

## Call for Input

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Future regulation of alternative  
fund managers

**April 2025**

## How to respond

We are asking for comments on this Call for Input (Cfi) by **9 June 2025**.

You can send them to us using the form on our [website](#).

Or in writing to:

Asset Management and  
Funds Policy Team  
Wholesale Buy-side Division  
Financial Conduct Authority  
12 Endeavour Square  
London E20 1JN

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## Chapter 1

# Summary

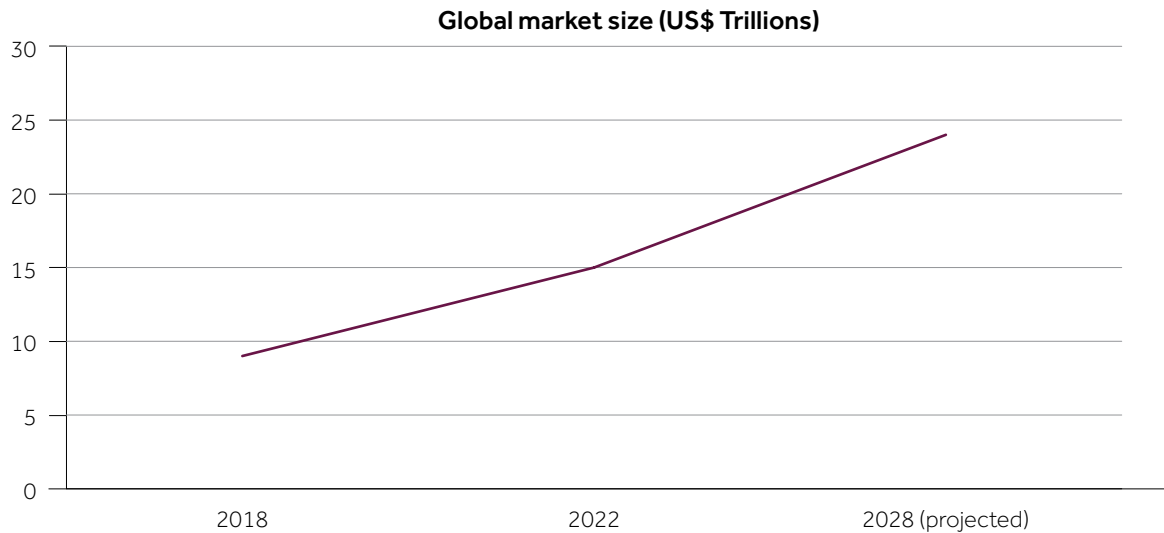
- 1.1** Asset managers are crucial for the financial well-being of millions and play a key role in capital formation for the UK economy. UK asset managers manage £12.3trn in mainstream assets and £2trn in alternative assets. Many UK firms are part of international groups serving clients worldwide, and the UK market is the second largest in the world behind the United States.
- 1.2** This paper outlines our approach to changing the regulatory framework for alternative investment fund managers (AIFMs) in the UK. We want to make it easier for firms to grow, compete, innovate and enter the market. We also want to protect consumers and encourage firms to manage risks responsibly. This work is part of our commitment to streamline the regulatory regime for asset managers.
- 1.3** We propose an approach that is proportionate to firms' size and activities, allowing for growth without sudden or undue regulatory burdens. We also plan to remove unnecessary regulation and reduce the administrative burden for all AIFMs. We want a regime that has enough flexibility to allow firms to do business across borders and is consistent with international standards. Annex 1 gives examples of how rules might apply to firms proportionately within the framework, although we will subsequently consult on specific rules.
- 1.4** This Call for Input accompanies the [Treasury's consultation](#) on its proposed changes to the legal framework. Much of the UK's asset management regulation is derived from European Union (EU) legislation, including the Alternative Investment Fund Managers Directive (AIFMD). The Treasury has proposed to bring into effect provisions to repeal AIFMD's firm-facing legislative requirements. Where appropriate, we will replace those legal provisions in our rules.

## Why we are publishing this paper

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- 1.5** Private markets have grown substantially, with global assets under management (AuM) trebling in the decade to 2023. Private markets include a range of alternative assets, such as instruments issued by non-listed and early-stage companies and investments in infrastructure. AIFMs help channel investment into these alternative assets, supporting the long-term growth of the economy.

**Figure 1: projected growth of private market assets**



Source: Preqin, Future of Alternatives 2028

- 1.6** We published a Discussion Paper in 2023, DP23/2: Updating and improving the UK regime for asset management. Respondents thought that we should make the rules for AIFMs less complex, more proportionate and better tailored to the UK market. They argued we should not replace the regime altogether and few felt significant changes were needed to the parallel rules for Undertakings for Collective Investment in Transferable Securities (UCITS) funds. Many saw benefits in the UK remaining broadly aligned with the EU. Respondents also saw advantages in moving towards a clearer and more consistent set of rules for firms subject to requirements derived from the UCITS Directive, AIFMD or the Markets in Financial Instruments Directive (MiFID), but argued this should happen gradually.
- 1.7** This feedback helps us develop a new AIFM regime. We see a strong case for retaining – but substantially improving – the existing framework. We are publishing this Call for Input now, alongside the Treasury's consultation, to give stakeholders clarity about the intended direction of our reforms and an opportunity to comment before we develop detailed rules and guidance for consultation.
- 1.8** Other jurisdictions are also reviewing alternative investments regulation, including the EU which has made changes to its AIFMD. Global standard-setters, the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB) are considering recommendations in relevant areas such as Non-Bank Financial Intermediation and fund liquidity. We continue to monitor international initiatives while developing our own reforms.
- 1.9** In designing the new regime, we have considered our strategic and operational objectives, and our secondary objective to promote international competitiveness and growth.
- 1.10** We believe that clearer rules, better tailored to firms, could create efficiencies in how firms do business and further support economic growth and competition.

