Chapter 16

Scope of the Alternative Investment Fund Managers Directive

16.1 Introduction

G **Question 1.1: What is the purpose of the questions and answers in this chapter?**

The purpose is to consider the scope of *regulated activities* specifically relating to the Alternative Investment Fund Managers Directive 2011/61/EU ("*AIFMD*") as implemented in the *UK* through the *RAO*.

Question 1.2: What are the regulated activities specifically relating to AIFMD?

The *regulated activities* that specifically relate to *AIFMD* are:

(1) *managing an AIF* (see ■ PERG 16.3); and

(2) acting as a depositary of an AIF (see ■ PERG 16.4).

Question 1.3: What are the main European measures dealing with the scope?

As well as *AIFMD* itself, they are:

(1) Commission delegated regulation (EU) No 231/2013, supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (the *AIFMD level 2 regulation*); and

(2) the ESMA document "Guidelines on key concepts of the AIFMD" (the *ESMA AIFMD key concepts guidelines*).

Question 1.4: What is the approach to deciding whether something is covered by the AIFMD?

When defining what an *AIF* is, the drafters of *AIFMD* faced a dilemma. If there is a precise and detailed definition there is a risk that some funds that should be regulated would fall outside regulation, given the wide variety of legal forms they can take. However, a broad definition entails a risk that *AIFMD* is given a much wider scope than intended. The agreed definition of *AIF* is drafted at a high level of generality and uses words which have a wide meaning. So we have approached ■ PERG 16 by looking at what sorts of entities are clearly meant to be caught and then using that as a guide to identify cases which are not fairly within the definition, to avoid an interpretation that would give an exorbitantly wide scope. In the same way, descriptions of what is excluded should not be read in a way that would take cases out of scope that are fairly within it.

A number of answers in ■ PERG 16 take a broad purposive interpretation and look at economic substance. The definition of *AIF* is drafted at a high level without much detail and uses broad concepts rather than precise technical or legal ones, meaning that ■ PERG 16 takes a similar approach to interpreting it.

Question 1.5: Are there transitional arrangements?

Yes. Some of the transitional arrangements for implementing the *AIFMD* may affect the date by which a *person* who would otherwise be *managing an AIF* or acting as a depositary of an AIF needs *permission* to do so. ■ PERG 16 does not deal with these arrangements. Details are in Part 9 of the *AIFMD UK Regulation*.

16.2 What types of funds and businesses are caught?

G **Question 2.1: What is the basic definition of an AIF?**

An *AIF* is a collective investment undertaking, including investment compartments of such an undertaking, which:

(1) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and

(2) does not require authorisation pursuant to article 5 of the *UCITS Directive*.

The key elements of the definition are:

(3) it is a collective investment undertaking (*CIU*);

(4) it has a defined investment policy;

(5) it raises capital with a view to investing that capital for the benefit of those investors in accordance with that policy;

(6) an *AIF* does not include an undertaking that requires authorisation under article 5 of the *UCITS Directive*.

It is necessary to satisfy all the elements of the definition in order to be an *AIF*.

Question 2.2: Does an AIF have to take any particular legal form?

No.

- An *AIF* may be open-ended or close-ended.
- It may or may not be listed.
- It does not matter whether it is set up under contract, trust or statute or if it takes another type of legal form. It does not matter what kind of legal structure it has.
- A limited partnership, a limited liability partnership, a limited liability company, an ordinary partnership, a unit trust, an *ICVC* and a contractual scheme could all be covered.
- It does not matter where the *AIF* is formed. It may be formed under the laws of any *EEA State* (including any part of the *UK*) or any *non-EEA state*.

Question 2.3: What is an undertaking for these purposes?

It covers a wide range of entities and goes beyond the *Glossary* definition of *undertaking*. It will include a *body corporate*, a *partnership*, an unincorporated association and a fund set up as a trust.

Question 2.4: Is an AIF the same as a collective investment scheme?

No, although the two concepts overlap considerably.

Question 2.5: Is an undertaking excluded because it has no external manager?

No. An undertaking that has no external manager and is managed by its own *governing body* may be an *AIF*.

Question 2.6: Is the definition restricted to funds that invest in certain kinds of asset?

No. Assets can include traditional financial assets (equity, equity related and debt), private equity, real estate and also non-traditional asset classes such as ships, forests, wine, and any combination of these assets. These are just examples; assets can include assets of any kind or combinations.

Question 2.7: Does the definition depend on how the underlying property is held?

No. The investors may receive a beneficial interest in the underlying property, as might be the case in a trust structure. They may also receive no interest in the underlying property but, instead, their interest may be represented by shares or units in the *AIF*, as would be the case where the *AIF* takes the form of a company limited by shares. It might even be possible for the investors to own the assets jointly.

Question 2.8: Must the scheme be time-limited or designed to allow investors to exit from time to time or at a particular time?

A scheme may be an *AIF* even if there are no arrangements for units or shares to be repurchased, redeemed or cancelled. Likewise a scheme may be an *AIF* even if it does not have a finite life.

Question 2.9: Is a business excluded because it is exclusively or largely funded by debt or other types of leverage rather than equity capital?

No. See the answers to Questions 2.37 (Is a securitisation vehicle covered?) and 2.44 (Can an issue of debt securities be an AIF?).

Key elements of the definition

Capital-raising

Question 2.10: You say that an undertaking needs to raise capital to be an AIF. What does capital raising involve?

Under the *ESMA AIFMD key concepts guidelines*, the commercial activity by an undertaking or a *person* (or entity acting on its behalf - typically, the *AIFM*) of taking direct or indirect steps to procure the transfer or commitment of capital by one or more investors to the undertaking for the purpose of investing it in accordance with a defined investment policy, should amount to the activity of raising capital.

It is immaterial whether:

(1) the activity takes place once, on several occasions or on an ongoing basis;

(2) the transfer or commitment of capital is in the form of subscriptions in cash or in kind.

If the capital raising is complete before the *regulated activities* of *managing an AIF* and acting as a depositary of an AIF come into force, the undertaking may still be an *AIF*, although transitional arrangements may apply (see Part 9 of the *AIFMD UK Regulation*).

An undertaking which makes investments will not be an *AIF* if those investments are funded by the undertaking other than by raising capital in accordance with the definition of an *AIF*. The fact that the undertaking's shares can be bought and sold on a stock exchange is not, of itself, the raising of capital by the undertaking.

Question 2.11: Is a fund that only allows a single investor caught?

Under the *ESMA AIFMD key concepts guidelines*, an undertaking which is not prevented by its national law, the rules or instruments of incorporation, or any other provision or arrangement of binding legal effect, from raising capital from more than one investor should be regarded as an undertaking which raises capital from a number of investors. This is the case even if it has only one investor.

A limited partnership in which there is a single limited partner making a substantive contribution and a general partner making a nominal £1 contribution will not be an *AIF* (subject to the answer to Question 2.12 (Is a fund that only allows a single investor always outside the definition of an AIF?)) as the undertaking will only have raised capital from one investor. The £1 contribution should be ignored for this purpose as it is wholly nominal.

Question 2.12: Is a fund that only allows a single investor always outside the definition of an AIF?

No. Under the *ESMA AIFMD key concepts guidelines*, an undertaking which is prevented by its national law, the rules or instruments of incorporation, or any other provision or arrangement of binding legal effect, from raising capital from more than one investor should be regarded as an undertaking which raises capital from a number of investors if the sole investor:

(1) invests capital which it has raised from more than one legal or natural person with a view to investing it for the benefit of those persons; and

(2) consists of an arrangement or structure which in total has more than one investor for the purposes of the *AIFMD*.

Examples of arrangements or structures of this type include:

(3) master / feeder structures where a single feeder fund invests in a master undertaking;

(4) fund of funds structures where the fund of funds is the sole investor in the underlying undertaking; and

(5) arrangements where the sole investor is a nominee acting as agent for more than one investor and aggregating their interests for administrative purposes.

Defined investment policy

Question 2.13: What indicative criteria could be taken into account in determining whether or not an undertaking has a defined investment policy?

Under the *ESMA AIFMD key concepts guidelines*, an undertaking which has a policy about how the pooled capital in the undertaking is to be managed to generate a pooled return (see the answer to Question 2.16 for what pooled return means) for the investors from whom it has been raised should be considered to have a defined investment policy. The following factors would, singly or cumulatively, tend to indicate the existence of such a policy.

(1) Whether the investment policy is determined and fixed, at the latest by the time that investors' commitments to the undertaking become binding.

(2) Whether the investment policy is in a document which becomes part of, or is referenced in, the rules or instruments of incorporation of the undertaking.

(3) Whether the undertaking, or the legal person managing the undertaking, has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy, including all changes to it.

(4) Whether the investment policy specifies investment guidelines, with reference to criteria including any or all of the following:

(a) to invest in certain categories of asset, or conform to restrictions on asset allocation; or

(b) to pursue certain strategies; or

(c) to invest in particular geographical regions; or

(d) to conform to restrictions on leverage; or

(e) to conform to minimum holding periods; or

(f) to conform to other restrictions designed to provide risk diversification.

For the purposes of (4), any guidelines for the management of an undertaking that determine investment criteria, other than those in the business strategy followed by an undertaking having a general commercial or industrial purpose, should be regarded as investment guidelines. See the answer to Question 2.18 (Is an ordinary commercial business a collective investment undertaking?) for what an undertaking having a general commercial or industrial purpose means.

Under the *ESMA AIFMD key concepts guidelines*, leaving full discretion to make investment decisions to the legal person managing an undertaking should not be used to circumvent the provisions of *AIFMD*. Part of the definition of an *AIF* is that there should be a defined investment policy. It is our view that this guidance is aimed at arrangements that whilst in form do not meet the definition, may in practice do so. For example, say that the manager has a legal discretion that is too wide to meet the definition of a defined investment policy but publishes a detailed investment policy (which is not legally binding) and leads the investors to expect that it will follow it. Under the approach in *ESMA AIFMD key concepts guidelines* that fund may still be an *AIF*.

Collective investment undertaking

Question 2.14: What is a collective investment undertaking?

See Questions 2.15 to 2.25.

It is important to remember that even if a business is a *CIU* that does not necessarily mean it is an *AIF*. To be an *AIF* it must meet all the criteria set out in the answer to Question 2.1 (What is the basic definition of an AIF?).

Question 2.15: What is the basic definition of a collective investment undertaking?

Under to the *ESMA AIFMD key concepts guidelines*, the following characteristics, if all of them are exhibited by an undertaking, should show that the undertaking is a *CIU*:

(1) the undertaking does not have a general commercial or industrial purpose (please see the answer to Question 2.18 (Is an ordinary commercial business a collective investment undertaking?) to see what this means);

(2) it pools together capital raised from its investors for the purpose of investment with a view to generating a pooled return for those investors from investments; and

(3) the Unitholders or shareholders of the undertaking - as a collective group - have no day-to-day discretion or control.

For (3), the fact that one or more, but not all, of the Unitholders or shareholders are granted day-to-day discretion or control should not be taken to show that the undertaking is not a *CIU*.

Question 2.16: What is a pooled return for these purposes?

Under the *ESMA AIFMD key concepts guidelines*, it is the return generated by the pooled risk arising from acquiring, holding or selling investment assets - including activities to optimise or increase the value of these assets - irrespective of whether different returns to investors, such as a tailored dividend policy, are generated.

Question 2.17: The answer to Question 2.15 refers to day-to-day control. Is it necessary to show day-to-day control to show that there is no AIF?

No. This is explained further in the answer to Question 2.47 (What factors are relevant to whether a joint venture is excluded on the basis that it is managed by its members?).

Question 2.18: Is an ordinary commercial business a collective investment undertaking?

No. An undertaking with a general commercial or industrial purpose is not a *CIU*. The primary purpose of a *CIU* is investment to generate a pooled return. This is in contrast to an ordinary commercial business of manufacturing, production, trading or the supply of services. Hence a supermarket, professional services firm or manufacturer is not generally a *CIU* or an *AIF*. However, distinctions between "investment" and "trading" for tax purposes are not determinative here.

