EXPLANATORY MEMORANDUM TO

THE ALTERNATIVE INVESTMENT FUND MANAGERS REGULATIONS 2013

2013 No.

1.

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations implement the majority of Directive 2011/61/EU of the European Parliament and the Council on Alternative Investment Fund Managers. The Directive requires Member States to put in place a harmonised regulatory framework for funds currently not within the scope of European regulation.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 These Regulations transpose most provisions of the Directive, and come into force on the Directive transposition deadline of 22 July 2013. A further set of Regulations will be made to transpose those provisions of the Directive which do not apply until a date that will be specified in an EU Regulation to be made under the Directive. A transposition note is at Annex A to this Memorandum.

4.2 The Regulations implement the Directive by making amendments to the Financial Services and Markets Act 2000 and other relevant legislation (in the Schedules to the Regulations) so that managing an alternative investment fund, which is required to be authorised under the Directive, is regulated under the regime set out in the 2000 Act. Stand alone provisions in the main body of the Regulations and further amendments in the Schedules also apply Directive requirements both to persons regulated under that regime, and to other persons who are not required to be authorised under the Directive but on whom the Directive imposes requirements.

4.3 The proposal for the Directive was considered by the House of Commons European Scrutiny Committee following the March 2009 European Council meeting proposing regulatory and supervisory reform and this was reported on in the Committee's Twentieth Report of the 2008-2009 Session. The Directive was debated in European Committee B following consideration of the Committee in its Seventh Report of the 2009-10 Session.

4.4 The proposal for the Directive was considered and reported on by the House of Lords European Union Committee in its Third Report of 2009-2010 Session. The Government provided an update to that Committee following political agreement on the Directive, the text of which can be found at page two of the Committee's

published correspondence from 1 December 2010 to 31 May 2011. The Directive was also the subject of a debate in the House of Lords on 6th July 2010.

4.5 The provisions transposing the Directive also reflect three directly applicable EU regulations related to the Directive: Regulation (EU) No 231/2013 which is made under and supplements the Directive, Regulation (EU) No 345/2013 on European venture capital funds and Regulation (EU) No 346/2013 on European social entrepreneurship funds.

4.6 The Regulations also complete the transposition of Directive 2011/89/EU of the European Parliament and of the Council as regards the supplementary supervision of financial entities in a financial conglomerate which relate to alternative investment fund managers, by making further amendments to the Financial Conglomerates and Other Financial Groups Regulations 2004.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Economic Secretary to the Treasury, Sajid Javid MP, has made the following statement regarding Human Rights:

"In my view the provisions of the Alternative Investment Fund Managers Directive Regulations 2013 are compatible with the Convention rights."

7. Policy background

7.1 The aim of Directive 2011/61/EU is to establish an EU-wide harmonised framework for monitoring, reporting on and supervising risks posed by Alternative Investment Fund Managers (AIFMs) and the funds they manage and for strengthening the internal market in alternative funds. The Regulations require all fund managers in scope to be authorised by national authorities in the managers' Member States. In the United Kingdom, this will be the Financial Conduct Authority (FCA).

7.2 The Regulations will also put in place rules for the marketing of funds in the UK by non-UK fund managers. Powers will be put in place for the FCA to suspend or revoke the right of non-UK fund managers to market in the UK if they contravene Directive requirements.

7.3 The Regulations put in place safeguards to ensure fund managers are transparent in building stakes in unlisted companies. Private equity fund managers will be required to ensure employees are kept informed when a company is taken over and restructured. Restrictions are put in place to prevent the risk of a misalignment of incentives by authorised private equity fund managers in leveraged buy-outs.

7.4 The Regulations also introduce a right for authorised UK fund managers to manage and market funds in other Member States. AIFMs from other Member States will be able to manage and market alternative investment funds in the UK.