## Background

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- 1.11** The UK asset management industry is diverse and includes large global firms, mid-sized specialists, small boutiques and start-ups. The UK AIFM regime applies to a subset of these firms. This subset is made up of the managers of various investment vehicles, excluding UK UCITS funds. This includes managers of:
- hedge funds
  - private equity funds
  - venture capital and growth capital funds, including Registered Venture Capital Funds (RVECAs)
  - Social Entrepreneurship Funds (SEFs)
  - real estate funds
  - other types of private market funds, such as infrastructure and private debt funds
  - funds of funds
  - investment companies, and
  - authorised funds that are not UK UCITS, such as Non-UCITS Retail Schemes (NURS), Long Term Asset Funds (LTAFs), and Qualified Investor Schemes (QIS).
- 1.12** There are 4 main parts to the work that we and the Treasury are doing to reform the regime for AIFMs. These are:
- Establishing the perimeter that determines which firms must be authorised and regulated.
  - Establishing the legislative framework for the regime, such as provisions for marketing alternative investment funds (AIFs) in the UK.
  - Reviewing our existing requirements for firms.
  - Transferring firm-facing provisions currently in secondary legislation to our rules.
- 1.13** The Treasury's concurrent consultation focuses on establishing the perimeter of regulation. This Call for Input reflects how we intend to regulate in response to the Treasury's proposed changes. We are working together with the Treasury on other aspects of the legislative framework and on transferring provisions from the [AIFMD Level 2 Regulation](#) into our rules. We will subsequently consult on detailed rule changes.
- 1.14** This paper addresses issues related to the regime for managers of unauthorised AIFs. It does not address at length other issues we are considering, including:
- Simplifying the requirements for managers of authorised AIFs into a single set of rules
  - Prudential rules for AIFMs
  - Regulatory reporting under AIFMD
  - Requirements for AIFMs around disclosure, distribution and marketing to retail investors
  - Remuneration requirements for AIFMs
  - The AIFM business restriction that applies to an external AIFM that is a full-scope UK AIFM.
- 1.15** We will address these topics separately. The conclusion of the second chapter sets out more details about our next steps.

## Chapter 2

# A new regime for UK AIFMs

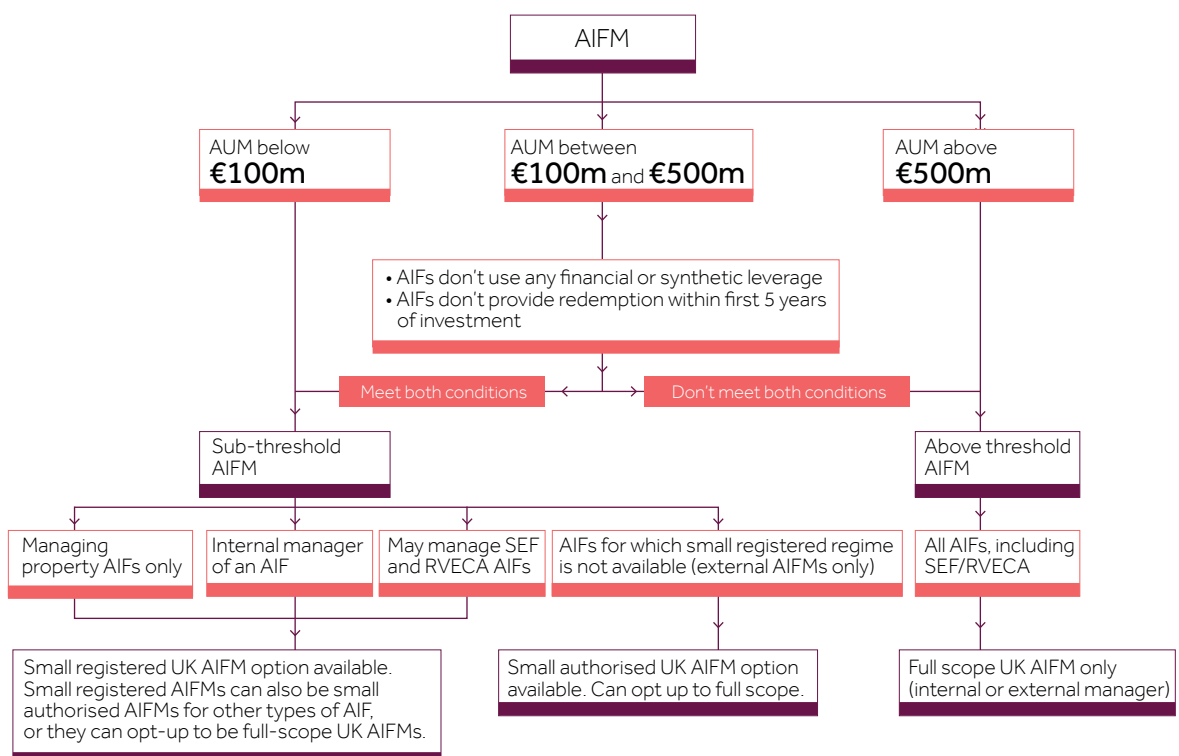
**2.1** The Treasury is proposing to change the scope of firms subject to the UK AIFM regime. It also proposes to remove the threshold that determines when a firm is subject to the full AIFMD regime from legislation. We would then be able to determine that threshold and are considering how to apply the regime across different size firms and those doing different activities after the legislative changes have been made.

## The current regulatory framework for AIFMs

**2.2** The AIFM regime applies to managers of all types of AIF, including FCA authorised AIFs such as LTAFs and NURS. Firms managing authorised funds, regardless of size, must also comply with other rules, particularly those in the Collective Investment Schemes sourcebook (COLL).

**2.3** Treasury legislation includes thresholds that determine whether an AIFM is subject to the full-scope AIFM regime, based on the firm's AuM. These thresholds are set out in the 2011 EU Directive and have not changed since then, despite significant growth in AuM. Above threshold firms must comply with stringent and wide-ranging rules in the full-scope regime.

**Figure 2: AIFM regulatory status in the current regime**



- 2.4** The table below sets out the number of firms and the proportion of total assets managed by firms in each category. Currently, most assets managed by AIFMs are regulated under the full-scope regime.