A general commercial or industrial purpose is defined in the *ESMA AIFMD key concepts guidelines* as the purpose of pursuing a business strategy which includes characteristics such as running predominantly:

(1) a commercial activity, involving the purchase, sale, and/or exchange of goods or commodities and/or the supply of non-financial services; or

(2) an industrial activity, involving the production of goods or construction of properties; or

(3) a combination thereof.

Question 2.19: Does that mean that if my undertaking deals in non-financial assets it can't be a CIU?

Not necessarily. As explained in the answer to Question 2.6 (Is the definition restricted to funds that invest in certain kinds of asset?), an *AIF* may invest in non-financial assets. In deciding whether an undertaking is for general commercial or industrial purposes you must look at all relevant factors. Other examples include:

(1) whether the undertaking merely holds the property to take advantage of changing market prices or the income stream (which points towards it being a *CIU*), or whether the undertaking carries on construction, professional service, industrial or manufacturing works (which points away from it being a *CIU*);

(2) if the undertaking is designed to further the existing commercial businesses of the investors, rather than to achieve gain by realisation of the underlying assets, this points away from it being a *CIU*;

(3) whether the undertaking itself creates the property underlying the scheme (which points away from it being a *CIU*).

Question 2.20: Are there any other factors to take into account?

If the application of the factors in the answer to Question 2.1 (What is the basic definition of an AIF?) gives a clear answer then the matter is resolved. However, sometimes there will not be a clear answer. In that case, our view is that you must also look at whether the undertaking is structured like a typical fund. If it is, that points towards it being an *AIF*.

One important factor is whether there is a defined mechanism for winding up or distribution of investment returns at a particular time or over a designated period. This may apply if the undertaking is open ended, allowing an investor to redeem his interest within a reasonable time.

Hence if the undertaking is set up to carry out a particular project and then to wind itself up and distribute the profits to investors, that points towards it being an *AIF*.

Another factor is whether an offer to invest in an undertaking is marketed as an investment in a fund.

A key factor is how strongly the factors listed in the answer to Question 2.13 (What indicative criteria could be taken into account in determining whether or not an entity undertaking has a defined investment policy?) point towards a defined investment policy. If it is clear that there is no defined investment policy then there is no *AIF*, because a defined investment policy forms part of the definition of an *AIF*. However, if the application of the factors in the answer to Question 2.1 does not give a clear answer, the fact it is very clear that the undertaking has a defined investment policy points towards its being an *AIF*. In particular, the following key factors should be taken into

account (in each case an affirmative answer points towards the entity being an *AIF*):

(1) Whether the investment policy is fixed by the time that investors' commitments to the business become binding on them.

(2) How detailed the investment policy is.

(3) Whether the investors may take legal action against the manager of the *AIF* or the investment vehicle for a breach of the policy.

(4) Whether the investors' consent is needed for a change to the investment policy or whether the investors have the right to redeem their holdings if the policy changes.

Question 2.21: Please give some further examples of factors to take into account when deciding whether an undertaking is set up like a fund.

(1) Whether the undertaking requires substantial numbers of personnel to run it (which points away from it being an *AIF*). One would look at whether the business is carrying out commercial activities which require the employment of employees, such as for the development of properties. However, an undertaking having its own employees does not definitively mean that it is not an *AIF* - for example, it may be consistent with being a fund for it to have skeleton staff to ensure that the value of its investment is maintained, eg, to ensure adequate maintenance work on the physical investments of the fund is carried out.

(2) The extent to which the undertaking outsources its core operations to a third party (and the large-scale outsourcing of core operations points towards its being an *AIF*).

(3) Whether the undertaking has the skill to monitor and control the work outsourced to a delegate and whether the undertaking has expertise in the area of the work being outsourced (each of which points towards its being an *AIF*).

(4) Whether the undertaking has an external manager (which points towards its being an *AIF*).

(5) Whether all the directors of the undertaking are non-executive and whether their compensation packages reflect this (each of which points towards its being an *AIF*).

(6) The frequency of board meetings (the more frequent the meetings, the more this points away from its being an *AIF*).

(7) Whether the undertaking's business is to invest in businesses carried on by others without having control over the management of those businesses (which points towards its being an *AIF*).

(8) Where the potential *AIFM* controls a portfolio of several different groups, it is helpful to ask whether those investee companies/groups:

(a) are segregated from one another and if each of them is held and structured for their most effective future disposal (which points towards its being an *AIF*); or

(b) support one another and the group as a whole (which points away from its being an *AIF*).

(9) How much of the undertaking's revenue is derived from activities that are characteristic of a *CIU*.

None of these factors are conclusive.

Question 2.22: Do the answers to Question 2.18 (Is an ordinary commercial business a collective investment undertaking?) to Question 2.21 (Please give some further examples of factors to take into account when deciding whether an undertaking is set up like a fund) apply where the relevant business is a financial business?

If the underlying business of the undertaking relates to financial assets, it will not be an undertaking set up for a general commercial or industrial purpose. In that case it does not matter whether the business involves short-term buying and selling or holding for the medium term or until maturity.

However, a conventional non-financial business will often carry out its business through shares in its subsidiaries. A share in a subsidiary is a financial asset. Thus it is necessary to distinguish between a conventional holding company of this sort and an *AIF*. Similarly, if a business holds an asset through a shell company or bare nominee, the categorisation of the business should generally look through the shell to the underlying assets. The answer to Question 2.21 (Please give some further examples of factors to take into account when deciding whether an undertaking is set up like a fund) is relevant to identify such a case. An undertaking holding assets through subsidiaries in this way is not a financial business for the purposes of ■ PERG 16.

The ordinary cash management activities and treasury functions of a general commercial venture do not indicate that the venture is a *CIU*.

Question 2.23: What are financial assets for the purpose of Question 2.22?

Financial assets include investments under *MiFID* and investment life insurance contracts; real estate is not considered a financial asset.

An asset held for hedging purposes is not generally considered to be a financial asset for these purposes.

Question 2.24: What factors are relevant in the case of a financial business?

A financial business must meet the definition of an *AIF*. In our view the answer is likely to depend on the following factors.

(1) The need for a defined investment policy (see Question 2.13).

(2) Whether it raises external capital (see Question 2.10).

(3) The main activity of a *CIU* is the investment of capital, not the provision of services. Hence a professional partnership, even with outside investors, is unlikely to be a *CIU*.

(4) The pooled return point in Question 2.15 (What is the basic definition of a collective investment undertaking?) and Question 2.16 (What is a pooled return for these purposes?).

(5) The day-to-day discretion or control point in Question 2.15.

Question 2.25: What is the justification for the approach in the answers to Questions 2.15 (What is the basic definition of a collective investment undertaking?) to 2.23 (What are financial assets for the purpose of Question 2.22?)?

If the definition of *CIU* were interpreted broadly it would cover many ordinary commercial undertakings with external passive investors. The only things preventing such undertakings from being an *AIF* would then be the requirements for a defined investment policy and to raise capital.

In one sense the shareholders in a supermarket invest on a collective basis in the underlying business of the company. It invests its assets to buy goods and sell them at a profit. The supermarket may set out its policy for investing shareholder funds in a formal policy document and it may raise external capital to fund its business. On a broad reading of the *AIF* definition, that would mean that the supermarket would be an *AIF*.

Not all commercial ventures have the general commercial objects of a standard private company; many will have very specific and detailed objects. For example, say that a new business is set up to sell consumer electronics. It raises capital and to reassure its investors its constitutional documents restrict it to this business. However, in every other way it is a conventional consumer retailer. On a broad reading of the *AIF* definition, this too would be an *AIF*.

Such a wide interpretation would be unreasonable. It would be unreasonable to say that a detailed statement of commercial objects turns an undertaking into a *CIU*. It would be contrary to the early recitals of *AIFMD*. The exclusion for holding companies (see Questions 6.2 to 6.5) may not apply because the business may not be acting through subsidiaries. Therefore, it is necessary to consider the policy objectives of *AIFMD*.

AIFMD is aimed at funds. This is shown by the title of the Directive itself. The lists of the main types of undertaking covered by *AIFMD* in the answer to Question 2.28 (What are the commonest types of AIFs?) are taken from formal *EU* documents, which assist in analysing *AIFMD's* intended scope.

The *FCA* considers that the term investment is being used in contrast to "commercial". ■ PERG 16.2 is designed to draw out that distinction.

The reason for looking at whether an undertaking is set up as a fund is that it helps to make the distinction required by the *AIFMD* between a fund that invests in non-financial assets and an undertaking with a general commercial or industrial purpose and to reflect the fact that the *AIFMD* is aimed at funds.

However, it is clear from *AIFMD* and the *EU* documents referred to in the answer to Question 2.28 that private equity, hedge funds and venture capital funds are intended to be within the scope of *AIFMD*. *AIFMD* expressly refers to these types of funds in a number of places.

Also, a fund controlling a business is more than an investor, as it is in a position to control and run that business. Indeed, one of the benefits of a private equity fund is that it can restructure and improve businesses of target companies for the long term. These funds may need an extensive staff to carry on the business of the fund. It is clear though that a fund that takes over a business can still be an *AIF*, as *AIFMD* has detailed requirements for *AIFs* that do that.

Another point is that, as far as financial businesses are concerned, it is not a question of identifying businesses that should not be subject to financial services legislation, as many financial services businesses that do not fall within the scope of *AIFMD* are regulated under *MiFID* instead.

Therefore, the distinctions in the answers to Question 2.19 (Does that mean that if my undertaking deals in non-financial assets it can't be a CIU?) to 2.21 (Please give some further examples of factors to take into account when deciding whether an undertaking is set up like a fund) do not work for all the types of undertakings to which *AIFMD* is meant to apply. The distinction between an undertaking with a general commercial or industrial purpose and a financial purpose made by the *ESMA AIFMD key concepts guidelines* (see the answer to Question 2.18) is the key to reconciling the aim of excluding ordinary businesses and regulating funds.

Looking at whether an undertaking is set up as a fund is less useful for a financial business as that factor is based on the distinction between an ordinary commercial business and an investment one. For the reasons discussed in this answer a financial business is not an ordinary commercial business for these purposes. However, this factor has some relevance to a financial business for the reasons explained in the answer to Question 2.22 (Do the answers to Question 2.18 to Question 2.21 apply where the relevant business is a financial business?).

Overview of the AIF definition

Question: 2.26: Could you give a brief overview of how I should go about applying the guidance in PERG 2.2 in deciding whether AIFMD applies?

(1) Apply the Directive definition to see if it gives a clear answer. If it does, there is no need to go further.

(2) See whether one of the exclusions summarised in ■ PERG 16.6 (Exclusions) could apply.

(3) Look at all the factors and come to an overall judgment. In particular, look at the following issues.

(a) Whether it has a defined investment policy.

(b) Whether it raises external capital from a number of investors.

(c) Whether there is pooling.

(d) Whether capital is invested on behalf of the investors, as opposed to the parties investing the capital for themselves. In particular, see whether the undertaking is excluded as a joint venture (Questions 2.46 to 2.49).

(e) Whether it is structured as a typical fund. The answer to Question 2.22 (Do the answers to Question 2.18 to Question 2.21 apply where the relevant business is a financial business?) explains how this is relevant to a financial business.

(f) Whether it carries on an ordinary commercial business as opposed to investment and whether it is a financial business. If an undertaking carries on a commercial business, and not a financial or investment one, that points towards it not being an *AIF*.

A financial business is described in the answer to Question 2.23 (What are financial assets for the purpose of Question 2.22?).

In some cases, the factors in (3)(e) and (f) will point to different answers. One may have an otherwise conventional business that is deliberately structured as a fund. In general, it is likely that the tests of whether it is an undertaking set up for a general commercial or industrial purpose (see (3)(f)) will give the answer, as this is the most important factor in the *ESMA AIFMD key concepts guidelines* and these factors are closest to the distinction

between investment and commercial activities. However, it is our view that the *AIF* definition should be interpreted in a way that allows a fund to be set up to come within the *AIF* definition, even though the underlying business of the fund is a conventional commercial one, if it is very clear that the undertaking is being set up as a fund

Question: 2.27: Should all the factors be considered together?

