude many genuine joint venture arrangements from relying on this exemption given that nearly all JV participants would indirectly raise capital from third parties in some form). This also seems redundant if the participant in question is managed as an AIF, as the benefit of a double layer of reporting applicable to both the AIF and the underlying in scope residual CIS is unclear. It would also be beneficial if the definition could clearly include where capital was

[11] A residual CIS in which either:

(a)

(i) excluding borrowing, all the capital used by the vehicle has been contributed by the persons participating in the joint venture;
(ii) none of the persons participating in the joint venture has raised capital from one or more third parties with a view to investing it in the joint venture; and
(iii) excluding borrowing, none of the capital contributions transferred or committed to the joint venture was directly or indirectly raised from a third party with a view to investment; or

(b)

(i) the persons participating in the joint venture invest capital for themselves rather than on behalf of any third parties; and
(ii) the AIF is managed by the participants jointly and not by a third party or only by some of the participants.

contributed from prior participants, given that interests in real estate joint ventures are frequently transferred in secondary transactions.

2.5 Limb (b) is generally redundant in that if all the participants have day-to-day control then the vehicle should not be a CIS anyway. However, if the intention is to capture structures where, for example, control is exercised by affiliates of the limited partners at GP level, which might therefore not be an AIF under PERG guidance but is a CIS because the "participants" do not have control – this would need to be much clearer.

2.6 If retained, limb (b)(ii) refers to an AIF whereas it should refer to a residual CIS. It is market standard for joint ventures that are limited partnerships and where no exemptions are available to be operated by an FCA authorised entity which would typically be one or neither of the participants. The same applies for onshore trusts. Under the current drafting, the vast majority of real estate JVs are in scope as a result purely because of the most appropriate structure that is used, e.g. a limited partnership.

3. "SINGLE INVESTOR VEHICLE"

3.1 In principle, a vehicle with only one participant is not a CIS anyway so this exemption may be largely redundant. In fact, the "single investor" requirement as proposed is more difficult to satisfy than the CIS position as it requires a look through, binding restriction [12]

preventing there being more than one investor, etc. It would however be useful where there is a fund of one with a single investor plus a vehicle receiving carry which makes only a nominal contribution, as that might be CIS but not an AIF.

3.2 If retained, we suggest the definition should include a vehicle with more than one investor from the same group.

4. "EXCLUDED ENTITY"

4.1 This definition[13] cross references the AIFM Regulations.

12

(a) Subject to (b) and (c), a residual CIS which is prevented from raising capital from more than one investor by the national law of the country or territory where it is established, by the instrument constituting the fund, or by any other legally binding provision.
(b) Subject to (c), a limited partnership in which only a single limited partner makes a substantive contribution and a general partner makes a nominal contribution is not considered to raise capital from more than one investor.
(c) A vehicle in which the sole investor or limited partner invests capital which it has raised from more than one person with a view to investing it for the benefit of them does not fall within (a) or (b).

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4.2 An occupational pension scheme should not be a CIS in any case, although we note the slightly different definition included in the CIS Order versus the AIFM Regulations, and question whether that has any potential for unintended outcomes.

4.3 As noted in the carried interest section, it would be useful to retain the PERG guidance on "employee participation schemes" and "employee savings schemes".

Means a residual CIS which is excluded from being an AIF by [regulation 3(3) to (6)] of the AIFM Regulations.

Those Regulations provide:

3(3) The excluded entities are— (a) an occupational pension scheme, within the meaning of section 1(1) of the Pension Schemes Act 1993; (b) a holding company; (c) an employee participation scheme or employee savings scheme; (d) a securitisation special purpose entity.

3(4) The Treasury may by regulations amend paragraph (3) to add or remove an entity.

…

3(6) Arrangements do not constitute an AIF where— (a) they are arrangements under which money or an asset is held for the stabilisation of a qualifying stablecoin, and (b) both the conditions specified by paragraph (7) are met.

ANNEX 2

Position Paper:
Leverage in the Context of UK AIFMD Reform

1. EXECUTIVE SUMMARY

1.1 This Position Paper is being submitted to the UK Financial Conduct Authority ("FCA") in advance of any formal consultation response by INREV or other interested parties to the FCA's Consultation Paper on the UK AIFM Regime (CP 26/28).