**Table 1: UK AIFMs by category under the current regime**

| Current                 | Number of firms         | % of total leveraged AuM            | % of total net asset value |
|-------------------------|-------------------------|-------------------------------------|----------------------------|
| <b>Full-scope</b>       | 699                     | 99.8%                               | 98.2%                      |
| <b>Small authorised</b> | 480                     | 0.1%                                | 1.5%                       |
| <b>Small registered</b> | 145                     | 0.02%                               | 0.3%                       |
| Source:                 | FCA data as at 31/12/24 | AIFMD reporting data as at 31/12/24 |                            |

## Issues with the current regulatory framework

- 2.5** When the value of an AIFM's AuM crosses the current full-scope threshold, it is required to hold substantially more regulatory capital and meet stricter regulatory requirements. But immediately imposing new requirements creates barriers for firms as they grow, known as 'cliff-edge effects'. For example, small AIFMs are not required to appoint a depositary, so a firm crossing the threshold must act quickly to do this for each of its funds. Small AIFMs are also not subject to the AIFM business restrictions, which limit the other regulated activities that full-scope AIFMs can carry out in addition to managing AIFs. We know that some firms manage their assets so they do not cross this threshold and become subject to the full-scope regime, thus intentionally limiting their growth.
- 2.6** We want smaller firms to grow without making abrupt and significant changes to the regulation of their business and to avoid requirements that create cliff-edge effects that discourage growth. This means the regime should be coherent and consistent, but more proportionately applied to smaller and growing AIFMs.
- 2.7** The current rules also include detailed procedural requirements. But the same outcomes might be achieved through less prescription, allowing firms more flexibility in how they comply. This would increase the opportunities for firms to achieve the same regulatory outcomes, while delivering greater cross-border efficiencies and more competition between different business models.
- 2.8** The UK market for AIFMs also includes many specialist and boutique firms. Many of these firms currently operate as full-scope UK AIFMs, but do not have the same level of market presence or pose the same level of risk as the largest full-scope AIFMs. The regime for mid-sized firms should be coherent and consistent with larger AIFMs but could be more flexible and less prescriptive, proportionate to their risks.
- 2.9** The activities of AIFMs vary widely. Some rules are relevant to all AIFMs, while others are only relevant to firms undertaking specific activities, such as trading in financial instruments. The rules could apply more clearly to different categories of firms based on their activities.



**2.10** We have not reviewed the conduct rules for small AIFMs since AIFMD was implemented in 2013. We have identified issues through our supervision that we could address by clarifying our expectations. These include poor conduct and valuation practices, inappropriate and incorrectly classified products, and weak risk management controls.

**Question 1:** Do you agree that the areas outlined above are issues with the current regime? If not, please explain why. Are there any issues beyond those that we have identified that we should consider when amending the regime?

## Making the rules clearer

**2.11** Our goal is to make the regime easier to understand and navigate, making it simpler for new entrants to join the market and for existing firms to grow without undue regulatory burdens.

**2.12** In several areas of the AIFM regime, our rules and the Level 2 Regulation set out expectations for different activities or phases of the product cycle within the same rule or provision. This approach makes the rules difficult for firms to understand, and to know when a rule applies to their business. So, we plan to group the rules into clearer, thematic categories that reflect different business activities and phases of the product cycle, as follows:

**Table 2: proposed new rule structure for AIFMs**

|  |  |
|--|--|
| <b>Structure and operation of the firm</b> | General standards of governance and behaviour                          |
|  | Basic systems and controls requirements                                |
| <b>Pre-investment phase</b>                | Requirements during product design and development                     |
|  | Disclosure requirements to prospective investors                       |
| <b>During investment</b>                   | Ongoing obligations while a product is in operation                    |
|  | Periodic investor information disclosure requirements                  |
| <b>Change-related</b>                      | Rules that apply when a manager changes something about the product    |
|  | Rules that apply or require disclosure when something specific happens |

**2.13** By structuring the rules like this, it should be easier for us to set clear requirements for firms of different size.

### For the largest firms:

**2.14** The largest firms would be subject to a regime like the current rules for full-scope UK AIFMs. But we will disapply unnecessarily burdensome rules from all firms and apply certain rules only to firms doing specific activities. In some areas, such as disclosure and

reporting to investors, we will remove some detail where prescription is not necessary to achieve the intended outcome.

### **For mid-sized firms:**

- 2.15** Mid-sized firms would follow a comprehensive regulatory regime that is consistent with the rules that apply to the largest firms. It would cover all major aspects of fund management as outlined in the existing AIFMD-derived rules in Chapter 3 of the Investment Funds sourcebook (FUND), along with other AIFMD-derived standards in Senior Management Arrangements, Systems and Controls (SYSC) and the Conduct of Business sourcebook (COBS). But to allow greater flexibility and proportionality, we do not plan to impose more detailed procedural requirements – typically those in the Level 2 Regulation – except where necessary to set appropriate standards, specify exceptions or clarify expectations. Our expected outcomes will be clearer for these firms, and there will be more flexibility in how they achieve those outcomes.
- 2.16** Existing full-scope firms that become reclassified as mid-sized under the new rules would be subject to a simpler, more flexible and less onerous regime. A significant number of firms should be reclassified as mid-sized as we increase the thresholds. Reducing prescriptive rules would give firms the option to comply in a way that works best for them. This could reduce costs for some firms, improve their efficiency and promote more competition in the market. These firms would also benefit from the removal of unnecessary rules across the board and applying certain rules only to those undertaking specific activities.

### **For small firms:**

- 2.17** Small firms would be subject to core requirements appropriate to their size and activity. The rules for small firms would set baseline standards essential for maintaining appropriate levels of consumer protection and market integrity. These standards would be broadly consistent with the rules that apply to larger firms.
- 2.18** Firms that are currently full-scope UK AIFMs, and who become reclassified as small under the new rules, would see a significant reduction in detailed and prescriptive requirements. They would also have greater flexibility. For existing small AIFMs, we expect to set basic standards that reflect a minimum standard appropriate to a firm that is entrusted with managing a fund. We do not expect most existing small AIFMs will need to materially raise standards. However, we welcome feedback from small AIFMs if they think any provisions of the type set out in this paper might be unnecessary or unduly onerous.

**Question 2:** Do you have any comments on structuring the presentation of our rules thematically based on the product cycle and business activities?

**Question 3:** Do you agree with the principle of creating three levels of firms based on their size to achieve proportionality? If not, what alternative approach would you suggest?

**Question 4:** Do you agree with our approach to rule-making for each level? If not, what alternative approach would you suggest?

## Moving up to a higher category

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**2.19** The rules will set minimum standards for differently sized firms. Without legislative thresholds, firms will not need to apply for a variation of permission as they change size category. We could require firms to notify us of their size category, including any opting up. This would be a significant simplification of the requirements that apply when a firm passes a threshold. For example, we could use a similar process to that currently used under the Senior Managers and Certification Regime (SM&CR).

**2.20** Firms will have the option to comply with rules that apply to larger firms but will not be required to do so. We know professional clients sometimes require their investment managers to exceed regulatory minimum standards. Firms should not interpret greater flexibility in our rules as a reason to ignore client expectations. Firms undertaking cross-border business might also find it easier to opt-in to more prescriptive overseas rules that are consistent with the UK's more flexible, internationally aligned regime.

