

9 June 2025

By e-mail to: AIFMRegimeCFI@fca.org.uk

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

Re: Call for Input - Future regulation of alternative investment fund managers

Dear Sir/Madam,

Managed Funds Association (“**MFA**”)¹ appreciates the opportunity to represent the views of the global alternative asset management industry in this written response to the Financial Conduct Authority’s (“**FCA**”) Call for Input on future regulation of alternative investment fund managers (“**Call for Input**”). The Call for Input represents an opportunity for MFA and its members to contribute their views regarding the proposed changes to the regulatory framework affecting alternative asset managers. Effective and appropriate regulation plays an important role in ensuring that the UK’s regulatory regime continues to set high standards for the alternative asset management industry while ensuring it does not stifle growth or undermine the UK as a competitive jurisdiction for managers of various sizes and strategies.

Of MFA’s 180-plus alternative asset manager members, approximately half have a significant presence in the UK – either as their headquarters, with offices typically in the EU, US, and elsewhere, or as a significant component of a US-based firm. MFA membership includes hedge funds, credit, and crossover funds that invest across a diverse group of investment strategies. Accordingly, MFA and its members are interested in the Consultation and believe that the proposals are an important component in the revision of the regulatory framework for alternative investment fund managers and have potential to promote dynamic growth and success of the UK as a leading centre for the asset management industry.

MFA is supportive of the FCA’s intentions to improve the regulation of alternative investment fund managers with a more tailored regime to meet the needs of UK financial market participants. We believe such a regime also

¹ Managed Funds Association (“**MFA**”), based in Washington, D.C., New York City, Brussels, and London, represents the global alternative asset management industry. MFA’s mission is to advance the ability of alternative asset managers to raise capital, invest it, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 fund manager members, including traditional hedge funds, private credit funds, and hybrid funds, that employ a diverse set of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns throughout the economic cycle.

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further the FCA's secondary objective of facilitating, subject to aligning with relevant international standards, the international competitiveness and medium to long-term growth of the UK's economy, in particular, the financial services sector. MFA has separately responded to HM Treasury's Consultation, which was issued alongside this Call for Input.

Taking steps to refine the regulatory framework applicable to alternative investment fund managers will improve the effectiveness of regulation by reducing the complexity of the rules as well as the corresponding compliance burden and facilitating more consistent application of the standards among alternative investment fund managers. A consequence of the same is also improved investor protection.

While the UK is an important international financial centre, it is competing for its position as a key location for alternative asset managers with other jurisdictions. It is vital for the competitiveness of the UK alternative asset management industry to ensure that UK regulatory standards do not place UK alternative asset managers at a competitive disadvantage while avoiding the degradation of regulatory standards that underpin confidence in financial markets. MFA believes that pragmatic changes to the alternative asset managers regulation will demonstrate the FCA's role as an experienced, sophisticated and commercially astute regulator and ensure that the UK remains a world-leading centre for alternative asset managers and facilitate the growth and operation of fair, liquid and stable financial markets.

MFA is grateful for an opportunity to highlight the views and specific observations of its members, as set out below.

- **Thresholds.** MFA and its members are concerned that introducing quantitative thresholds that are linked to increased regulation leads to cliff-edge effects which disincentivize growth, especially crossing the relevant thresholds. The current proposals do not address how to decouple thresholds from an increased regulatory burden, but MFA believes it is possible to impose the same high-level regulatory standards across all categories of alternative investment fund managers and tie the thresholds to a decreasing level of prescriptive requirements, rather than an increase in the applicable rules without compromising effective regulation.
- **Proportionality.** MFA notes that the approach to proportional regulation of alternative investment fund managers set out in the Call for Input contemplates an increasing regulatory burden linked to the growth of the NAV of the funds managed by the fund manager. The proposals seem to contemplate that larger firms would be subject to more rules and a greater degree of regulatory prescription than small and mid-sized firms.

MFA acknowledges that the FCA intends to disapply or simplify unnecessarily burdensome or prescriptive rules (e.g. disclosure and investor reporting) and apply certain rules only to larger firms doing specific activities, and that otherwise larger firms would continue to comply with the currently applicable regulatory requirements.

MFA considers that, although it may be appropriate to impose specific rules to managers deploying certain investment strategies, the same high-level regulatory standards should be applied to all alternative

investment fund managers regardless of the NAV of their funds. For example, all alternative investment fund managers should be required to comply with a high-level requirement to ensure they have in place appropriate arrangements to ensure accurate and timely valuation of the assets of the fund.

Accordingly, MFA and its members are interested in the Call for Input and believe that the proposals are an important component in the revision of the regulatory framework for alternative investment fund managers and have potential to promote dynamic growth and the success of the UK as a leading centre for the asset management industry.