Yes. As the *ESMA AIFMD key concepts guidelines* point out, appropriate consideration should be given to the interaction between the individual concepts of the definition of an *AIF*. An undertaking should not be considered an *AIF* unless all the elements in the definition (summarised in the answer to Question 2.1 (What is the basic definition of an AIF?)) are present. For example, undertakings which raise capital from a number of investors, but not with a view to investing it in accordance with a defined investment policy, should not be considered *AIFs* for the purposes of *AIFMD*.

Another example is a company formed for the purpose of operating a family-owned business. Later, the business is sold and the proceeds of sale invested by the company. The company may have become an investment vehicle but, without any capital being raised in accordance with an investment policy, it will not be an *AIF*. See the answer to Question 2.50 (family vehicles) for another reason why the company is unlikely to be an *AIF*.

Examples of schemes that are AIFs and of ones that are likely not to be AIFs

Question 2.28: What are the commonest types of AIFs?

The Commission Staff Working Document (Impact Assessment) accompanying the Proposal for the Directive (COM(2009) 207) lists the commonest types:

(1) hedge funds;

(2) commodity funds;

(3) private equity funds (including large buy-out funds, mid-cap investment funds and venture capital funds);

(4) infrastructure funds;

(5) real estate funds;

(6) conventional non-UCITS investment funds. These invest primarily in traditional asset classes (such as equities, bonds and derivatives) and pursue traditional investment strategies.

The list of fund types in the reporting templates in the *AIFMD level 2 regulation* is also useful. The main types it lists are:

(7) hedge funds;

(8) private equity funds;

(9) real estate funds;

(10) fund of funds;

(11) commodity funds;

(12) equity funds;

(13) fixed income funds;

(14) infrastructure funds.

Question 2.29: Is an arrangement whose activities are for non-business purposes covered?

No. Arrangements do not amount to an *AIF* if the predominant purpose of the arrangements is not to invest its capital for the benefit of its investors. So an undertaking is not an *AIF* if the predominant purpose of the undertaking is to enable the participants to share in the use or enjoyment of physical property or to make its use or enjoyment available gratuitously to others. The reason for this is that the purpose of the undertaking is not investment.

For example, a group of householders purchases a piece of neighbouring land to preserve or develop it as an amenity and prevent it from being used for housing or commercial exploitation. This should not be considered to be an *AIF*, since the capital raising and the investment are primarily undertaken for non-business purposes and are not intended to deliver an investment return or profit. Also, there will probably not be a commercial communication of the kind referred to in Question 2.10 (Meaning of capital raising).

However, the fact that a fund's investors are charities or not-for-profit organisations does not necessarily mean that the fund is not an *AIF*.

Question 2.30: Is a real estate investment trust (REIT) caught?

The meaning, substance and structure of REITs vary across European jurisdictions. So this answer looks at *UK* REITs.

A REIT is a concept used for tax purposes. So if a business is a REIT, there is no presumption either way as to whether or not it is a *CIU* or *AIF*.

Question 2.31: Is a timeshare scheme covered?

No. Arrangements do not amount to an *AIF* if the rights of the investors are rights under a timeshare contract or a long-term holiday product contract as defined in the Holiday Products, Resale and Exchange Contracts Regulations 2010, because these are already regulated under other European legislation.

Question 2.32: Is a pension scheme covered?

No. Neither an *occupational pension scheme* nor a *personal pension scheme* is covered. ■ PERG 16.6 (Exclusions) sets out the relevant exclusions. The breadth of the wording in recital (8) of *AIFMD* shows that these exclusions should be interpreted broadly so as to cover both sorts of scheme. In addition, a pension scheme is sufficiently well established as a category of investment to mean that if *AIFMD* intended to catch pension schemes it would have made that clear.

However, a scheme is not excluded from being an *AIF* just because all its investors are themselves pension schemes benefitting from an exclusion.

Question 2.33: Is a pension Common Investment Fund (CIF) covered?

This answer deals with a scheme under which separate *occupational pension schemes* run by companies within one group co-mingle their assets or part of their assets in another trust. Typically, the operators of the pension schemes

will be corporate trustees established by the employing companies, as will the trustee of the CIF. In such an arrangement, the *persons* participating in the CIF are the trustees of the *occupational pension schemes* and not the beneficiaries under the *occupational pension schemes*. Hence, the group exclusion described in ■ PERG 16.6 (Exclusions) should apply.

Question 2.34: Is an employee participation scheme covered?

No. Employee participation schemes and employee savings schemes are not covered. ■ PERG 16.6 (Exclusions) sets out the exclusion.

This exclusion covers schemes in which an employee invests in securities of the employer or in a company in the employee's group (or derivatives in relation to them such as options). As explained in the answer to Question 2.35 (Is an employee carried interest or co-investment vehicle caught?) it also covers other schemes.

In our view, the term employee is not limited to the technical definition in *UK* law. It would include personnel who work in the business of the undertaking concerned, contributing their skills and time, including partners, directors and consultants. Employee participation schemes generally allow participation by former employees and spouses/close relatives and this exclusion allows schemes that include such participants. Trustees of an employee's family trust may also participate.

The exclusion can apply however the scheme is structured and whether or not a trustee is involved in the scheme.

Question 2.35: Is an employee-carried interest or co-investment vehicle caught?

The carried interest participation of the employees of a private equity fund manager that manages private equity funds will typically be structured through one or more carried interest vehicles to receive the carried interest and in which employees of the manager will have a participation.

In our view, such vehicles will generally not be an *AIF* because the employee participation scheme exclusion will often apply. The exclusion applies because a scheme for carried interest participation allows the employees to benefit from the success of the *AIF* management undertaken by the employer.

Family members of an employee, or trustees of an employee's family trust, may also participate in the carried interest vehicle on this basis without that vehicle becoming an *AIF*.

Sometimes the manager may invest in the vehicle alongside the employees. This should not mean that the employee participation scheme exclusion is not available (see the answer to Question 2.52 (Is a co-investment vehicle caught?)).

Question 2.36: Is this is the only basis on which a carried interest vehicle can be excluded?

A carried interest vehicle may be excluded for another reason. As explained in the answer to Question 2.1 (What is the basic definition of an AIF?), part of the definition of an *AIF* is that it raises capital from a number of investors. If employees only invest a nominal amount of capital, the undertaking does

not meet this criterion because the employees are not investors. An employee is not investing his salary (by being remunerated in part by way of an interest in the vehicle) if it is a term of his employment that he would be remunerated with an interest in the vehicle.

Question 2.37: Is a securitisation vehicle covered?

No, as long as its sole purpose is to carry on:

(1) a securitisation or securitisations; and

(2) other activities which are appropriate to accomplish that purpose.

Securitisation has the meaning in Regulation (EC) No 24/2009 of the European Central Bank concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions. This says that securitisation means a transaction or scheme whereby:

(3) an asset or pool of assets is transferred to an entity that is separate from the originator and is created for or serves the purpose of the securitisation; and/or

(4) the credit risk of an asset or pool of assets, or part thereof, is transferred to the investors in the securities, securitisation fund units, other debt instruments and/or financial derivatives issued by an entity that is separate from the originator and is created for or serves the purpose of the securitisation.

In the case of transfer of credit risk, the transfer is achieved by either:

(5) the economic transfer of the assets being securitised to an entity separate from the originator created for or serving the purpose of the securitisation (which is accomplished by the transfer of ownership of the securitised assets from the originator or through sub-participation); or

(6) the use of credit derivatives, guarantees or any similar mechanism.

Where such securities, securitisation fund units, debt instruments and/or financial derivatives are issued, they should not represent the originator's payment obligations.

Question 2.38: Can a contract of insurance itself be an AIF?

No, as confirmed by recital (8) of the *AIFMD*.

Question 2.39: Are funeral plans caught?

No. A funeral plan contract is not caught. Neither is a contract which would be a funeral plan contract but for the proviso to article 59(2) of the RAO or the exclusion in article 60 of the RAO.

Question 2.40: Are individual investment management agreements caught?

In principle, No.

An *AIF* is an investment undertaking which pools together capital raised from investors to invest it on a collective basis. The management of a portfolio of investments or other property on an individual client-by-client basis is covered by *MiFID* rather than *AIFMD*.

The pooled return concept in the *ESMA AIFMD key concepts guidelines* (see the answer to Question 2.16 (What is a pooled return for these purposes?)) is particularly relevant here. One of the characteristics of an *AIF* is that there is pooling. An individual investment management arrangement falls outside the definition of an *AIF* as there is no pooling and thus no *CIU*. So, in principle, individual investment management arrangements do not give rise to an *AIF*.

However, an *AIF* can take any form. It may be that a scheme is set up with a separate individual investment management agreement for each investor but that the scheme is, in reality, a collective scheme. If the individual investment management agreements are being run on a common basis and as a single economic undertaking, then the arrangements may be considered as a single *CIU*. That means that the arrangements will be an *AIF* as long as the other elements of the definition are also met.

This is consistent with the pooled return concept in the *ESMA AIFMD key concepts guidelines*. Pooling for these purposes does not require that the underlying property is pooled. There must be pooling of capital, risk and return. If the capital is invested on a collective basis (in a way that creates pooled risk, for example by investment in a single project) there may be a single *CIU*.

A *firm* that manages the portfolios of a number of separate clients using the same investment strategy and taking advantage of economies of scale does not, for that reason, stop being an individual portfolio manager.

If the manager holds out his ability to provide bespoke investment management services but arranges a fair amount of bulk dealing for clients with similar investment objectives, that is compatible with individual portfolio management.

If an investment manager aggregates orders on behalf of multiple clients or accounts, which are then allocated back to the clients following execution, this does not mean that there are collective arrangements of the type that would suggest that an arrangement is a *CIU*.

The fact that the manager is obliged to protect the interests of the investors on an individual client-by-client basis points towards the arrangement being individual portfolio management, rather than a *CIU*.

However, if each separate investment management agreement provides that the manager will carry out investments and sales in a synchronised way so that the securities to which different investors are entitled are bought and sold at the same time, this may result in the scheme being a *CIU*. The same may apply if the scheme is marketed or held out as being operated in this way, for instance as a single fund.

Therefore, a scheme may be a *CIU* if it is part of the scheme's investment policy for investors' holdings to be managed as a single holding. For example, if the policy of the scheme is to take control of a company but each individual investor's stake is too small to achieve control, the scheme as a whole may be a *CIU*. The same may apply for other large stakes. If, for some reason, a scheme's investment policy relies on the manager exercising the voting or other rights of investors in the underlying companies as a single bloc, the scheme may also be a *CIU*.

Question 2.41: Is a stocks and shares ISA caught?

In principle, No.

A stocks and shares ISA takes the form of a scheme of investment managed by an account manager and under which the account investments are held in the beneficial ownership of the account holder. There is no pooling of the type described in section 235 of the *Act* (Collective investment schemes).

Some ISAs are run on a self-determined basis where investors decide what might be held in the ISA. In that case, there will be no collective element and no *AIF*.

In some cases, the parts of the property held in a particular ISA scheme are bought and sold at the same time as they are for other ISAs run by the same manager, except when a particular *person* becomes or ceases to be an investor in the plan. In that case, there is a collective element in the arrangements. However, in the light of the answer to Question 2.40 (Are individual investment management agreements caught?) this will not be enough on its own to mean that the ISA is an *AIF*.

Question 2.42: Is a child trust fund caught?

No.

As explained in the answer to Q53A in ■ PERG 13, the link between the underlying investment and the rights and interests acquired by the CTF account holder is too remote for the account holder to be considered as having acquired the underlying investment itself. Similarly, a child trust fund should not be seen as raising capital from the beneficiaries to invest it for their benefit.

In any case, it is also likely to be excluded for the reason described in the answer to Question 2.41 (Is a stocks and shares ISA caught?).

Question 2.43: Is an enterprise investment scheme (EIS) fund caught?