**Question 5:** Are there any benefits or costs associated with opting up to a higher threshold regime that we should consider when we draft rules? If you are an AIFM, would you consider opting up to a higher regulatory threshold?

## Setting the thresholds

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**2.21** The current legislative thresholds use leveraged AuM, which includes assets acquired through the use of leverage. There may be merit in retaining this gross measure of value as the basis for determining the size of firms and setting thresholds for different categories in the future regime. But there may be a better case for basing these determinations on net asset value: an AIFM's assets minus its liabilities. This is a more common measure of size used in the industry and may be easier for firms to understand than leveraged AuM.

**2.22** Using high levels of leverage creates risk, both to AIF investors and potentially to wider financial markets. We want to set appropriate standards for firms that do this, as described below. However, we think the regime might operate more simply if

determinations of size and thresholds are based on net asset value. This approach would also reduce the risk that firms try to manage their leveraged AuM around reporting dates to remain below a category threshold. Our standards would still reflect the scale of a firm's activities in different markets and the potential for harm should something go wrong.

**2.23** Tables 3 and 4 below show the numbers of AIFMs in the regime as a whole and the scale of their activities. Each row in the tables shows the cumulative number of firms above the potential threshold shown in the left column and their proportion of total leveraged AuM and net asset value under the regime. Table 3 shows the data for firms using thresholds based on leveraged AuM. Table 4 shows the data for firms using thresholds based on net asset value. The shaded rows in Table 4 show where we propose to set the upper and lower thresholds.

**Table 3: Firms above different thresholds based on leveraged AuM**

| Threshold | Number of firms | % of total leveraged AuM | % of total net asset value |
|-----------|-----------------|--------------------------|----------------------------|
| >£25bn    | 40              | 94%                      | 53%                        |
| >£10bn    | 74              | 97%                      | 71%                        |
| >£5bn     | 105             | 98%                      | 80%                        |
| >£2bn     | 173             | 99%                      | 89%                        |
| >£500m    | 312             | 100%                     | 96%                        |
| >£300m    | 399             | 100%                     | 98%                        |
| >£200m    | 467             | 100%                     | 99%                        |
| >£100m    | 565             | 100%                     | 99%                        |

Source: AIFMD reporting data as at 31/12/24

**Table 4: Firms above different thresholds based on net asset value**

| Threshold | Number of firms | % of total leveraged AuM | % of total net asset value |
|-----------|-----------------|--------------------------|----------------------------|
| >£25bn    | 17              | 21%                      | 42%                        |
| >£10bn    | 38              | 73%                      | 63%                        |
| >£5bn     | 64              | 78%                      | 74%                        |
| >£2bn     | 124             | 93%                      | 85%                        |
| >£500m    | 277             | 100%                     | 96%                        |
| >£300m    | 357             | 100%                     | 98%                        |
| >£200m    | 428             | 100%                     | 99%                        |
| >£100m    | 527             | 100%                     | 99%                        |

Source: AIFMD reporting data as at 31/12/24

- 2.24** The regime for the largest firms will ensure that the strictest risk management standards apply to the firms with a broad reach and potential for harm. We propose an upper threshold of £5bn net asset value to distinguish the largest firms. As Table 4 shows, this captures 64 AIFMs in the current regime, around three-quarters of total net asset value and over three-quarters of leveraged AuM. A higher threshold, such as 10bn, would capture a smaller proportion of firms and assets. We do not think that this goes far enough in capturing firms with broad reach.
- 2.25** We considered a lower threshold, such as £2bn net asset value, which would capture virtually all leveraged AuM. But a lower threshold would cover a wide range of firms, including specialist and boutique AIFMs. On balance, we believe that including those firms in a category with AIFMs with much wider reach could place unnecessary burdens on smaller, growing firms. Our view is that a £5bn threshold strikes an adequate balance. It is also a significant increase on the current full-scope threshold of €100m (or €500m in some circumstances – see Figure 2) and provides substantial opportunities for firms to grow without undue burdens. We welcome feedback on any practical implications from us setting the threshold at a particular level.
- 2.26** We think the regime for small firms should be primarily for AIFMs in the early stage of development, or which operate solely in a highly focused segment of the market. This should help them adapt to being regulated and provide a regulatory environment that will help them to grow. We propose setting the lower threshold at £100m. The current threshold is set at €100m of leveraged assets, calculated on a gross basis. The new lower threshold would be assessed against the net asset value of the funds managed by an AIFM. This would increase the threshold before firms are deemed to be mid-sized.
- 2.27** Firms over the new lower – but below the upper – threshold would be subject to the mid-sized firm regime, a more flexible and proportionate regime than the current full-scope regime. We considered a higher threshold, such as £200m. However, our supervisory experience is that firms with more than £100m of net asset value are capable of having developed systems and controls and should therefore be subject to clear yet flexible rules that reflect their relative maturity. Small AIFMs are also subject to a less onerous prudential regime. We plan to review AIFMs' prudential requirements, as we explain at the end of this chapter.

**Question 6:** Do you agree with the proposed levels of the thresholds?  
Do you have any other comments on the proposed levels  
and the metrics used for the thresholds?

## Leverage

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- 2.28** Our view is that the most appropriate threshold for large firms is £5bn net asset value. Much of the leveraged exposure is concentrated in the firms with the largest net asset value, so setting the threshold at this level would, by default, capture most leveraged assets within the most stringent regime. While the level of these assets is an important measure of how much risk a firm poses, it is not the only relevant metric. Firms that are not highly leveraged may also have a large footprint in some markets and so, proportionally, pose a material risk in those markets.

- 2.29** We know that some hedge funds use substantial leverage to increase returns for their investors. Both the Bank of England and the FSB have noted that some types of leveraged funds could pose systemic risk if they follow very similar strategies and make very similar investments. In stressed market conditions, groups of highly leveraged funds like this could act in the same way. For instance, during a market downturn, several funds could act simultaneously to de-leverage, reduce risk exposure and/or recapitalise. This may result in them simultaneously exiting similar positions, causing asset prices to move significantly and impacting market liquidity.
- 2.30** AIFMs and the funds they manage play an important role in non-bank financial intermediation, which has grown significantly since the 2008 global financial crisis. The FSB has consulted on leverage in non-bank financial intermediation and we expect it to publish recommendations later this year. We will then consider the implications of these recommendations for the AIFM regime.
- 2.31** It is important that we can measure, monitor and manage the risks of high leverage in AIFs. Under the AIFMD regime, we get a significant amount of data for measuring these risks. We are required to assess risks involving the use of leverage by full-scope AIFMs and impose limits on the level of leverage that they can use or other necessary restrictions to ensure the stability and integrity of the UK financial system. We plan to evaluate the adequacy and effectiveness of current AIFMD provisions in addressing risks from leverage in line with the forthcoming FSB recommendations. We are also considering if we need to be clearer about our expectations of risk management by highly leveraged firms. We welcome feedback on the best ways to do this. We also recognise that different approaches might be needed for different types of activities and investments.