Smaller AIFMs, who are more likely to benefit from specific guidance to inform their compliance approach, could be required to comply with more prescriptive requirements (for example, specifying the need for a written valuation policy) but dispensing with the detailed procedural requirements currently set out in the Level 2 rules. Larger AIFMs are more experienced, typically face active investor due diligence scrutiny, and have greater access to compliance resources. Larger AIFMs are therefore able to put in place more tailored compliance programmes and should have greater discretion to determine what appropriate arrangements look like, without being subject to additional rules. As firms may achieve the same level of investor protection or operational integrity through a variety of different arrangements, discretion to adapt internal processes to the structure, strategy and complexity of the firm, puts firms in charge of actively considering how to achieve the regulatory outcomes the high-level standards impose. This approach is largely consistent with that of the US Securities and Exchange Commission and places a greater onus on compliance. Further, increased dedicated supervision of larger firms through the Buy-Side Directorate of the FCA would facilitate active dialogue with larger firms and give the FCA an opportunity to test the appropriateness of the larger firms' arrangements.

The UK's asset management regulatory regime is the product of decades of EU policy and legislation under the Alternative Investment Fund Managers Directive, the Undertakings for Collective Investment in Transferable Securities Directive, and the Markets in Financial Instruments Directive. MFA considers the Call for Input to be an important opportunity to return to first principles of regulation and to move away from a highly prescriptive and often inefficient regulatory framework that is often inconsistent with firms' objectives to attain sustainable and prudent growth without losing their competitiveness as against managers based in other international financial centres. A review of the asset management regulatory framework more generally, and with respect to alternative investment fund managers specifically, would allow managers to establish businesses more efficiently and would enhance the competitiveness of the UK's financial markets. MFA and its members consider it essential that the UK maintains an internationally competitive regulatory framework that does not disincentivise growth or impede business while ensuring adequate investor protection and the integrity of financial markets.

We understand that the FCA will actively take into consideration the potential costs and disruptions that may stem from a substantial transformation of the requirements, as well as potential divergence from other international regulatory standards. However, MFA considers that there is a clear benefit in having a well-constructed and coherent regulatory framework that is more intuitive for asset managers, allows firms to determine the most suitable approach to effective risk management and ensures greater consistency of standards across alternative investment fund managers.

We have set out our responses to the relevant questions in the Annex.

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MFA appreciates the opportunity to provide these comments to the FCA in response to the Call for Input. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact me, via rhailey@mfaalts.org, or Jeff Himstreet (jhimstreet@mfaalts.org).

Yours sincerely,

/s/ Rob Hailey

Rob Hailey
Managing Director, Head of EMEA Government Affairs
MFA

Annex

Call for Input: Future regulation of alternative investment fund managers

Making the rules clearer

Q3 Do you agree with the principle of creating three levels of firms based on their size to achieve proportionality? If not, what alternative approach would you suggest?

MFA supports a proportional approach to regulation to ensure applicable rules reflect the size, operations, complexity and strategy of the investment manager. In particular, MFA and its members would encourage an outcomes-based approach to regulation. This would mean setting high standards applicable to all firms, and only prescribing granular rules in limited cases where there are specific, clearly identified circumstances that regulation seeks to address, e.g. in respect of public market transactions.

As the FCA notes, the existing rules for AIFMs include detailed procedural requirements where the same outcomes could be achieved less prescriptively, allowing firms more flexibility in how they comply. We agree that this would increase the opportunities for firms to achieve the same regulatory outcomes, while delivering greater cross-border efficiencies and more competition between different business models. Similarly, MFA notes that the existing complex, time consuming and expensive FCA authorisation process should be simplified and made more efficient to avoid creating obstacles to market entry for small managers which impair the development of a competitive alternative asset management market.

With a view to clarifying the proportional approach to regulation, MFA would like to highlight some practical considerations.

Proportionality and thresholds. MFA agrees with the FCA's aim to allow smaller firms to grow without making abrupt and significant changes to the regulation of their business and to avoid requirements that create cliff-edge effects that discourage growth. Increasing the level or intensity of regulation as the firms grow necessarily creates a disincentive to grow, especially when a firm crosses the threshold from one category to another. MFA is concerned that a proportional approach which links a greater number of specific rules with growth creates obstacles to growing and developing the business. It discourages the growth of alternative investment fund management businesses in the UK, and encourages exploring other locations in which to grow the business.

For example, US regulatory requirements applicable to registered investment advisors are widely seen to achieve a comparable level of high standards and investor protection but impose fewer prescriptive rules or specific operational restrictions, which encourages business growth to be directed to the US instead of the UK. [Similar considerations increasingly apply to considering whether to develop a presence and operations in the U.A.E.]