7.5 The majority of provisions of the Regulations only apply to fund managers managing funds in scope of the directive holding assets in excess of €100m, or €500m in the case of unleveraged funds whose investors have no right of redemption for at least 5 years. Fund managers below the threshold will be required either to register with the FCA or to remain authorised under the current requirements while complying with basic reporting requirements.

7.6 The Regulations also place certain obligations on the FCA for the collection and sharing of data necessary for the monitoring of the build-up of systemic risk in the financial system by the European Securities and Markets Authority. The FCA will be given the power to impose leverage limits on authorised fund managers.

- ***Consolidation***

7.7 The Regulations amend the Financial Services and Markets Act 2000 and related provisions. There are no current plans to consolidate the Act.

8. Consultation outcome

8.1 The Government initially engaged UK stakeholders through a discussion paper in March 2012. Responses received to the discussion paper were considered closely with the FCA. The Government published a formal consultation paper with a draft set of Regulations in January 2013. There was a consensus amongst respondents that fund managers not previously regulated by the FCA who fall below the threshold of the Directive should be subject only to the requirements to register with the FCA and submit to basic reporting requirements but otherwise maintain the status quo. This consultation received 30 responses from industry bodies, legal and advisory firms, fund administrators and fund managers.

8.2 A second consultation was published in March 2013. HM Treasury consulted on permitting charity funds to be marketed abroad, the regime for non-UK fund managers marketing to retail investors in the UK and a proposal not to apply the approved persons regime to investment companies. All of the proposals were welcomed. This consultation received 12 responses from fund managers and industry bodies.

8.3 The first consultation paper was published in January 2013 and gave respondents just over two months to respond. The period was shortened as the consultation paper did not differ broadly from the principles of the discussion paper published in March 2012 which was broadly welcomed. The second consultation paper published in March 2013 gave respondents three weeks to respond and reflected the technical nature of the issues. Throughout this period, HM Treasury worked with the FCA, industry bodies and professional advisors to the industry to address their concerns in the development of the draft Regulations. The Treasury published its final response to the consultation along with guidance to answer commonly asked questions raised in the process.

9. Guidance

9.1 The Treasury is not planning to issue any further guidance on these Regulations. The FCA will issue a policy statement in order to set out the implementation of the Directive.

10. Impact

10.1 The UK is a major hub for the management of alternative investment funds and a key part of the UK financial services sector. The Government estimates that there are likely to be at least 850 fund management companies in the UK managing £550bn of assets in alternative investment funds both in the UK and abroad. In addition, there are also fund management activities carried out in the UK by or on behalf of fund managers from other countries.

10.2 An impact assessment accompanies this instrument as Annex B. The Government approach will mean the fund management industry will face additional one-off costs of £226m-£353m and £863m-£1.8bn in annual ongoing costs. The variation takes account of the inherent uncertainty. Depositaries will also face £4m in one-off costs and £3m in annual ongoing costs in order to be permitted to provide regulated functions to authorised AIFMs. These business costs reflect the transposition where the Government had no discretion.

10.3 The Regulations amend existing obligations on the FCA with regard to their supervisory functions, in particular concerning information sharing and consultation requirements. The FCA estimates the additional one-off costs at £13.4m.

11. Regulating small business

11.1 The Regulations require small AIFMs that are newly subject to regulation by the FCA to register with the FCA and to comply with ongoing disclosure obligations. These are the minimum additional requirements necessary for correct transposition of the Directive.

11.2 The opportunity to lower requirements for small AIFMs that are already subject to regulation by the FCA, including those that qualify as micro-businesses, has been considered but rejected in line with the consensus from consultation feedback.

12. Monitoring & review

12.1 The Government will review the Regulations and publish a report setting out the conclusions of the review by 22 July 2018. The Directive itself may be reviewed at a European level before the Government has reviewed the Regulations. This may have an impact upon the Government’s review.

13. Contact

Queries regarding this statutory instrument should be directed to Jonathan Gee at HM Treasury: Tel: 0207 270 6275 email: jonathan.gee@hmtreasury.gsi.gov.uk