**Question 7:** **Do you agree that we should make our expectations of risk management by highly leveraged firms clearer? Do you have any comments on the best way to achieve this?**

## Applying the rules to firms undertaking different activities

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- 2.32** Many requirements, particularly those in the Level 2 Regulation, assume that the AIFM is managing a diversified portfolio of transferable securities. These rules largely mirror those for UCITS fund managers. However, they are not always suitable for managers of funds focused on less liquid investment types, such as private equity and real estate, or which hold significant positions in these assets.
- 2.33** An example is the rules on risk limits. These are relevant to most hedge fund managers. But they are not relevant to private equity fund managers in the same way, where investment risks mainly depend on individual investments and cannot be easily categorised into market risk, credit risk, liquidity risk, counterparty risk and operational risk. We expect firms to comply with rules where they are relevant, but we do not want to impose unnecessary standards on firms. In Annex 1, we give examples of how the rules might apply to firms doing different activities.

- 2.34** Some AIFMs also operate business models where it might be better to use a more bespoke regime to set regulatory standards. Examples of areas where we are considering this are managers of venture capital and growth capital funds and investment trust managers.

### Venture capital and growth capital

- 2.35** Venture capital and growth capital provide finance for early-stage companies, as well as research and development. Venture capitalists have an important role in funding and guiding companies that can grow rapidly and be more productive on average than later stage companies.
- 2.36** The regulatory status of the managers of these funds varies. Some are authorised AIFMs and others are small registered AIFMs. Some managers also register as managers of managers of RVECA and are subject to additional requirements set out in the RVECA Regulation.
- 2.37** Respondents to Government and FCA consultations have made the case for better regulatory treatment of the sector. Stakeholders consider that the RVECA regime could be improved, for example, by giving qualifying funds more flexibility in their eligible investments. The Treasury intends to retain the current RVECA regime for now, while considering how it could be best adapted to support the venture and growth capital sector. When the Treasury has made its decision, we will consider how to adapt our regime accordingly. We see the potential benefit of creating a bespoke regulatory regime given the importance of the sector to economic growth and its distinct characteristics.

**Question 8:** **Do you see a need for a separate regime for venture capital and growth capital funds? Are there any other areas where we should consider setting up tailored regimes?**

### Listed closed-ended investment companies (investment trusts)

- 2.38** The Treasury has set out a policy proposal for the regulation of managers of listed closed-ended investment companies (LCICs) in its consultation. This proposes that LCICs remain in-scope of AIFM regulation for financial stability and consumer protection reasons.
- 2.39** We recognise that LCICs have some unique characteristics. They share some features with operating companies, but the majority are structured and operated as a fund. They are often presented to investors as an alternative collective investment vehicle. If managers of LCICs remain within the AIFM regime, we would set appropriate standards, taking into account the specific nature of that market and their wider regulatory framework.

### Background

- 2.40** LCICs are a popular investment structure with a market value of approximately £170bn. As explained in the Treasury's consultation, many retail customers invest in these funds.

LCICs invest in a range of asset classes, including listed securities, private equity, debt, property and infrastructure. As LCICs are closed-ended and their securities are traded on the stock market, they do not have to sell assets when investors want to cash in their investment. We recognise that this structure means that LCICs are well-placed to contribute to the UK's growth agenda, providing long-term investment in illiquid asset classes, including providing productive finance and investment in net zero-aligned assets.

- 2.41** The sector operates within a comprehensive regulatory framework. Before the implementation of AIFMD, LCICs were not regulated as funds in the UK, although some additional conduct requirements may have applied if they were sold to retail investors. Alongside the requirements introduced during AIFMD implementation, LCICs are also subject to the UK Listing Rules (UKLRs), Disclosure Guidance and Transparency Rules, the Prospectus Regulation Rules and the UK Market Abuse Regime.
- 2.42** The UKLRs require LCICs to invest and manage their assets in line with their object of spreading investment risk. They must also have a published investment policy that is always complied with, and the board of directors must be able to act independently of any investment manager. Annual financial reports must include a statement explaining how the company has invested its assets with a view to spreading investment risk in line with its published investment policy, as well as a comprehensive and meaningful analysis of the LCIC's portfolio.
- 2.43** Additionally, the UKLRs require annual disclosure against the Financial Reporting Council's (FRC) UK Corporate Governance Code (the Code) by a LCIC. An LCIC must state how they have applied the Principles of the Code, and whether they have complied with the provisions in the Code and explain if they have not.
- 2.44** The FRC states in the Code that 'Externally managed investment companies (which typically have a different board and company structure that may affect the relevance of particular Principles) may wish to use the Association of Investment Companies' Corporate Governance Code to meet their obligations under the Code'.
- 2.45** Furthermore, the boards of UK incorporated LCICs (and the directors on those boards) are subject to UK company law.

### ***Approach to regulation of LCICs and areas of potential reform***

- 2.46** While a robust regulatory framework benefits firms and investors, we know that, following on from the UK listing regime reforms, streamlining the AIFMD requirements for LCICs may also contribute to growth in UK asset management and the economy. However, we need to allow flexibility for an LCIC's board to comply with additional requirements where they consider it to be in their shareholders' best interests.
- 2.47** We have explained how the regime would work for different-sized firms and have proposed thresholds based on net asset value. We would apply these thresholds in the same way to LCICs. The Treasury's consultation proposes to remove the small registered regime. This would mean that an internally managed LCIC that can register as a small registered UK AIFM under the current regime would need to become authorised.



**2.48** We aim to create a more proportionate regime for AIFMs. So, we are considering whether, due to the characteristics of LCICs and the broader regulatory framework that applies, we could take a different approach to the regulation of LCIC managers in the areas set out below.