This answer deals with a fund set up in this way. When an investor subscribes to an EIS fund, it will appoint a manager to invest his subscriptions, on a discretionary basis, in qualifying companies. The investor in the EIS fund is the beneficial owner of the shares in which the fund invests for him. The investor is entitled to a whole number of shares in each company and not just a proportionate interest in all the shares in which the fund capital is invested. There is no pooling of the type in section 235 of the *Act* (Collective investment schemes).

It is likely that the property held in a particular EIS fund, to which the different fund investors are entitled, is not bought and sold separately, except where a *person* becomes or ceases to be an investor in the fund. It is likely that the manager will exercise the voting and other rights in the EIS fund shares as a bloc and hold the investments as nominee for the investor. These arrangements are likely to be formally documented. The EIS fund may be approved by HM Revenue and Customs but need not be.

The answer to Question 2.40 (Are individual investment management agreements caught?) is relevant here. In particular, it is useful to take into account the difference between conventional individual portfolio management arrangements (where an investor entrusts a manager with a sum of money, to be invested on a discretionary basis, based on the individual circumstances of the particular investor) and EIS funds, where the

manager would not be making investments on the basis of their suitability for any individual investor. Hence, it is likely that an EIS fund should be considered to be a *CIU* and an *AIF* (if all the other conditions of the *AIF* definition are met).

Question 2.44: Can an issue of debt securities be an AIF?

In general, No. The arrangements for an issue of debt securities by an ordinary commercial or financial company will not generally be an *AIF* or turn the issuer into one, although an *AIF* may invest in debt securities. In general, an issuer of debt securities does not invest the capital it raises for the benefit of the subscribers for the debt securities. In any case, for there to be an *AIF* there is still a need for the investors to expect to get the return from investment by the undertaking under a defined investment policy. If the return on the debt securities was simply set at a certain rate of interest and fixed premium, and the undertaking was liable to make those payments whether or not they were generated by management of the assets in line with the investment policy, this condition would not be met.

However, other cases may not be so straightforward. For example, say that an SPV is set up to invest in financial assets. It finances the purchase of those assets by an issue of debt securities. Profits and income from the assets are channelled back to the holders of the debt securities through interest on the debt securities and a payment on redemption. In principle, such a scheme could be a *CIU* if the investors invested through shares in the SPV. If the SPV has no equity shareholders (or no significant equity shareholders) and if all the profits and losses flow through to the investors via the return on their debt securities there is an argument that it should make no difference that the investors hold their interest through debt securities rather than through shares.

Further guidance from *ESMA* or the European Commission may be given in due course. However, given that the list of the main types of undertaking covered by *AIFMD* taken from the Commission impact assessment referred to in the answer to Question 2.28 (What are the commonest types of AIFs?) does not mention debt instruments of this kind, it seems likely that they were not meant to be caught. Pending any future clarification at the *EU* level, we shall assume that an SPV issuing debt securities in the way described in the answer to this question will not be an *AIF* if the arrangements meet the exclusion in paragraph 5 of the Schedule to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (Debt securities).

We shall also assume that an issue of an *alternative debenture* is not an *AIF* on the same basis, although it may be clear for other reasons that it is not. For instance, in some cases the bond assets will include a promise from a substantial commercial entity to buy the other bond assets. In such a case the *alternative debenture* is essentially a credit obligation of that commercial entity. In addition, part of the definition of an *alternative debenture* is that the amount of any payments in addition to the principal amount does not exceed an amount which would, at the time at which the bond is issued, be a reasonable commercial return on a loan of the capital. The effect is that an *alternative debenture* of this type is, in substance, a form of unsecured debt obligation of an ordinary commercial company. Therefore, it is not an *AIF* any more than the arrangements for a conventional debt issue by an ordinary company are an *AIF*.

Debt securities in a securitisation special purpose vehicle are likely to be excluded, as explained in the answer to Question 2.37 (Is a securitisation vehicle covered?).

Question 2.45: Is an exchange traded fund (ETF) caught?

An ETF can take various forms. This answer focuses on a fund in the form of an undertaking that seeks to replicate or track movements in a chosen securities index by holding some or all of the underlying constituents of the index or entering into derivatives contracts that replicate their performance synthetically.

In practice, an ETF of this sort is likely to be an *AIF* unless it is a *UCITS*.

Question 2.46: Is a joint venture caught?

Not normally.

There is no exclusion for joint ventures in *AIFMD*. However, recital (8) confirms that they are not covered. Therefore, to decide what undertakings are excluded as joint ventures, one must identify the principles on which the recital appears to be based. Another reason for looking at the underlying principles is that the term 'joint venture' does not have a precise legal meaning in *EU* law or a commonly accepted meaning across the legal systems of all Member States.

The key part of the definition of *AIF* reads "collective investment undertakings which raise capital from a number of investors, with a view to investing it or the benefit of those investors". Two aspects of this are particularly relevant to joint ventures.

(1) Capital is invested on behalf of the investors, as opposed to the parties investing the capital for themselves. An *AIF* does not include an undertaking that is managed by its members jointly and that is not managed by a third party or by only some of the investors.

(2) A venture that does not raise external capital (see the answer to Question 2.50 (Are family investment vehicles AIFs?) for a discussion of external capital) is not an *AIF*. The clearest example of this is the family investment vehicle but it is relevant to joint ventures too.

This approach to joint ventures means that if an undertaking meets the definition of an *AIF* it will be an *AIF* even if it is referred to as, or intended to be, a joint venture. Similarly, just because something is set up as a joint venture but is not excluded on the grounds in this answer does not mean that it must be an *AIF*. In all cases it is necessary to apply the *AIF* definition to the specific undertaking.

Question 2.47: What factors are relevant to whether a joint venture is excluded on the basis that it is managed by its members?

The clearest example of a joint venture is when all the parties have day-to-day control (in the ordinary sense) over its activities. However, it is still possible to have a joint venture in which not all the parties have day-to-day control.

This point is made by the definition of day-to-day discretion or control in the *ESMA AIFMD key concepts guidelines*. They define it as a form of direct and

ongoing power of decision - whether exercised or not - over operational matters relating to the daily management of the undertakings' assets and which extends substantially further than the ordinary exercise of decision or control through voting at shareholder meetings on matters such as mergers or liquidation, the election of shareholder representatives, the appointment of directors or auditors or the approval of annual accounts.

Joint ventures are often a marriage of equity and expertise, with one partner having the necessary experience to carry out the day-to-day management and the equity partner being involved in making more key, strategic decisions. The parties may also hire an outside *person* to manage the venture. These factors do not necessarily mean that the undertaking is an *AIF*. Such an undertaking may still be excluded as a joint venture if the strategic financial and operating decisions are under the control of all the parties. Each of the parties should have a continuous involvement in the overall strategic management of the undertaking.

For these purposes, a party does not manage the undertaking just because he is consulted or has the right to give directions.

No single party should be in a position to control the activity unilaterally. One factor to take into account is whether strategic decisions require the unanimous consent of the parties sharing control.

The requirement that all take part in strategic management also means that the number of parties should be sufficiently low for joint management to be practical.

If the parties carry on the venture through a corporate vehicle, an investor may exercise this control through a nominee it appoints to the board of the undertaking.

This approach to the exclusion of a joint venture is not based on a formal legal definition of a joint venture but on the application of the broad concepts included in the *AIF* definition. Therefore, in looking at control, it is necessary to take account of commercial substance as well as legal relationships.

For example, it is quite common for a joint venture in England and Wales to be structured as a limited partnership under the Limited Partnerships Act 1907 for reasons of commercial flexibility and tax transparency. To maintain the limited liability conferred by limited partner status, investors investing in the joint venture through limited partners must not take part in the management of the partnership business. Therefore, the business of the partnership is managed by a general partner, which is controlled (through the exercise of voting rights or the appointment of nominees to the board of directors) by the investors. In such a structure, each investor in the joint venture structure has economic participation (through its limited partner) and strategic management control (through the general partner) but those two roles are separated and carried on through different entities.

Notwithstanding that separation of roles, as a matter of commercial substance, that arrangement can still be an excluded joint venture. The investing organisations will exercise control through the general partner, as well as investing economically through their respective limited partners.

If an undertaking switches from one in which all parties have control to one in which some do not, that does not necessarily mean that it ceases to be a

joint venture. In particular, if at the time that it was set up and the capital was put in all parties had joint control, but later one retires but remains a party to the investment, it should not be transformed into an *AIF* merely by virtue of the retirement of that party.

If any of the investors are retail investors, it is unlikely that an undertaking will be excluded from the definition of an *AIF* on the ground that the venture is managed by its investors. This is because the requirement for joint control takes into account the practical ability to participate in joint decision-making (as well as the right to do so), including skills and bargaining power. It is unlikely that retail investors will have such ability as against professional investors or managers.

An example of where a retail investor might be able to take part in joint decision making would be if the investor is a member of the management team. A member of the management team may have the practical ability to participate in joint decision-making with the professional investors.

Question 2.48: What factors are relevant to whether a joint venture is excluded on the basis that it does not raise external capital?

The definition of *AIF* envisages a distinction between the undertaking that raises capital and the parties who invest capital. In some cases, there may be no such distinction. For instance, commercial parties may come together on their own joint initiative. There is no external capital because the *persons* raising and providing capital are the same. This is explained further in the answer to Question 2.50 (Are family investment vehicles AIFs?).

Question 2.49: Can you give me some practical factors to take into account when deciding whether a commercial venture is excluded as a joint venture?

(1) Whether the parties come together in the proposed project before the structure of the venture is determined and capital is raised.

(2) Whether the venture relates to a business the parties are already carrying on at the time it is set up. For example, the joint venture vehicle may merely be a legally convenient means by which joint venture parties combine their resources and skills to carry out a business activity. When looking at whether a party is already carrying on an activity, one looks at whether it has been doing so on its own account, rather than through investing in funds.

(3) Whether the parties have an existing relationship.

(4) Joint ventures are more likely to have a policy focussed on the achievement of the parties' commercial goals, as opposed to a defined investment policy.

The factors in (1) to (3) are based on the answer to Question 2.48 (What factors are relevant to whether a joint venture is excluded on the basis that it does not raise external capital?). The factor in (3) is also based on the answer to Question 2.47 (What factors are relevant to whether a joint venture is excluded on the basis that it is managed by its members?). An undertaking in (4) may fall outside the *AIF* definition on the grounds that to be an *AIF* there must be a defined investment policy.

In some cases, a joint venture may be set up between a single investor providing capital and an active participant providing the expertise to manage the business. The investor providing the capital may choose not to be involved in the running of the venture. One reason why such a venture

might not be an *AIF* is explained in the answer to Question 2.52 (Is a co-investment vehicle caught?).

Question 2.50: Are family investment vehicles AIFs?

No. There is no specific exclusion for family investment vehicles in the operative parts of the *AIFMD*. Recital (7) of *AIFMD* says that a family office vehicle that invests the private wealth of investors without raising external capital is not an *AIF*. To decide what undertakings are excluded as family investment vehicles, one must identify the principles on which the recital appears to be based. The recital is making a distinction between external and internal capital. In our view this recital is based on the part of the *AIF* definition that requires capital to be raised. The recital explains that the *AIF* definition does not cover an arrangement in which the *persons* raising and providing capital are the same. Based on this, features of a family investment vehicle are likely to include:

(1) a family relationship between the investors;

(2) no raising of capital from investors outside the relationship.

(3) the money or assets to be invested and the relationship between the investors pre-date the relationship between the investors and the vehicle. Even though the family should pre-date the relationship between the investors and the vehicle, that does not mean that a vehicle becomes an *AIF* if an individual joins the family later.

Family investment vehicles can be used by large extended families spanning a number of generations and those born, or joining the family, before and after investment arrangements are made. Civil partnership and marriage may be included. A family can include step and cohabitation relationships, as well as blood and other immediate family relationships, such as adoption. *Persons* or vehicles representing eligible family members (such as the trustees of a family trust holding money or assets beneficially for a family member) may also be included.