1.2 INREV welcomes the FCA's proposals set out in Chapter 5 of CP26/28 insofar as they relate to leverage calculations. In particular, INREV is supportive of the FCA's objective to remove complexity from the current regime while continuing to address leverage risks. In due course, INREV may append this Position Paper to a broader consultation response submitted by INREV.

1.3 INREV:

1.3.1 Welcomes the FCA's proposal to remove the two mandatory leverage calculations under the commitment method and gross method. These calculations are complex and time consuming and are of limited utility to investors seeking comparability between AIFs.

1.3.2 Supports the FCA's decision to permit firms to calculate and disclose a fund's leverage ratio to investors using a method (or methods) that the firm considers best tailored to their fund or investment strategy, subject to the requirement that any such disclosure must be clear, fair and not misleading. We believe that this introduces much needed flexibility for firms.

1.3.3 Supports the FCA's decision to introduce simple and streamlined reporting requirements and to remove the threshold for calculating whether an AIF is "substantially leveraged".

1.3.4 Urges the FCA to exercise caution when repealing the AIFMD Level 2 Regulation as on-shored into UK legislation without ensuring that the detail of e.g., the Level 2 AIFMD Regulation recitals and annexures relating to leverage are appropriately and thoughtfully reflected in the new ALTS sourcebook (or deliberately and explicitly left behind). As the FCA is intending to carry forward

the AIFMD definition of "leverage" many of the uncertainties currently embedded in this definition will be carried forward and/or exacerbated if these additional sources of reference are lost.

1.3.5 Encourages the FCA to recognise that over the years market participants have, with the assistance of their legal advisors, formulated well understood and widely held positions. The FCA should carefully consider whether its proposed changes will impact these positions.

1.3.6 Encourages the FCA to be explicit about whether exposures contained in SPVs are deemed to be exposures of an AIF and, if so, in what circumstances and subject to which conditions. If such deeming continues, the FCA should retain the "PE Carve Out" in Article 6(3) AIFMD Level 2 Delegated Regulation and expand it to cover real estate and infrastructure funds.

2. DEFINITION OF 'LEVERAGE'

2.1 INREV notes that the FCA is proposing to transpose the existing EU AIFMD-derived [14] definition of "leverage" into the new Handbook Glossary definition of leverage, i.e. "*any method by which an 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*".

2.2 An AIF's leverage is always expressed as the ratio between the "exposure" of an AIF and the AIF's net asset value[15]. Though this definition has been used for a number of years, INREV notes that several constituent elements of this definition are uncertain.

2.2.1 "**Exposure**": Neither the EU AIFMD nor AIFMD Level 2 Regulation conclusively define "exposure", although Annex 1 to the AIFMD Level 2 Regulation sets out the methods by which an AIF's exposure may be increased. Market participants have broadly taken the position that the concept of "exposure" is intended to capture the value of capital that the fund has at risk[16] or in simple terms the cash equivalent value an AIF stands to lose. The lack of a more definitive

definition has led to firms taking a wide variety of positions. Some relate to the level at which borrowing is relevant for the purposes of the AIFMD leverage calculation. Others relate to more fundamental questions such as what qualifies as an "exposure", e.g., whether foreign currency held in the fund amounts to an "exposure" – there is a risk that a foreign currency could devalue and be worth less than payment obligations to investors.

2.2.2 "**By any other means**": the definition of leverage is open-ended and includes any method which increases an AIF's exposure "by any other means". This is vague and non-exhaustive. The market has coalesced around a position where the phrase is interpreted narrowly to cover methods of increasing "exposure" that are similar to borrowing/leverage embedded in derivatives as described in Annex 1.

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[14] Article 4(1)(v) AIFMD (Directive 2011/61/EU)

[15] Article 6(1) AIFMD Level 2 Regulations (231/2013)

[16] See e.g., Recital 13 AIFMD Level 2 Regulations (231/2013) which notes that when calculating the exposure of an AIF "all positions of the AIF should initially be included, including short and long assets and liabilities, borrowings, derivative instruments and any other method increasing the exposure where *the risks and rewards of assets or liabilities are with the AIF*…" (emphasis added).