**Question 9:** **Do you have any comments on our planned approach to set different rules for managers of LCICs?**

**Question 10:** **Do you have any comments on our proposed approach to applying the thresholds in the same way to LCICs as to other types of AIF?**

### ***Transparency requirements***

**2.49** Under AIFMD, investors in LCICs must be offered additional information before entering into a contract. They must also be given periodic information in addition to the LCIC's annual financial report. We understand investors may find these disclosures unnecessary and irrelevant. So, in addition to other separate work that we are carrying out in relation to disclosure requirements, we are considering disapplying the provisions in FUND 3.2 (Investor information) and FUND 3.3 (Annual report of an AIF) which require full-scope UK AIFMs of LCICs to disclose this extra information.

### ***Leverage***

**2.50** To operate efficiently, LCICs may use a relatively low level of leverage that does not create a significant risk to financial stability, compared with, for example, the risk from a highly leveraged hedge fund.

**2.51** Where an LCIC does not use significant leverage, there may be opportunities to take a more proportionate approach to applying risk management rules. We are considering whether we should disapply the requirements in FUND 3.6 (Liquidity) where an LCIC uses an insignificant amount of leverage. For example, FUND 3.6 includes a requirement for the AIFM of an LCIC to employ an appropriate liquidity management system, adopt procedures so it can monitor the LCIC's liquidity risk and regularly conduct stress tests. Currently, the rules apply where an LCIC has any level of leverage at all.

**2.52** LCICs do not present liquidity risk because of investor redemptions. So, where an LCIC has an insignificant level of leverage, the liquidity risk should be sufficiently low that disapplying these rules would not have a material impact on investors or market confidence. We would consider how to determine what is an insignificant level of leverage. For example, whether a figure of 10% of net asset value is appropriate or whether it could be based on qualitative factors set out in guidance. It is possible for an LCIC to have liquidity issues, as it may be exposed to margin call liquidity risk or to sharp falls in the value of its assets or earnings. For this reason, we would continue to apply the risk management rules to an LCIC with a higher level of leverage.

## Delegation

- 2.53** We are considering tailoring the rules on delegation for full-scope AIFMs of LCICs to reflect the structure of LCICs. The AIFM is appointed by an LCIC's board of directors with the AIFM's responsibilities set out in a contractual agreement. Under the AIFMD regime, functions such as administration and third-party marketing are considered as having been delegated by the AIFM to the third party. However, it is likely that, in practice, the board will have appointed third parties to carry out these functions.
- 2.54** In areas where, in practice, the board may have taken the decision to delegate, we would clarify our expectations of the AIFM of a LCIC. For example, the rules in FUND 3.10 (Delegation) currently require a full-scope UK AIFM to justify its delegation structure with objective reasons.
- 2.55** There may be other areas that do not involve delegating functions to third parties where the responsibilities of the board and the AIFM overlap. For example, both have a role in deciding an LCIC's maximum level of leverage. The UKLRs provide that an LCIC's investment policy must contain quantitative information about gearing and maximum exposures. Additionally, AIFMD requires an AIFM to set a maximum level of leverage it can undertake on behalf of the company. We welcome feedback on whether there are any AIFMD requirements that, taking into account the respective responsibilities of the board and AIFM of a LCIC, should not be retained or where clarification would be helpful.

**Question 11:** **Given the role of an LCIC's board of directors, are there any areas that would benefit from us clarifying our expectations of AIFMs and/ or any requirements that should not be retained in so far as they apply to the AIFMs of LCICs?**

**Question 12:** **Do you have any comments on our proposed areas of reform for LCICs? Are there any further areas of the regime where different requirements should apply to the AIFMs of LCICs? If so, please explain how the requirements should apply differently and why this is the case.**

## Depositories

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- 2.56** Safekeeping client money and assets is a critical function which must generally be carried out by or on behalf of an authorised person. We start from the presumption that the role of depositories in providing safe custody of AIF custodial assets works in the interests of investors and does not need substantial change. If depositories did not carry out this function, at least for specified investments, another regulated firm would need to do so.
- 2.57** Where the depository's duty is to verify that the AIF (or the AIFM on its behalf) owns a particular non-custodial asset, this includes both specified investments and other types of assets, such as land and buildings or infrastructure assets (for which safekeeping would not otherwise be a regulated activity). Given an increasing focus on private

markets as a source of growth, some investors may see appointing a depositary as a proportionate measure to protect the integrity of private assets. We think this process has consumer protection benefits, although we acknowledge that some institutional and professional investors in unregulated AIFs may not place great value on this protection.

- 2.58** AIF depositaries must also monitor cash flows and oversee various processes for operating and managing the fund. Those requirements are based on rules for authorised funds, where they offer proportionate consumer protection. However, it is less evident that unauthorised AIFs aimed at professional investors require these protections, or at least in such a detailed and prescriptive form.
- 2.59** The AIFMD depositary model was largely based on the UCITS Directive and is not a standard feature of funds internationally. Regulatory systems in many other jurisdictions have different ways of protecting client money and assets, or of independently monitoring that fund operations are carried out effectively and consumers adequately protected. We see no immediate need to make radical changes to how asset safekeeping and fund oversight should be carried out for large and mid-size AIFMs. However, we welcome input from stakeholders on whether they would like us to explore proportionate alternatives that meet global regulatory standards.
- 2.60** We do not expect to change the rules that are unique to depositaries of authorised funds in any material way. Small authorised AIFMs and those full-scope AIFMs that manage overseas AIFs not marketed in the UK are not required to appoint a depositary. We do not propose to make them do so in future. The Client Assets sourcebook (CASS) applies safekeeping rules to small authorised AIFMs and would continue to apply to small firms in the new regime.

**Question 13: Do you see a need for changes to the regime’s depositary requirements? Should these requirements apply only to specific levels of firm or certain types of fund, such as authorised funds? Should our regime seek to align its depositary rules with those of another jurisdiction or jurisdictions?**

## Remuneration

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- 2.61** AIFMD introduced remuneration requirements for AIFMs, which led to the creation of the AIFM Remuneration Code for staff working for full-scope firms. Following changes to the dual-regulated firms’ Remuneration Code in 2023 and further reforms proposed in CP24/23: Remuneration Reforms, we will also review the operation and effectiveness of the remuneration rules for AIFMs, alongside the code for UCITS management companies and investment firms, to consider whether we should make changes to these requirements.