This is confirmed by the *ESMA AIFMD key concepts guidelines*. They say that when capital is invested in an undertaking by a member of a pre-existing group, for the investment of whose private wealth the undertaking has been exclusively established, this is not likely to be within the scope of raising capital.

The *ESMA AIFMD key concepts guidelines* define a pre-existing group as a group of family members, irrespective of the legal structure put in place to invest in an undertaking and provided that the sole ultimate beneficiaries are family members, where the existence of the group pre-dates the establishment of the undertaking. The guidelines say that this does not prevent family members joining the group after the undertaking has been established. The guidelines say that 'family members' means the spouse of an individual, the person who is living with an individual in a committed intimate relationship, in a joint household and on a stable and continuous basis, the relatives in direct line, the siblings, uncles, aunts, first cousins and the dependants of an individual.

Question 2.51: What happens if a family group invests alongside others investors?

The *ESMA AIFMD key concepts guidelines* say that the fact that a member of a pre-existing group invests alongside investors not being members of a pre-

existing group, should not have the consequence that the part of the *AIF* definition requiring the raising of capital is not fulfilled. Whenever such a situation does arise, all the investors should enjoy full rights under *AIFMD*. If a family group invests in an undertaking alongside other investors and the undertaking meets the other parts of the *AIF* definition, that undertaking is an *AIF* and the family members are treated as investors with the same protections under *AIFMD* as other investors. However, please also see the answer to Question 2.52 (Is a co-investment vehicle caught?).

A manager may establish a vehicle to invest the wealth of several families. Such a vehicle will not be excluded on the grounds in Question 2.50 (Are family investment vehicles AIFs?).

Question 2.52: Is a co-investment vehicle caught?

Co-investment vehicles come in many forms. This question refers to a case in which an institutional investor confers a substantial mandate on an investment manager and structures the mandate through an investment vehicle (the co-investment vehicle). The other investors are the manager itself and its employees, or a vehicle taking a carried interest for the benefit of employees of the manager. The manager and carried interest vehicle may make a nominal contribution for tax or other structuring reasons.

A similar issue can arise with family investment vehicles. The family vehicle may employ third-party professional investment managers, who have no family relationship, to manage the assets of the family. To align their interests with those of the family, the employees and managers invest in the co-investment vehicle alongside the family vehicle.

In our view, a co-investment vehicle of the type covered by this question should not be seen as an *AIF*. If the manager or employees only make a nominal investment, there is no *AIF* as nominal investments should be disregarded (see the answer to Question 2.11 (Is a fund that only allows a single investor caught?)). Even if the investment is more than nominal, the undertaking only raises capital from a single external investor, which is the institutional investor. Please see the answer to Question 2.50 (Are family investment vehicles AIFs?) as to why the *FCA* believes that the concept of an external investor is part of *AIFMD*.

In addition, in our view, an investment by the manager should not normally change an undertaking into an *AIF*. The purpose of the *AIFMD* is to protect the investors from whom capital is raised as referred to in the answer to Question 2.1 (What is the basic definition of an AIF?) and Question 2.10 (You say that an undertaking needs to raise capital to be an AIF. What does capital raising involve?) by regulating, among others, the manager. In our view, this means that co-investment by the manager should not generally affect the status of an undertaking as an *AIF*.

The vehicle through which employees invest is not itself an *AIF* because of the exclusion for employee participation schemes (see Question 2.34).

Another type of co-investment vehicle is where the employees of a private equity fund manager invest alongside the manager in private equity funds managed by the manager. This is dealt with by Question 2.35 (Is an employee carried interest or co-investment vehicle caught?) and Question 2.36 (Is this is the only basis on which a carried interest vehicle can be excluded?).

Question 2.53: Is an acquisition vehicle for an AIF itself a separate AIF?

Sometimes, an *AIFM* establishes an SPV or acquisition vehicle as an administrative convenience, to facilitate a specific transaction(s) to be carried out by the *AIFM*.

Generally, the SPV should not be treated as a separate *AIF* for the purposes of *AIFMD*. The vehicle does not raise capital from investors. Rather, it would merely be a means of investing capital already raised by the *AIF*. It is merely part of the mechanical and administrative mechanisms for putting into operation a scheme of investment that has already been set up.

Question 2.54: Is an arrangement for multiple participation by a number of funds in a single investment, a single AIF?

Sometimes a manager may set up an arrangement under which a number of *AIFs* participate in a particular investment.

The question is then whether this creates a new *AIF* alongside the *AIFs* that invest in it or creates a single *AIF* made up of the participating *AIFs*.

As explained in the answer to Question 2.40 (Are individual investment management agreements caught?) the starting position is that a series of investments in parallel do not amount to a single *AIF*. The fact that each fund has different investors and its own arrangements between its investors is an additional factor that points towards there being separate funds.

It is also necessary to take into account article 26 of *AIFMD* (Obligations for AIFMs managing *AIFs* which acquire control of non-listed companies and issuers: Scope), which contemplates that several *AIFs* may agree jointly to acquire control of a non-listed company without that resulting in all the *AIFs* being considered as a single *AIF*.

This is consistent with the policy of *AIFMD*, because the investors will still have the protections given by national laws implementing *AIFMD*.

The factors relating to whether an undertaking is excluded as a joint venture are likely to be relevant (see the answer to Questions 2.46 to 2.49). For these purposes, it will normally only be necessary to consider the involvement of the *AIFs* themselves and not the individual investors in each *AIF*.

Question 2.55: Does it make a difference if there are co-investors?

Sometimes not all of the co-investors participating in an investment will themselves be *AIFs*. An acquisition vehicle may be set up for the *AIF* and the other co-investors. Such an arrangement might not be a separate *AIF*. Many of the points in the answer to Question 2.54 (Is an arrangement for multiple participation by a number of funds in a single investment, a single AIF?) apply here too. The factors relating to whether an undertaking is excluded as a joint venture are likely to be relevant (see the answers to Questions 2.46 to 2.49).

Question 2.56: Is a central counterparty in a clearing system an AIF?

No.

The undertaking is providing a service to members of the system in its role as central counterparty and not investing in the securities bought and sold for their benefit.

Question 2.57: Is a firm that deals in financial instruments on its own account caught?

As explained in the answer to Question 43 in ■ PERG 13.5 (Exemptions from MiFID), *CIUs* are specifically exempt from *MiFID*, as are their depositaries and managers. An *AIF* is a *CIU* and an *AIFM* is a manager.

However, that does not mean that a company that buys and sells financial instruments for its own account is covered by *AIFMD* rather than covered by *MiFID*, or rather than excluded from both *AIFMD* and *MiFID*.

The answer to Question 2.24 (What factors are relevant in the case of a financial business?) sets out the key factors in deciding whether a financial services company is an *AIF*.

Question 2.58: Is a bank or insurer caught?

An undertaking authorised under the *Solvency II Directive* or the*CRD* will not be an *AIF*.

Question 2.59: Is a depositary receipt caught?

In our view, certificates representing certain securities are unlikely to be units in an *AIF*. This is because they simply involve a method of investing in the underlying security without a collective investment element. However, the fact that units of an *AIF* are issued in the form of certificates representing certain securities does not mean that it stops being an *AIF*.

Question 2.60: Is a client account caught?

A solicitor's client account or a client money account which is ancillary to the true *AIF* are not themselves *AIFs*.

Investment compartments

Question 2.61: What is an investment compartment of an AIF?

An investment compartment is similar to, and corresponds with, the *Glossary* term *sub-fund*. It refers to an undertaking whose property is divided into separate pools, each of those pools being a compartment.

Question 2.62: How do I tell the difference between investment compartments of a wider fund and separate funds?

Sometimes it is necessary to decide whether investment pools that are linked in some way should be treated as being investment compartments of the same fund or as separate funds. A key factor is whether the investment pools are documented and operated as a single fund. This takes into account whether the investment pools are documented as separate funds and managed as a whole, and whether an investor in one pool is entitled to exchange his investment in that pool for an investment in another one. If a creditor has recourse to the assets of all the pools, that is likely to mean that there is a single fund, but if a creditor does not have such recourse this is

neutral as to whether the pools are separate funds or investment compartments of the same fund.

The fact that one fund invests all its assets in another does not make them into a single fund, as *AIFMD* recognises that feeder and master funds can remain separate funds.

Question 2.63: Is each investment compartment a separate AIF?

In our view, an investment compartment of an *AIF* should not be treated as a separate *AIF* for the purpose of the *general prohibition*. The phrase "including investment compartments of such an undertaking" in the definition of an *AIF* means that an investment compartment of an *AIF* is treated as being part of that *AIF*.

An alternative approach is that each compartment should be treated as a separate *AIF* but the overall fund should not. We do not agree with this interpretation because a compartment in its ordinary meaning is something that is part of something bigger. Also, potentially the role of manager of the overall fund is significant and it is unlikely that it would fall outside regulation altogether. This alternative approach would be inconsistent with the part of the *ESMA AIFMD key concepts guidelines* discussed in the answer to Question 2.65 (What if part of an undertaking meets the AIF definition and part does not?).

Another argument against this alternative approach is the requirement in article 5(1) of *AIFMD* that each *AIF* have a single *AIFM*. It would be difficult to meet that requirement if each compartment is subject to the management of the manager of the overall fund. It would also seem unlikely that *AIFMD* would get round that problem by implicitly prohibiting funds from having an overall manager.

Another interpretation is that the undertaking as a whole and each compartment are separate *AIFs*. We do not agree with that interpretation for similar reasons.

Hence, an investment compartment of an *AIF* should not be treated as a separate *AIF*. It is part of the overall *AIF*. The manager of the sub-fund is not *managing an AIF* whereas the manager of the overall fund is.

Question 2.64: How do Questions 2.62 and 2.63 apply to umbrellas?

This answer only relates to an *umbrella* as defined in the *Glossary*. Broadly, this defines an *umbrella* as a single scheme that provides for pooling of the type mentioned in section 235(3)(a) of the *Act* (Collective investment schemes) in relation to separate parts of the scheme property and whose Unitholders are entitled to exchange rights in one part for rights in another. These two factors are likely to mean that (assuming all the requirements of the *AIF* definition are met) the *umbrella* should be treated as a single *AIF* with each sub-fund being treated as an investment compartment of that *AIF*. If this is the case, the sub-funds will not be separate *AIFs* in their own right.

Question 2.65: What if part of an undertaking meets the AIF definition and part does not?

Under the *ESMA AIFMD key concepts guidelines*, where an investment compartment of an undertaking exhibits all the elements in the definition of

an *AIF* this should be sufficient to determine that the undertaking as a whole is an *AIF*.

Other general points

Question 2.66: Does the interpretation of a CIU in PERG 16 apply to MiFID?

PERG 16 is not intended to cover the meaning of a collective investment undertaking in other *EU* Directives. This reflects the fact that the *ESMA AIFMD key concepts guidelines* do not apply to *MiFID*.

16.3 Managing an AIF

G **Question 3.1: What does managing an AIF mean?**

A *person* manages an *AIF* when the *person* performs:

(1) risk management; or

(2) portfolio management;

for the *AIF*.

Question 3.2: If a person performs only one of the activities listed in the answer to Question 3.1 does it manage an AIF?

Yes. However, an *AIFM* is not permitted to be authorised to manage an *AIF* on that basis (see ■ FUND 1.4.4 R (4)). An undertaking that is seeking *permission* to *manage an AIF* will not be given *permission* to provide portfolio management without also providing risk management or vice versa.

Question 3.3: Are the activities mentioned in the answer to Question 3.1 the only activities included in managing an AIF?

No. If a *person* manages an *AIF* (within the meaning set out in the answer to Question 3.1), and also carries on:

(1) one or more of the additional activities listed in the answer to Question 3.4); or

(2) one or more other activities in connection with or for the purposes of the management of that *AIF*;

those activities are included in the *regulated activity* of *managing an AIF*.

Question 3.4: What are the additional activities referred to paragraph (1) of the answer to Question 3.3?