2.3 In light of the above, we suggest making the following targeted changes to the definition of leverage (our suggested additions are underlined):

> *""leverage":*
>
> *(1) (in accordance with [regulation 2] of the AIFM Regulations (Interpretation) and in relation to an AIF) any method by which an 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 similar means without giving rise to an equivalent increase in its NAV.*
>
> *(2) (in relation to a residual CIS) any method by which the exposure of a residual CIS is increased, whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other similar means without giving rise to an equivalent increase in its NAV."*

2.4 The definition of leverage is substantiated by the recitals of the AIFMD Level 2 Regulation, and informed by Annex 1. We note that the FCA is currently planning to repeal the AIFMD Level 2 Regulation as on-shored into UK legislation. We urge the FCA to address explicitly in the policy statement and final rules the matters covered in the recitals and Annex 1, either by carrying them forward explicitly in the new ALTS sourcebook or explaining if they are being left behind and what are the implications. Key recitals for the definition of leverage include, but are not limited to:

(a) Recital 10 (which covers the treatment of equity shares in listed companies and options on an equity index);

(b) Recital 14 (which covers the treatment of temporary borrowing and revolving credit facilities); and

(c) Article 6(3) AIFMD Level 2 Regulation (which covers the exemption for below the fund leverage in respect of investment strategies that acquire control of non-listed companies or issuers, known as the "PE Carve-Out").

3. INTERACTION BETWEEN 'LEVERAGE', 'UNLEVERAGED CLOSED-ENDED AIF' AND USING LEVERAGE 'FOR INVESTMENT PURPOSES'

3.1 Where an AIF uses leverage "*for investment purposes*", additional reporting requirements under FRAME will apply[17]. The concept of using leverage "*for investment purposes*" is not defined, though SUP 16 Annex 63.2(6)(d) provides a negative confirmation that leverage used for foreign exchange and interest rate hedging purposes should not be regarded as leverage used for "investment purposes". However, the Glossary definition of an "unleveraged closed-

[17] See SUP 16 Annex 63.2

ended AIF" seems to be narrower insofar as it provides that an AIF will be unleveraged where it only employs leverage embedded in derivatives used for currency and interest rate hedging purposes where the derivatives: (a) do not aim to generate a return; (b) offset specific risks; and (c) result in a verifiable reduction of market risk for the AIF. We urge the FCA to ensure that the concept of leverage and associated terms/definitions are used consistently throughout the rules or, if differences are intended, this is made clear.

4. TREATMENT OF INVESTOR LOANS AND CAPITAL CONTRIBUTIONS

4.1 Investors in real estate funds, particularly those structured as English or Scottish limited partnerships, often split their commitments into "investor loans" and "capital contributions". This is now primarily because of the requirements of UK partnership law which prevent the repayment of capital under the end of the life of a partnership (unless the partnership has opted in to the PFLP regime that was created in 2017).

4.2 In such a limited partnership, "investor loans" typically form the substantial majority of any investor's commitment (c. 99%). An investor's loan operates commercially as equity capital.

Over the years, reflecting the commercial reality, market participants have taken the view that for the purposes of calculating leverage under the AIFMD, the NAV of an AIF should not treat investor loans as third party debt to be deducted from the value of assets held as these loans are not repayable in the manner loans are. It would be helpful for that approach to be explicitly confirmed in the revised rules.

5. TREATMENT OF BRIDGING FINANCE

5.1 Recital 14 to the AIFMD Level 2 Regulations (and Article 6(4)) make clear that temporary borrowing arrangements that are fully covered by capital commitments from investors are to be excluded from the leverage calculation (and, by implication, do not, on their own, cause a fund to be "leveraged"). Recital 14 also states that revolving credit facilities are not to be regarded as temporary in nature. We note that the AIFMD itself does not define what is to be regarded as "temporary" borrowing for these purposes. (To add to the confusion, under the EU's new AIFMD 2 rules, any borrowing regardless of duration which is fully covered by contractual capital commitments from investors is excluded from leverage calculations for the purposes of calculating the leverage cap using the commitment method under new Article 15(4b) of AIFMD as amended by AIFMD 2, whether or not such borrowing is temporary.)

5.2 We believe that:

5.2.1 it is important that the FCA reinstate the effect of Recital 14; and

5.2.2 there is an opportunity for the FCA to rationalise the position and the uncertainties that exist under EU law in relation to arrangements that are fully covered by capital commitments from investors.