## Prudential requirements

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- 2.62** The AIFMD regime includes prudential rules for AIFMs, for example, requiring authorised firms to hold a liquid capital buffer. The Treasury's consultation explains that the AIFMD requirements were introduced partly in response to risks identified during the global financial crisis. Since 2013, there have been changes in the perceived balance of risks and the potential for a recalibration of the rules to address those risks. We will review the regime's prudential requirements and how they apply to different-sized firms.

## Business restrictions

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- 2.63** The AIFM business restrictions allow an external full-scope AIFM to undertake only AIFM management functions and the management of UCITS or other collective investment undertakings as its principal activities. If they have the necessary permissions, they can also carry on the management of portfolios of investments and can provide specific additional services. The rules were copied into AIFMD from the UCITS Directive and were intended to address conflicts of interest. Conflicts of interest are already adequately covered by other rules for AIFMs, so we consider that the business restriction does not meaningfully reduce risks. However, the current rules appear to create costs and inefficiencies, requiring firms to seek top-up permissions for some activities or create new legal entities once a firm passes the size threshold. We will consider the business restriction when we consider how the conduct and prudential rules will apply to firms in the new regime.

## Regulatory reporting

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- 2.64** AIFMs must report information about their business and the funds that they manage to us. The reporting regime has not been reviewed since it was introduced. We want to collect meaningful information in a way that is future proof, helps us understand the market and monitor the collective and individual risks posed by firms. We want to achieve a more effective reporting regime that is proportionate in its demands on firms and will consider how to achieve this.

## Next steps

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- 2.65** This paper is open for comment until 9 June 2025. Subject to feedback, and to decisions by the Treasury on the future regime, we plan to consult on detailed rules in the first half of 2026. We will also provide more details on the timeline for implementation. Broadly, we intend to give firms time to adapt to the new regime, while removing unnecessary rules relatively quickly.

## Equality and diversity considerations

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- 2.66** We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.
- 2.67** As part of this, we ensure we consider the equality and diversity implications of any new policy proposals.
- 2.68** Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010 (in Northern Ireland, the Equality Act is not enacted but other anti-discrimination legislation applies). But we will continue to consider the equality and diversity implications of the proposals when determining our approach to reform of the regime.

**Question 14:** **Could any of the ideas in this Call for Input adversely impact any of the groups with protected characteristics i.e. age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment?**

**Question 15:** **Are there other steps we could take to improve outcomes for fund investors or potential investors with any of these protected characteristics?**

## Annex 1

# Examples of how we might rewrite the rules

1. We want to make our rules more proportionate. This annex gives an illustrative example, showing how we might rewrite the risk management rules to conform with the proportionate approach outlined in this paper. It is not a consultation on specific rules.

## High-level risk management rules

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2. Currently there are detailed risk management requirements that apply to full-scope AIFMs. These come from both the Directive (appearing as rules in our Handbook) and the AIFMD Level 2 Regulation (assimilated law). We plan to replace the provisions of the Level 2 Regulation with similar rules where appropriate.
3. The current rules in this area, including the requirements of the Level 2 Regulation, apply to full-scope AIFMs managing all types of AIF. To allow a more proportionate approach which is tailored to different business models, we plan to apply the rules differently to firms carrying out different activities.
4. AIFMs operate a wide range of different investment strategies. Some are hedge fund managers operating short-term trading strategies in highly liquid assets. Others are private equity managers investing in companies for several years. Our expectations of firms operating different types of strategies would be very different.
5. For example, it is reasonable to expect that a private markets fund manager of any size would need to conduct detailed due diligence before investing. But a hedge fund manager trading assets over the short term might only need to establish that an instrument is sufficiently liquid to trade. By contrast, a hedge fund manager would have risk limits as an integral part of its investment process. But a private markets fund manager might not need to set all risk limits in the way the rules envisaged. This is because the investment risks of a private market investments portfolio will be mainly determined by the specific investments, in addition to concentration risk, rather than considering categories such as credit risk and market risk.
6. The following table summarises the risk management rules that currently apply to full-scope AIFMs. Not all rules are relevant to all firms. The table identifies where a rule should only be applied to some firms based on their size or activities. We would re-craft the rule so that it applies accordingly and proportionally to those types of firms.

| Examples of high-level rules  | Possible future application   |
|---|---|
| <b>Obligations not specific to risk management</b>  |   |
| Documenting and annually reviewing policies and procedures  | <i>General requirement</i>  |
| <b>Structure and governance</b>   |   |
| An AIFM must establish and maintain a permanent risk management function  | <i>General requirement</i>  |
| This function must be hierarchically and functionally independent from operating units, except where this independence would not be appropriate or proportionate given the nature, scale and complexity of the AIFM's business and of each AIF it manages | <i>General requirement, but applied proportionally (as per UCITS)</i>   |
| An AIFM must ensure it has adopted appropriate safeguards against conflicts of interest so as to allow risk management activities to be independently performed   | <i>General requirement</i>  |
| An AIFM must ensure the risk management function has the authority necessary to escalate issues to senior management and the governing body   | <i>General requirement</i>  |
| <b>Systems and controls</b>   |   |
| An AIFM must identify and assess the risks for each AIF it manages  | <i>General requirement</i>  |
| An AIFM must have adequate risk management systems to measure, manage and monitor all risks relevant to each AIF it manages   | <i>General requirement</i>  |
| An AIFM must have a risk management policy  | <i>General requirement</i>  |
| Have a process for investment due diligence   | <i>Only for AIFMs with AIFs investing in illiquid assets</i>            |
| Ensure that it can identify and monitor the risks associated with each investment position  | <i>Broad principle for larger firms</i>                                 |
| Set risk limits   | <i>Only for AIFMs with significant leverage or liquidity mismatch</i>   |
| <b>Ongoing obligations</b>  |   |
| The risk profile of each AIF must be in line with its investment objectives, policy and strategy  | <i>General requirement</i>  |
| The risks of each investment must be monitored  | <i>Only for larger AIFMs</i>  |
| <b>Specific obligations for specific types of AIF</b>   |   |
| Rules for funds that use leverage   | <i>Only for certain managers and based on size or scale of leverage</i> |

## Level 2 detailed risk management rules

7. Risk management provisions are contained in FUND 3.7 and articles 38 to 45 of the Level 2 Regulation. Our starting assumption is that we would apply all the detailed provisions as rules to the largest AIFMs, proportionally to mid-sized AIFMs but not to smaller AIFMs.
8. Many of the rules are similar to provisions that UCITS managers are required to comply with under rules in COLL 6.11 and 6.12 which derive from the UCITS implementing Directive. Many of these rules appear to envisage that the manager is managing a diversified portfolio of transferable securities. This is reasonable for managers of UCITS, given the investment restrictions in the UCITS rules.
9. The Level 2 Regulation contains some proportionality clauses. A proportionate approach could be to apply the current Level 2 Regulation requirements to larger managers of hedge funds and other funds investing in transferable securities. But it may not be proportionate to apply these rules to managers of funds investing in private equity or real estate.
10. In the following table, we present examples of how certain Level 2 provisions could be applied proportionally to mid-sized AIFMs based on the relevance of the rules to their activities.