They are as follows:

(1) administration:

(a) legal and fund management accounting services;

(b) *customer* inquiries;

(c) valuation and pricing (including tax returns);

(d) regulatory compliance monitoring;

(e) maintenance of *unit* / *share* holder register;

(f) distribution of income;

(g) *unit* issues and redemptions;

(h) contract settlements (including certificate dispatch) and;

(i) record keeping;

(2) *marketing*; and

(3) activities related to the assets of *AIFs*, namely:

(a) services necessary to meet the fiduciary duties of the *AIFM*;

(b) facilities management;

(c) real estate administration activities;

(d) advice to *undertakings* on capital structure, industrial strategy and related matters;

(e) advice and services related to mergers and the purchase of *undertakings*; and

(f) other services connected to the management of the *AIF* and the companies and other assets in which it has invested.

Question 3.5: Does anyone carrying on only the activities listed in the answer to Question 3.4 carry on the regulated activity of managing an AIF?

No. Those activities only involve *managing an AIF* for a particular *AIF* if the *person* doing them is carrying on, for that *AIF*, the part of the *regulated activity* of *managing an AIF* described in the answer to Question 3.1. If an *AIFM* carries on the activities listed in the answer to Question 3.4 in relation to a fund of which it is the *AIFM* those activities are included in the *regulated activity* of *managing an AIF*. But, if the activities listed in the answer to Question 3.4 are carried on by a third party, that third party will not be carrying on the *regulated activity* of *managing an AIF* for that *AIF*, although that third party may be carrying on other *regulated activities*, such as *arranging (bringing about) deals in investments* or *making arrangements with a view to transactions in investments*.

Question 3.6: Can an AIF manage itself?

Yes. An *AIFM* may be:

(1) another *person* appointed by or on behalf of the *AIF* and which through that appointment is responsible for managing the *AIF* (an external *AIFM*); or

(2) where the legal form of the *AIF* permits internal management and where the AIF's *governing body* chooses not to appoint an external *AIFM*, the *AIF* itself (an internal *AIFM*).

Question 3.7: What effect does delegation have?

An *AIFM* is permitted to appoint a delegate to provide portfolio management and/or risk management services for the *AIFM* (see ■ FUND 3.10 and regulation 26 of the *AIFMD UK Regulation*).

If the delegation relates to the additional services described in the answer to Question 3.4 (What are the additional activities referred to paragraph (1) of the answer to Question 3.3?) the delegate will not be *managing an AIF*, for

the reason in the answer to Question 3.5 (Does anyone carrying on only the activities listed in the answer to Question 3.4 carry on the regulated activity of managing an AIF?).

In any case, under article 51ZC(3) of the RAO a *person* does not *manage an AIF* if the functions it performs for the *AIF* have been delegated to it by another *person*, provided that such other *person* is not an *AIFM* that has delegated such functions to the extent that it is a letter-box entity. So a *person* who has received a delegation of some of the *AIFM's* core functions (ie, the functions listed in the answer to Question 3.1 (What does managing an AIF mean?)) generally does not *manage an AIF*. Letter box entities are described in the answer to Question 3.8 (Does this mean that delegation can never affect who is doing the regulated activity of managing an AIF?).

This answer reflects *AIFMD*, which envisages that generally an *AIFM* may delegate functions without the delegate becoming the *AIFM* in place of the original manager, or the delegate becoming the *AIFM* alongside the original manager, in breach of the requirement that there be only one *AIFM*.

Question 3.8: Does this mean that delegation can never affect who is doing the regulated activity of managing an AIF?

Delegation can sometimes affect who is *managing an AIF*.

Article 82 of the *AIFMD level 2 regulation* says that an *AIFM* shall be deemed a letter-box entity and shall no longer be considered to be the manager of the *AIF* at least in any of the situations set out in that article, which is reproduced in ■ FUND 3.10.9 EU.

This raises four questions. First, whether an *AIFM* that delegates in such a way as to make itself into a letter-box entity is still carrying on the *regulated activity* of *managing an AIF*. This is dealt with in Question 3.9. Secondly, whether the delegate is carrying on the *regulated activity* of *managing an AIF*. This is dealt with in Question 3.10. The third question is whether this only applies when article 20 of *AIFMD* (which contains the letter-box entity provisions elaborated by article 82) applies. This is dealt with by Question 3.12. The fourth question is what the test for a letter-box entity is. This is dealt with in Question 3.13.

Question 3.9: Does delegation by the manager mean that it is no longer carrying on the regulated activity of managing an AIF?

The fact that article 82 of the *AIFMD level 2 regulation* says that a letter-box entity shall no longer be considered to be the manager of the *AIF* would appear to mean that an *AIFM* that delegates in this way is no longer *managing an AIF*. However, in our view, an *AIFM* that delegates in such a way as to make itself into a letter-box entity is still carrying on the *regulated activity* of *managing an AIF*. The following points support this:

(1) Article 82 of the *AIFMD level 2 regulation* describes who is acting as the manager. The *regulated activity* does not refer to acting as an *AIFM*; it simply refers to managing an *AIF*. The *regulated activity* does not expressly incorporate article 82 as part of the definition.

(2) The RAO does not include the requirement in the *AIFM* definition that the *AIFM* be a legal *person*, which shows that the definition of *AIFM* is not fully aligned with the definition of *managing an AIF*.

(3) Regulation 4(3) of the *AIFMD UK Regulation* envisages that the *AIFM* will be appointed by or on behalf of the *AIF* or by its *governing body*. This is not reflected in the RAO either.

(4) Article 20 of *AIFMD* (which contains the letter-box entity provisions elaborated by article 82) deals with regulating how an *AIFM* should manage its *AIF*.

(5) There is a good reason why an *AIFM* that has delegated its functions in a way that means it has become a letter-box entity should still be carrying on the *regulated activity* of *managing an AIF*. It is necessary to avoid the risk that a manager that delegates to this degree falls out of regulation, because it stops carrying on a *regulated activity*. One of the purposes of regulation is to stop a manager doing this and effective implementation of *AIFMD* requires us to be able to do so.

Question 3.10: Does delegation by the manager mean that the delegate is carrying on the regulated activity of managing an AIF?

The factors listed in the answer to Question 3.9 (Does delegation by the manager mean that it is no longer carrying on the regulated activity of managing an AIF?) support the view that a delegate of a letter-box entity does not *manage an AIF*. However, despite this, we believe that a delegation by the *AIFM* to a delegate can result in the delegate *managing an AIF* if the delegation results in the *AIFM* becoming a letter-box entity.

(1) Recital (9) of *AIFMD* confirms that the letter-box entity provision is an anti-avoidance provision preventing circumvention of *AIFMD* by means of turning the *AIFM* into a letter-box entity. A provision of this kind reflects a more general principle that rights given by European law (such as the right of a manager to delegate or the right of a delegate to carry on its business without being authorised as an *AIFM*) should not be abused. It is important to know who the real manager of an *AIF* is, so as to know whether an *EEA State* is responsible for its supervision or whether the *AIF* is managed from outside the *EEA*. If the real manager is not *managing an AIF*, it may not be carrying on any *regulated activity* and may not fall under any *EEA* financial services regulation, even though effective implementation of *AIFMD* would require the situation to be regularised.

(2) Article 51ZC(3) of the RAO implies that a *person* that has accepted a delegation from a manager that results in the manager becoming a letter-box entity, can be *managing an AIF*.

(3) It is not unreasonable to say that, if the delegate is in practice carrying out the management activities described in the answer to Question 3.1 (What does managing an AIF mean?), it should be treated as carrying on the *regulated activity*.

Question 3.11: Does this mean that delegation that results in the manager being a letter-box entity always means that the delegate will be carrying on the regulated activity of managing an AIF?

No. In each case it is necessary to apply the tests set out in ■ PERG 16.3. If all the functions that have been delegated by the letter-box entity manager have been delegated to the same delegate, it is likely that that delegate is *managing an AIF*. However, if the delegation is to a number of delegates, it may be that none of those delegates is *managing an AIF*.

Question 3.12: Do the answers to Questions 3.7 to 3.11 apply just to delegation by a full-scope UK AIFM?

No. For example, they would be relevant to whether a delegate in the *UK* is *managing an AIF* if it accepts a delegation from an overseas manager. We take this approach for the following reasons.

(1) The arguments in Question 3.10 (Does delegation by the manager mean that the delegate is carrying on the regulated activity of managing an AIF?) are also in favour of the view that the effect of delegation on a delegate should not be confined to delegation by an authorised *AIFM*. In any case, it would be anomalous for delegation to affect who is *managing an AIF* only when article 20 of *AIFMD* applies, particularly given that article 82 is, in our view, an anti-avoidance provision (see the answer to Question 3.10).

(2) Article 51ZC(3) of the RAO is not specifically limited to circumstances in which article 20 applies. It applies in any situation in which it is necessary to decide whether a *person* is *managing an AIF* for the purpose of the *general prohibition*.

Question 3.13: What is the test for a letter-box entity?

In our view, the test of whether delegation results in the delegate *managing an AIF* is decided by article 82 of the *AIFMD level 2 regulation* in circumstances when article 82 and article 20 of *AIFMD* apply to the delegating *AIFM*.

When article 20 does not apply we look at whether the delegation is to such a degree that the manager can no longer be considered to be carrying out the activities in the answer to Question 3.1 (What does managing an AIF mean?). We take the various factors elaborated in article 82 into account but they will not necessarily decide the matter because article 82 is, on its face, linked to article 20 and article 51ZC(3) of the RAO does not specifically refer to article 20 or 82.

If a manager to which article 82 does not apply can nevertheless satisfy all the conditions set out in that article to demonstrate that it has not become a letter-box entity, any delegation by it will not result in the delegate *managing an AIF*.

However, we do not necessarily require that delegate to demonstrate to us that every condition of article 82 is satisfied, to conclude that the manager is not a letter-box entity and that the delegate is not *managing an AIF*. The importance of the tasks carried out by the manager is a key consideration, taking particular account of the right and ability of the manager to exercise oversight and control and the degree to which these rights are exercised. In our view, these factors reflect the fact that we are applying a broad anti-avoidance approach to a letter-box entity rather than the detailed requirements of article 82.

Question 3.14: Is the material in PERG 16.3 about delegation relevant to delegation between branches of the same firm?

No. Please see Question 8.4 (Is the material in PERG 16.3 about delegation of management functions from one firm to another relevant to delegation from one branch to another?).

Question 3.15: If a person is not eligible to be appointed as an AIFM because it is not a legal person but is appointed to manage an AIF, does that mean that it cannot carry on the regulated activity of managing an AIF?

No. The fact that it is not eligible to be appointed as an *AIFM* does not mean that it is not *managing an AIF*. That means that an *unauthorised person* may breach the *general prohibition* by carrying on the *regulated activity* of *managing an AIF*, even though the *person* does not qualify for a *Part 4A permission* because that *person* is not a legal *person*.

Article 6(1) of *AIFMD* provides that no *AIFMs* should manage *AIFs* unless they are authorised in accordance with that Directive. An *AIFM* must be a legal *person*. So it appears that the *regulated activity* of *managing an AIF* cannot apply to someone who is not a legal *person*. However, in our view, this is not the case. As explained in the answer to Question 3.9 (Does delegation by the manager mean that it is no longer carrying on the regulated activity of managing an AIF?), the definition of an *AIFM* is not fully aligned with the definition of *managing an AIF*. In particular, the *regulated activity* does not refer to acting as an *AIFM* (the definition of *AIFM* in the *AIFMD UK Regulation* includes the legal *person* requirement), it simply refers to managing an *AIF*. There is a good policy reason for this. It is not the intention of the legislation to allow someone who is not a legal *person* to manage an *AIF* without being authorised, but to stop an *AIF* being managed by someone who is not a legal *person*.

Question 3.16: Can an AIF in the form of a limited partnership under the Limited Partnerships Act 1907 appoint its general partner as the AIFM?

Yes. If the general partner is the *AIFM* it will be an external *AIFM*.

Strictly speaking this question is not relevant to the definition of *managing an AIF* but this is a convenient place to discuss the point.

