# UKLA Technical Note

## Infrastructure funds

Ref: UKLA / TN / 406.1 Guidance Consultation

LR 11.1.4R and LR 15.5.4R

### Background

LR 15, which came into force as a result of the Financial Services Authority's (FSA's) Investment Entities Listing Review,[1] opened listing to a wide range of investment entities, including those investing in infrastructure assets.

It was suggested to us at the time that, for large-scale infrastructure assets, there is no true secondary market and that, consequently, infrastructure funds are dependent on a tie-up with key providers to source future investment opportunities and satisfy investor demand for exposure to this specific asset class. Such a provider may also be the investment manager. As an investment manager falls within the definition of related party (LR 15.5.4R and LR 11.1.4R), this means that any such transactions would prima facie be a related party transaction and subject to the requirements in LR11.

As a result, it was suggested to us that, given the illiquid nature of the asset class, if a fund had stated its intention to make such purchases and had procedures in place to manage any conflicts arising from the purchase, then it should be able to successfully argue that such acquisitions are in the ordinary course of its business (and therefore in accordance with LR 11.1.5R, not subject to the related party rules in LR 11).

While we have accepted such arguments on a number of occasions, we have also rejected these arguments in some instances (e.g. where a fund proposes to invest in small-scale infrastructure assets that would appear to be readily purchasable).

### Current interpretation

As markets have developed in the intervening period, we have reviewed our approach to make sure it is fit for purpose.

Closed-ended investment funds are exempt from LR 10 (Significant transactions) for transactions that are executed in line with the fund's published investment policy (LR 15.5.2R); such transactions are always deemed to be in the ordinary course of the fund's business.

No such wholesale exemption exists for LR 11 (Related party transactions). When a fund acquires new investments, it would not typically be expected that these would be sourced from the balance sheet of the fund's investment manager, and so our presumption is that the requirements in LR 11 will apply.

In some limited cases, a fund may be able to argue that, due to the nature of the asset class it invests in, new investments can only be acquired from an entity with which the fund has a long-standing relationship (which may be the investment manager) and so, in that context, what constitutes 'ordinary course' should be interpreted differently.

1 CP 06/4, CP 06/27 and CP 07/12.

We would only accept this argument where the fund:

- can point to structural characteristics in the sector it invests in that make purchases from the related party the only viable option to enable the fund to provide investors with exposure to the asset class. A statement of intent to purchase from a related party, made by funds investing in sectors where investments can be sourced from other parties, will not be sufficient grounds for a fund to successfully argue that such purchases will be 'ordinary course'. In such cases, the requirements in LR 11 will apply; and
- is able to demonstrate that it has in place arrangements to effectively process such purchases and manage any conflicts of interest that may arise.

We would expect sponsors advising on the application of LR 11 to such investments to discuss with us whether such transactions should be considered to be in the ordinary course.

We would also remind funds and sponsors that, as markets for specific asset classes continue to develop, funds may not be able to successfully argue that such investments are in the ordinary course, even where other funds may have successfully argued this in the past in relation to that asset class.