5.3 From a policy perspective, irrespective of duration, investors do not typically consider borrowing arrangements covered by investors' capital commitments to be leverage. Typically, the use of borrowing arrangements covered by investor commitments serves a different purpose to borrowing not covered by investor commitments. The purpose of the former is usually to provide investors with flexibility on their drawdowns, while latter seeks to enhance returns. Importantly, bridging finance that is covered by commitments from investors, does not increase the total size of the fund available for investment.

5.4 Our understanding is that one policy rationale underlying the requirement for AIFMs to calculate and disclose their leverage ratio to investors is to ensure that investors are informed about the level of risk in the fund's portfolio. Where borrowing is covered by investors' capital commitments, the AIF's exposure is to its investors (i.e., an AIF would not be able to repay the loan if an investor did not honour their capital commitment). We therefore urge the FCA to restate and express more clearly the exception for bridge financing into the definition of leverage in the Glossary.

5.5 We also ask that where the FCA does this, the FCA removes the uncertainty that has been created under EU law by the inclusion of the word "*temporary*" in Recital 14. The word "*temporary*" is subjective, and moreover, if the policy rationale explained in paragraph 4.4 above is correct, we do not see a policy objective for including long-term borrowing that is covered by investor commitments in the definition. We note that this view is supported by the fact that the EU has removed the word "*temporary*" in Article 15(4b) AIFMD.

5.6 We also believe that the FCA has the opportunity to clarify some of the uncertainty surrounding the use of revolving credit facilities that Recital 14 created. It is not clear to us why the EU took the view that it did relating to revolving credit facilities. We believe that the relevant question for whether borrowing ought to be disregarded for the purposes of calculating leverage under AIFMD/ALTS is whether the borrowing is covered by investor commitments and not the nature/description of the facility under which that finance is advanced.

6. PRESERVING THE PROVISIONS FOR PE-TYPE ARRANGEMENTS

6.1 Recital 78 of AIFMD and Article 6(3) of the AIFMD Level 2 Regulation contains an important anti-avoidance provision which provides that "leverage" of an AIF is deemed to include "exposure contained in any financial or legal structures involving third parties controlled by the relevant AIF…where the structures referred to are specifically set up to directly or indirectly increase the exposure at the level of the AIF". The FCA should be explicit in the policy statement and final rules whether or not this deeming provision is to be carried forward and, if it is, subject to what conditions. If it is carried forward at all, we would encourage the FCA to grapple with the legal uncertainty inherent in the subjective, intention-based test i.e. question of the purpose for which any such financial or legal structures are set up. Does this have to

be the predominant purpose, or a motivating purpose, for example? The FCA may wish to cut through these questions by focussing simply on whether *any* third party's exposures are recourse to the fund, and ignoring them if they are not (beyond the exposure represented by the AIF's equity investment in them).

6.2 If the FCA chooses to carry forward the deeming provision at all, Article 6(3) AIFMD Level 2 Regulation provides that, where a fund's core investment policy is to acquire control of non-listed companies or issuers, any exposure that exists below the fund at the level of those non-listed companies and issuers is deemed to be excluded from the exposure of the AIF provided that the AIFM does not have to bear losses beyond its investment in the respective company (or issuer). In effect Article 6(3) acts as a carve-out to the general position that exposure contained in below the fund structures/entities set up directly or indirectly to increase the fund's exposure should be included when calculating leverage.

6.3 Currently this provision applies only to those fund's whose "core" investment policy is to acquire control of non-listed companies or issuers. This has created uncertainty as to whether real estate funds that acquire control over non-listed companies or issuers (such as property SPVs) are able to make use of this. Unhelpfully, and not based on any good policy rationale, in the EU, ESMA stated that this exemption is not available to AIFM's with a core investment policy to invest in real estate directly or indirectly[18]. This leaves real estate AIFMs in a different, and materially worse, position to their private equity counterparts.

6.4 There is no reason for the FCA to depart from the existing position for PE-type arrangements, as our understanding is that the policy purpose of the leverage provisions is to assess any risk to investors' capital arising from leverage. Further, the FCA should take the opportunity to expand on the exemption for the purposes of real estate and infrastructure assets.

[18] ESMA Q&A, Application of the AIFMD, ESMA34-32-352, Section VII, Question 8 (update 13 June 2023)