On the face of it the answer should be No. The starting position is that if an *AIF* is managed by the body that has responsibility for governing it under the legislation under which the *AIF* is formed, the *AIF* is internally managed, particularly if there is no *governing body* that appoints and supervises the manager and the manager is a member of that *AIF*. A general partner is a partner and there will usually be no *governing body* separate from the general partner. Under this approach, a limited partnership would be internally managed, which would be contrary to *AIFMD*, as an *AIFM* must be a legal *person* and an English and Welsh limited partnership is not a legal *person*.

However, in our view, the roles of the limited and general partners are sufficiently distinct for one to be able to say that the limited partnership does not manage itself. The distinction between the two roles does not stem from the fact that the general partner manages the partnership, but from the facts that:

(1) the roles of general and limited partner are provided for by the legislation under which limited partnerships are formed; and

(2) the legislation, in practice, prevents the limited partners from managing the partnership (because for as long as a limited partner takes part in the management of the partnership business, it is liable for the partnership's debts as though it were a general partner).

In principle, the same should apply for jurisdictions outside England and Wales with legislation drafted in the same way. We understand that this is the case with a Scottish limited partnership (which has legal personality) and

so if its general partner is appointed as its *AIFM* it will also be an external *AIFM*.

16.4 Acting as a depositary of an AIF

G **Question 4.1: What does acting as a depositary of an AIF involve?**

Acting as:

(1) the depositary of an *AIF* managed by a full-scope UK AIFM; or

(2) the depositary of a UK AIF managed by an EEA AIFM; or

(3) the depositary of any other *AIF*, if the *FCA* or an authority in another *EEA State* has permitted a *person* with its registered office or a branch in the *UK* to be appointed as a depositary of that *AIF* under article 61.5 of *AIFMD*; or

(4) the *trustee* of an *AIF* that is an *authorised unit trust scheme* but is not an *AIF* to which (1) to (3) apply; or

(5) the depositary of an *AIF* that is an *open-ended investment company* or *authorised contractual scheme* but is not an *AIF* to which (1) to (3) apply.

(3) only applies until 22 July 2017.

Question 4.2: What does depositary mean?

For the purposes of paragraphs (1) to (3) of the answer to Question 4.1, depositary means:

(1) a *person* appointed in compliance with the requirement for the *AIFM* to appoint a depositary in article 21.1 of *AIFMD*; or

(2) an Article 36 custodian as defined in regulation 57(5)(a) of the *AIFMD UK Regulation*.

For the purpose of paragraph (5) of the answer to Question 4.1, depositary has the meaning in section 237 of the *Act*.

Question 4.3: The AIFMD allows the depositary to delegate some functions to a third party. Is that third party acting as the depositary of an AIF?

No. Article 21 of *AIFMD* envisages that a *depositary* remains the sole depositary even if, in accordance with that article, it delegates certain of its functions.

16.5 How AIFMD affects other regulated activities

G **Overlap with the collective investment scheme definition**

Question 5.1: Do the definitions of collective investment scheme and AIF overlap?

Yes. The definition of a *collective investment scheme* does not exclude an *AIF*. The two definitions sit alongside each other and overlap extensively. Many *AIFs* will also be *collective investment schemes*. Therefore, it is possible that an *unauthorised person* who operates a fund will be *establishing, operating or winding up a collective investment scheme* and *managing an AIF*.

However, not every *AIF* is a *collective investment scheme*. The main example of an *AIF* that is not a *collective investment scheme* is an *AIF* in the form of a body corporate other than an *open-ended investment company*. Therefore, the existing case law on the definition of a *collective investment scheme* does not decide whether an undertaking is an *AIF* or *CIU* and the material in ■ PERG 16 about the definition of an *AIF* and *CIU* does not determine whether an undertaking is a *collective investment scheme*.

Question 5.2: Won't the overlap between collective investment schemes and AIFs mean that an AIFM will need unnecessarily overlapping permissions?

No. There are two important exclusions.

(1) If a *person* has a *Part 4A permission* to *manage an AIF*, activities carried on by that *person* in connection with or for the purposes of *managing an AIF* are excluded from all other *regulated activities*.

(2) A *person* (A) does not carry on the *regulated activity* of *establishing, operating or winding up a collective investment scheme* if A carries on that activity in relation to an *AIF*, and:

(a) at the time A carries on the activity, the *AIF* is managed by:

(i) a *person* with a *Part 4A permission* to *manage an AIF* (who may be a third party or A itself); or

(ii) a *person* registered as a *small registered UK AIFM* because the conditions in regulation 10(4) of the *AIFMD UK Regulation* are met in respect of that *AIF*; or

(b) no more than 30 days have passed since the *AIF* was managed by a *person* with that *permission* or registration.

The 30-day period in (b) can be extended in certain circumstances, as set out in article 51ZG(2) of the RAO.

Overlap between the depositary and custody activities

Question 5.3: Does the depositary of an AIF also need permission for safeguarding and administering investments?

No. A *person* does not safeguard and administer investments if the *person* carries on the activity in relation to an *AIF* and the *person* has a *Part 4A permission* to act as a depositary of an AIF in respect of that *AIF*.

Interests in an AIF as specified investments

Question 5.4: How do the advising and intermediary activities relate to an AIF?

Although an interest in an *AIF* is not separately specified by the RAO as a type of *security* or relevant investment in its own right it will normally fall within one of the other categories of *security* or relevant investment, such as a *share* or *unit*. That means that the *regulated activities* of:

(1) *dealing in investments as agent*;

(2) *arranging (bringing about) deals in investments*;

(3) *making arrangements with a view to transactions in investments*; and

(4) *advising on investments*;

will apply in the same way as they do to other investments of the relevant type. Therefore, for example, a *firm* that advises on investing in an *AIF* that is a *collective investment scheme* will be advising on *units*.

Examples

Question 5.5: Please give me some examples of how the regulated activities specific to AIFs interact with other regulated activities.

Please see the following table. All the examples involve *UK persons* and activities carried on in the *UK*. It is assumed that any manager delegating functions is not a letter-box entity.

Part 1: Examples of how the *regulated activities* specific to *AIFMs* interact with other *regulated activities*

Example	Explanation of interaction with other *regulated activities*
(1) A *firm* (A) with *permission* to *manage an AIF*, manages an AIF that is also a *collective investment scheme*	A does not need *permission* to *establish, operate or wind up a collective investment scheme*. The CIS exclusion applies.
(2) A *firm* (A) with *permission* to *establish, operate or wind up a collective investment scheme* wants to *manage an AIF*	A needs to vary its *permission* to cover *managing an AIF*
(3) An *unauthorised person* (A) manages an AIF that is also a *collective investment scheme* and also oper-	A will be *establishing, operating or winding up a collective investment scheme* and *managing an AIF*. The ef-

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ates it. No authorised AIFM is in place.	fect on *unauthorised persons* of the overlap between the definitions of *AIF* and *collective investment schemes* is different to the effect on *authorised persons*. The CIS exclusion does not apply as A is not an *authorised person*.
(4) A *firm* (A) with *permission* to *manage a UCITS* wishes to act as an *AIFM*	A needs to vary its *permission* to cover managing an AIF.
(5) A *firm* (A) with *permission* to *manage an AIF* delegates the management of some of the *AIF's securities* portfolios to B.	B does not *manage an AIF* for the reasons described in the part of the answer to Question 3.7 (What effect does delegation have?) dealing with the delegation of core functions. However, B *manages investments*. See article 78 of the *AIFMD level 2 regulation* (Delegation of portfolio or risk management) on the ability of an *AIFM* to delegate portfolio management or risk management to a *person* authorised or registered for the purpose of asset management. Even if B's activity could otherwise be *establishing, operating or winding up a collective investment scheme*, it will not be in this case because A's role means that the CIS exclusion is available to B.
(6) Same as (5). B's *Part 4A permission* covers *managing an AIF* or managing a UCITS.	Same answer. B's *Part 4A permission* should be amended to cover *managing investments*.
(7) A has *permission* to *manage an AIF*. The *AIF* has several investment compartments. A appoints B to manage the *securities* portfolio which makes up one of these compartments.	The answer in (5) applies here too. The investment compartment is not treated as a separate *AIF* (see Question 2.63 (Is each investment compartment a separate AIF?)). This arrangement is not contrary to the requirement in article 5(1) of *AIFMD* that each *AIF* have only one *AIFM*, as that requirement operates at the level of the *AIF* and not each separate investment compartment.
(8) A *firm* (A) with *permission* to *manage an AIF* delegates risk management to a *UK firm*, B.	B does not *manage an AIF*. If the fund is also a *collective investment scheme*, B does not need *permission* to *establish, operate or wind up a collective investment scheme*. (5) explains the reasons for this. If B's functions involve *managing investments* it will need *permission* for that (see (5)). Even if B's activities are not *regulated activities*, A will not be able to delegate to B unless B has *permission* to *manage investments*, *manage an AIF* or *manage a UCITS* because of article 78 of the *AIFMD*

	level 2 regulation (Delegation of portfolio or risk management).
(9) A carries out portfolio and risk management of an *AIF*. B runs the rest of the scheme.	A is *managing an AIF*. The difference from (5) is that B has not delegated portfolio management to A.
(10) A is *managing an AIF* (and has *permission* to do so). B is in charge of administering the scheme.	B is not *establishing, operating or winding up a collective investment scheme* because of the CIS exclusion. B is not *managing an AIF* for the reasons described in the answer to Question 3.5 (Does anyone carrying on only the activities listed in the answer to Question 3.4 carry on the regulated activity of managing an AIF?).
(11) Same as (11). Then A resigns as manager.	Same answer as (10). B may carry on its activities for 30 days while a new *AIFM* is put in place. That 30-day period may be extended in certain circumstances.
(12) A is*managing an AIF* (and has *permission* to do so) and is responsible for issuing and selling *units* or *shares* in the *AIF*.	Selling *shares* or *units* often involves dealing in investments as principal or dealing in investments as agent. However, A does not need these *permissions* as the activities are covered by the extended definition of *managing an AIF* described in the answer to Question 3.4 (What are the additional activities referred to paragraph (1) of the answer to Question 3.3?) and hence the connected purposes exclusion applies.
(13) A *firm* (A) with *permission* to *manage an AIF* sets up an *AIF* that is also a *collective investment scheme*. A intends to manage it.	The fact that A is establishing a *collective investment scheme* does not mean A needs *permission* to *establish, operate or wind up a collective investment scheme*. In our view, taking preliminary steps towards the carrying on of a *regulated activity* is itself carrying on that activity. A manager who is setting up a scheme is taking preliminary steps of that kind to *manage an AIF*. Hence, the connected purposes and CIS exclusions apply.
(14) A (acting by way of business) sets up an *AIF* that is also a *collective investment scheme*. A does not intend to manage it. B has been appointed as *AIFM*. B has *permission* to *manage an AIF*.	As explained in (13), taking preparatory steps towards carrying on a *regulated activity* is itself a *regulated activity*. On this approach, as B has started *managing an AIF*, the CIS exclusion comes into play and A does not need *permission* for establishing a *collective investment scheme*.
(15) A (acting by way of business) sets up an *AIF* that is also a *collective investment scheme*. A does not intend to manage it. A has lined up a *firm* (B) with permission to man-	A will require *permission* to *establish, operate or wind up a collective investment scheme* as B has not begun to *manage an AIF*.

age an AIF to be the *AIFM* but B has not been appointed yet.	
(16) A *firm* (A) with *permission* to *manages an AIF manage an AIF* and carries out portfolio and risk management for the *AIF*. A also is in charge of marketing and issuing units in the *AIF*. As part of that process A gives investment advice to potential investors.	A does not need *permission* for *advising on investments*. Instead the advisory activity is included within *managing an AIF*. The reasons are similar to those in (12).Marketing and issuing units in the *AIF* is part of the extended managing activity (see Question 3.4).The advising is carried on by A in connection with, or for the purposes of, marketing and issuing. As explained in paragraph (2) of the answer to Question 3.3 (Are the activities mentioned in the answer to Question 3.1 the only activities included in managing an AIF?), this means that the advising is included in *managing an AIF*. Therefore, the connected purposes exclusion excludes it from *advising on investments*.
(17) Same as (16). However, (leaving aside the RAO provisions explained in PERG 16.3 and PERG 16.5) the advisory activity would not have involved *advising on investments*.	For the reason in (16) the advisory activity is still a *regulated activity*, as part of *managing an AIF*.