### Summary table: Potential approach to Level 2 Regulation for mid-sized AIFMs

| Article | Summary of provision   | Managers of funds investing in transferable securities   | Managers of funds investing in other investments (e.g. private equity) |
|---------|--|--|--|
| 38      | Meaning of 'risk management systems'                                   | Glossary definition only, relevant where the term recurs in FCA rules  |  |
| 39      | Requirements for the permanent risk management function                | Provisions apply but with less detail (E.g., action must be taken in response to breach of risk limits, and regular updates to senior management/governing bodies, but without specifying content) |  |
| 40      | Contents of a risk management policy                                   | Provisions apply, broadly aligned with full-scope AIFMs but without specified detail   | Provisions apply where relevant  |
| 41      | Assessing, monitoring and reviewing risk management systems            | Guidance (e.g. frequency of review is no longer binding)   | Guidance   |
| 42      | Functional and hierarchical separation of the risk management function | Provisions apply   | Provisions apply   |



| Article   | Summary of provision   | Managers of funds investing in transferable securities | Managers of funds investing in other investments (e.g. private equity) |
|-----------|--|--|--|
| <b>43</b> | Safeguards against conflicts of interest within the risk management function | Provisions apply                                       | Certain provisions potentially do not apply                            |
| <b>44</b> | Risk limits  | Provisions apply                                       | Provisions do not apply  |
| <b>45</b> | Risk measurement and management  | Provisions apply                                       | Provisions do not apply  |

**Question 16:** Do you have any comments on the approach to the risk management rules outlined in this annex?

## Annex 2

### Questions in this paper

- Question 1:** Do you agree that the areas outlined above are issues with the current regime? If not, please explain why. Are there any issues beyond those that we have identified that we should consider when amending the regime?
- Question 2:** Do you have any comments on structuring the presentation of our rules thematically based on the product cycle and business activities?
- Question 3:** Do you agree with the principle of creating three levels of firms based on their size to achieve proportionality? If not, what alternative approach would you suggest?
- Question 4:** Do you agree with our approach to rule-making for each level? If not, what alternative approach would you suggest?
- Question 5:** Are there any benefits or costs associated with opting up to a higher threshold regime that we should consider when we draft rules? If you are an AIFM, would you consider opting up to a higher regulatory threshold?
- Question 6:** Do you agree with the proposed levels of the thresholds? Do you have any other comments on the proposed levels and the metrics used for the thresholds?
- Question 7:** Do you agree that we should make our expectations of risk management by highly leveraged firms clearer? Do you have any comments on the best way to achieve this?
- Question 8:** Do you see a need for a separate regime for venture capital and growth capital funds? Are there any other areas where we should consider setting up tailored regimes?
- Question 9:** Do you have any comments on our planned approach to set different rules for managers of LCICs?
- Question 10:** Do you have any comments on our proposed approach to applying the thresholds in the same way to LCICs as to other types of AIF?

- Question 11:** Given the role of an LCIC's board of directors, are there any areas that would benefit from us clarifying our expectations of AIFMs and/ or any requirements that should not be retained in so far as they apply to the AIFMs of LCICs?
- Question 12:** Do you have any comments on our proposed areas of reform for LCICs? Are there any further areas of the regime where different requirements should apply to the AIFMs of LCICs? If so, please explain how the requirements should apply differently and why this is the case.
- Question 13:** Do you see a need for changes to the regime's depositary requirements? Should these requirements apply only to specific levels of firm or certain types of fund, such as authorised funds? Should our regime seek to align its depositary rules with those of another jurisdiction or jurisdictions?
- Question 14:** Could any of the ideas in this Call for Input adversely impact any of the groups with protected characteristics i.e. age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment?
- Question 15:** Are there other steps we could take to improve outcomes for fund investors or potential investors with any of these protected characteristics?
- Question 16:** Do you have any comments on the approach to the risk management rules outlined in annex 1?

## Annex 3

# Abbreviations in this document

| <b>Abbreviation</b> | <b>Description</b>                                   |
|---------------------|--|
| <b>AIF</b>          | Alternative investment fund                          |
| <b>AIFM</b>         | Alternative investment fund manager                  |
| <b>AIFMD</b>        | Alternative Investment Fund Managers Directive       |
| <b>AuM</b>          | Assets under Management                              |
| <b>CASS</b>         | Client Assets sourcebook                             |
| <b>COBS</b>         | Conduct of Business sourcebook                       |
| <b>COLL</b>         | Collective Investment Schemes sourcebook             |
| <b>EU</b>           | European Union                                       |
| <b>FCA</b>          | Financial Conduct Authority                          |
| <b>FRC</b>          | Financial Reporting Council                          |
| <b>FSB</b>          | Financial Stability Board                            |
| <b>FSMA</b>         | Financial Services and Markets Act 2000              |
| <b>FUND</b>         | Investment Funds sourcebook                          |
| <b>IOSCO</b>        | International Organization of Securities Commissions |
| <b>LCIC</b>         | Listed closed-ended investment company               |
| <b>LTAf</b>         | Long Term Asset Fund                                 |
| <b>MiFID</b>        | Markets in Financial Instruments Directive           |
| <b>NURS</b>         | Non-UCITS Retail Scheme                              |
| <b>QIS</b>          | Qualified Investor Scheme                            |

| <b>Abbreviation</b> | <b>Description</b>  |
|---------------------|---|
| <b>RVECA</b>        | Registered Venture Capital Fund                                   |
| <b>SEF</b>          | Social Entrepreneurship Fund                                      |
| <b>SM&amp;CR</b>    | Senior Managers and Certification Regime                          |
| <b>SYSC</b>         | Senior Management Arrangements, Systems and Controls              |
| <b>UCITS</b>        | Undertakings for Collective Investment in Transferable Securities |
| <b>UK</b>           | United Kingdom  |
| <b>UKLRs</b>        | UK Listing Rules  |

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