References to the "connected purposes exclusion" are to the exclusion described in paragraph (1) of the answer to Question 5.2 (Won't the overlap between collective investment schemes and AIFs mean that an AIFM will need unnecessarily overlapping permissions?). References to the "CIS exclusion" are to the exclusion described in paragraph (2) of the answer to Question 5.2.

Part 2: Examples of how the *regulated activities* specific to depositaries interact with other *regulated activities*

Example	Explanation of interaction with other regulated activities
(1) A is the depositary of an *AIF* and its *permission* covers this activity	A acts as a depositary of an AIF. A does not *safeguard and administer investments*.
(2) A is the depositary of an *AIF* and its *permission* covers this activity. A delegates some of the custody activities to B.	For A, the result is the same as under (1). B does not act as a depositary of an AIF but instead *safeguards and administers investments*.
(3) A is depositary of an *AIF*. A carry vehicle or co-investment scheme invests alongside the *AIF*. That vehicle is a *collective investment scheme* and A is its custodian. The schemes invest in financial assets.	A's role in relation to the *AIF* means that its *permission* should cover acting as a depositary of an AIF. A's role in relation to the carry or co-investment vehicle means that its *permission* should cover *safeguarding and administering investments*. The exclusion described in the answer to Question 5.3 (Does the depositary of an AIF also need permission for safeguarding and administering investments?) does not apply in relation to the carry or co-investment vehicle.

16.6 Exclusions

G **Question 6.1: What exclusions from the regulated activities specific to AIFs are there?**

The following table lists the exclusions. Some exclusions are relevant to the definition of an *AIF*, some to the definition of an *AIFM* and some to both.

Table: Exclusions

Entities that are not *AIFs*	*Persons* excluded from the definition of *managing an AIF*	Where further *Handbook* material can be found
An institution for occupational retirement provision which falls within the scope of Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision	An institution for occupational retirement provision which falls within the scope of Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision, including, where applicable, the authorised entities responsible for managing such institutions and acting on their behalf referred to in article 2.1 of that directive, or the investment managers appointed pursuant to article 19.1 of that directive, in so far as they do not manage *AIFs*	Question 2.32
	A national, regional or local government or body or other institution which manages funds supporting social security and pension systems	
An employee participation scheme or employee savings scheme	An employee participation scheme or employee savings scheme	Question 2.34
A securitisation special purpose entity	A securitisation special purpose entity	Question 2.37
A holding company	A holding company	Questions 6.2 to 6.5
	A *small registered UK AIFM*, in respect of the	FUND 1

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AIFs managed by it by virtue of which it is entitled to be registered as a *small registered UK AIFM* (but not in respect of any other *AIFs* managed by it)	
An *AIFM* that manages a group *AIF*	Question 6.6
A national central bank	None
The European Central Bank, the European Investment Bank, the European Investment Fund, a bilateral development bank, the World Bank, the International Monetary Fund, any other supranational institution or similar international organisation, or a European Development Finance Institution, in the event that such institution or organisation manages *AIFs* and in so far as those *AIFs* act in the public interest	None
An *AIFM*, the registered office of which is not in an *EEA State*	Question 8.3

Note 1: All references are to this chapter of *PERG* unless otherwise stated

Note 2: In general the meaning of *AIF* in the RAO is the one in the *AIFMD UK Regulation*. The exclusions from the *AIF* definition noted in this table come from the *AIFMD UK Regulation*. However, the RAO article dealing with *managing an AIF* says that any expression used in that article which is not defined in the *AIFMD UK Regulation* and is used in *AIFMD* has the same meaning as in that directive. This makes no difference as, in our view, the *AIFMD UK Regulation* implements *AIFMD*.

Question 6.2: Is a holding company subject to AIFMD?

No. There is a specific exclusion for a holding company.

For these purposes, a holding company means a company with shareholdings in one or more other companies, the commercial purpose of which is to carry out a business strategy(s) through its subsidiaries, associated companies or participations in order to contribute to their long-term value and which is either a company:

(1) operating on its own account and whose shares are admitted to trading on a regulated market in the European Union; or

(2) not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or associated companies, as evidenced in its annual report or other official documents.

In our view, this exclusion is at least in part by way of clarification. In some circumstances, compliance with the conditions of the exclusion will mean that there is no *AIF* in the first place.

Question 6.3 How wide does the holding company exclusion go?

Broadly speaking, therefore, an undertaking will be able to use the holding company exclusion if:

(1) it carries out a commercial business strategy through its participations by contributing to their long-term value; and

(2) it does not generate its returns for its investors by means of divestment of its participations.

The question then is what else the exclusion covers.

Recital (8) of *AIFMD* says that managers of private equity funds or *AIFMs* managing *AIFs* whose shares are admitted to trading on a regulated market should not be excluded from its scope.

However, the exclusion envisages that an undertaking, whose main purpose is generating returns for its investors by means of divestment of its subsidiaries or associated companies, may still be excluded from *AIFMD* if its shares are listed.

The question then is how the recital and the exclusion are to be reconciled.

There is guidance on this on the *AIFMD* section of the European Commission's webpages "Questions on Single Market Legislation". The answer to Question ID 1146 says that the definition has to be read as a whole and jointly with recital (8). Consequently, private equity as such should not be deemed to be a holding company. The concept of "operating on its own account" should also be interpreted in the context of the requirement that the shares of such holding company are admitted to trading on an EU regulated market. Hence, says the guidance, this means that a holding company is a separate legal entity that carries out the business of owning and holding equity shares of other companies without the intent to dispose of such shares. Such business is done on the own account of the holding company and not on behalf of a third party. The answer says that the exemption is meant to cover "large corporates such as Siemens or Shell".

In theory, there is no distinction between a company whose returns are for itself and one whose returns are for its investors, as the returns of any company are generated for its investors as they change over time. However, in our view, this distinction is pointing towards the factors that distinguish a typical fund from a commercial company.

This does not completely explain the part of the exclusion that refers to shares being admitted to trading (see paragraph (1) of the answer to Question 6.2 (Is a holding company subject to AIFMD?)). In our view, this part of the exclusion is limited to internally managed *undertakings*. Therefore, this part of the exclusion applies to a business if:

(3) it carries out a commercial business strategy through its participations by contributing to their long-term value;

(4) the *AIF* is self-managed;

(5) it is not clearly acting as a fund taking into account the factors in the answers to Question 2.20 (Are there any other factors to take into account?) and Question 2.21 (Please give some further examples of factors to take into account when deciding whether an undertaking is set up like a fund); and

(6) the AIF's shares are admitted to trading on a regulated market in the European Union.

Paragraphs (3) to (6) do not apply to an undertaking that meets the criteria in paragraphs (1) and (2).

Question 6.4: Is the holding company exclusion always available where the fund holds controlling stakes in the businesses in which it invests so that the businesses are its subsidiaries?

No. It is important to remember that the exclusion is only available if the company carries out a business strategy(s) through its subsidiaries. The company should act in the same way that a conventional holding company of an industrial group would act. This means that the holding company must be responsible (with the subsidiaries) for the overall strategy of the subsidiaries. So, if the manager's subsidiaries are manufacturers, the manager must be responsible, with the subsidiaries themselves, for the manufacturing strategy of the subsidiaries.

The European Commission's Q&A about *AIFMD* say (Question ID 1146) that it is inherent in the concept of a holding company that all operations apart from those related to the ownership of shares and assets are done via its subsidiaries, associated companies or participations. In our view, the exemption is available only to the extent that the undertaking is acting as a holding company. It does not matter if the undertaking carries out other activities but any such activities will not get the benefit of the holding company exclusion. Those activities should be entirely ancillary to its role as a holding company or otherwise outside *AIFMD*. Thus, for example, a holding company may also provide services to other members of the group such as raising capital through the capital markets, treasury functions and human resources services.

If a holding company manages an *AIF* as well as acting as a holding company, its activities in managing that *AIF* are not excluded. The exclusion applies only in so far as it acts as a holding company. For example, if a holding company manages a conventional unit trust scheme it would not be excluded for that activity.

Question 6.5: What does company mean in the holding company exclusion?

As explained in the answer to Question 2.25 (What is the justification for the approach in the answers to Questions 2.15 to 2.23?), the basic distinction in *AIFMD* is between investment activities and commercial/industrial activities. The holding company exclusion is an illustration of this basic approach. For that reason, we believe that the term 'company' should be broadly interpreted to cover any undertaking such as, for example, a *limited liability partnership*.

Question 6.6: What does the group AIF exclusion involve?

An *AIFM* in so far as it manages one or more *AIFs* whose only investors are:

(1) the *AIFM*; or

(2) the *parent undertakings* of the *AIFM*; or

(3) the *subsidiary undertakings* of the *AIFM*; or

(4) other *subsidiary undertakings* of those *parent undertakings*;

is excluded from the *regulated activity* of *managing an AIF* provided that none of the investors is an *AIF*.

16.7 By way of business

G **Question 7.1: Must the AIFMD regulated activities be carried on by way of business for authorisation to be required?**

Yes. Under section 22 of the *Act* (Regulated activities), for any activity to be a *regulated activity* it must be carried on by way of business.

Question 7.2: What is the test for whether activities are carried on by way of business?

The test for whether the *regulated activities* of *managing an AIF* and acting as a depositary of an AIF are carried on by way of business is the one described in ■ PERG 2.3.2G (2).

16.8 Territorial scope

G **Question 8.1: What is the territorial scope of the AIFMD regulated activities?**

■ PERG 2.4 (Link between activities and the United Kingdom) describes the general principles.

Section 418 of the *Act* (Carrying on regulated activities in the United Kingdom) describes the circumstances in which an activity is treated as carried on in the *UK* in circumstances in which it would not otherwise be, as described by ■ PERG 2.4.3 G.

Leaving aside section 418, generally speaking the activities of *managing an AIF* and acting as a depositary of an AIF are carried on where the place of business of the *AIFM* or depositary from which those activities are carried out is located.

If one of these activities is carried on from a number of locations, some in the *UK* and some not, the activity is treated as being carried on in the *UK* if there is some continuity or regularity of provision within the *UK* of activities which are a significant part of the activity of *managing an AIF* or acting as a depositary of an AIF.

Question 8.2: Are the additional activities described in the answer to Question 3.3 relevant?

Yes. When deciding whether a company is *managing an AIF* in the *UK* if it splits the work between an office in the *UK* and one outside, one should take into account any of the additional activities described in the answer to Question 3.3 (Are the activities mentioned in the answer to Question 3.1 the only activities included in managing an AIF?) if the manager is performing risk management or portfolio management, even if all the risk management and portfolio management is carried on outside the *UK*.

Question 8.3: Can the AIF activities be carried on by an overseas firm?

As explained in the answer to Question 6.1 (What exclusions from the regulated activities specific to AIFs are there?), the *regulated activity* of *managing an AIF* does not apply to an *AIFM* whose registered office is not in an *EEA State*. Regulation 81 of the *AIFMD UK Regulation* restricts the scope of this exclusion from the date that the *EU* brings in certain further legislation relating to non-*EU AIFs* and *AIFMs*.

The *regulated activity* of acting as a depositary of an AIF can apply to a *person* whose registered or head office is outside the *UK*.

Question 8.4: Is the material in PERG 16.3 about delegation of management functions from one firm to another relevant to delegation from one branch to another?

This question is about the branch in one country of an undertaking being appointed as an *AIFM* and then delegating some or all of its tasks to another branch of the same undertaking. The question is whether any of the material in ■ PERG 16.3 about the effect of delegation on who *manages an AIF* is relevant to whether that undertaking is carrying on those activities in the *UK* if one of those branches is in the *UK* and the other is not.

The answer is that it is not relevant. The two branches are part of the same legal entity. The relevant factors are the ones in the answer to Question 8.1 (What is the territorial scope of the AIFMD regulated activities?).