Active dialogue with larger firms through the Buy-Side Directorate of the FCA would facilitate more effective supervision of those firms and give the FCA an opportunity to test the appropriateness of the larger firms' arrangements.

MFA considers that the regulatory regime should be coherent and consistent, with the high-level standards applicable uniformly across all categories of firms. Proportionate application of the rules, in practice, tends to require larger firms with more complex operating structures or strategies to have more comprehensive compliance processes. The larger, more complex firms typically have greater access to resources and more developed internal compliance functions. This means that the larger firms are generally better placed to evidence compliance of their internal processes with high-level standards.

By contrast, smaller, growing AIFMs often have less experience with compliance and have more modest compliance resources and, consequently, may find that more prescriptive rules and/or more detailed guidance on how to comply with the high-level standards are more conducive to compliance without increasing the compliance burden and associated costs.

MFA believes that, where the high-level standards applicable to all firms address key areas of compliance, having a set of more prescriptive rules guiding how the smaller AIFMs should approach compliance should not act as a barrier to market access or hinder the growth of smaller AIFMs.

Setting the thresholds

Q6 Do you agree with the proposed levels of the thresholds? Do you have any other comments on the proposed levels and the metrics used for the thresholds?

MFA supports the change of the threshold reference basis to Net Asset Value (“NAV”) rather than Assets Under Management.

However, MFA and its members are concerned that introducing quantitative thresholds that are linked to increased regulation leads to cliff-edge effects which disincentivise growth, especially crossing the relevant thresholds. The current proposals do not address how to decouple thresholds from an increased regulatory burden, but MFA believes it is possible to impose the same high-level regulatory standards across all categories of alternative investment fund managers and tie the thresholds to a decreasing level of prescriptive requirements, rather than an increase in the applicable rules without compromising effective regulation. Please see the response to Question 3 above.

Leverage

Q7 Do you agree that we should make our expectations of risk management by highly leveraged firms clearer? Do you have any comments on the best way to achieve this?

MFA recognises the importance of adequate risk management measures and the ability of the FCA to measure, monitor and manage the risks of high leverage in AIFs managed by UK AIFMs. MFA also acknowledges forthcoming Financial Stability Board (“FSB”) recommendations which are intended to address leverage-related risks and looks forward to the FCA’s assessment of the adequacy and effectiveness of the risk management standards under the AIFM Regulation. However, MFA considers that firms best achieve effective risk

management standards when they are able to reflect changes in market conditions, strategy and risk profile nimbly and responsively, without being required to comply with prescriptive, granular requirements.

Depositaries

Q13 Do you see a need for changes to the regime’s depositary requirements? Should these requirements apply only to specific levels of firm or certain types of fund, such as authorised funds? Should our regime seek to align its depositary rules with those of another jurisdiction or jurisdictions?

MFA welcomes and supports the FCA’s review of the depositary regime. Although all AIFs with custodial assets require an appropriately authorised service provider to provide custodial services, the asset ownership verification, cashflow monitoring and oversight functions are generally unnecessary for funds aimed at professional investors. By contrast, MFA agrees that the depositary asset verification, cashflow monitoring and oversight functions may provide valuable consumer protection with respect to authorised funds aimed at retail investors.

MFA requests the removal of the requirement under the AIFM Regulation to appoint a depositary, noting this requirement could be replaced by a requirement to appoint a reputable third-party custodian to provide custody services, where appropriate. MFA does not consider aligning the relevant UK rules to the AIFMD standards in the EEA to be necessary and notes that such standards are not internationally observed with respect to funds aimed at professional investors. As alignment with EEA rules does not enable UK managers to market their funds to investors in the EEA, compliance with the depositary requirements under the AIFMD provides limited benefit to UK AIFMs. Substantially similar protection may be achieved by market standard custody arrangements and appropriate internal and external audit controls.

Level 2 detailed risk management rules

Q16 Do you have any comments on the approach to the risk management rules outlined in annex 1?

MFA encourages the FCA to further explore a flexible approach to risk management which allows firms to set out strategy and asset class specific arrangements and to limit the application of prescriptive risk management rules. MFA considers that the risk management rules should be applied on a proportional basis, reflecting the manager’s investment strategy and asset class. The summary table in Annex 1 of the Call for Input envisages a distinction between managers of funds investing in “transferable securities” and “other investments (including private equity)”. The definition of “transferable securities” is broad² and encompasses instruments of varying liquidity and leverage profile and further nuance may be required to achieve appropriate calibration of the risk management rules to different strategies and asset classes.

² In summary, “transferable securities” are classes of securities which are negotiable on the capital market (excluding instruments of payment), such as shares and other equivalent securities to shares in companies, partnerships or other entities, and depositary receipts; bonds or other forms of securitised debt, including depositary receipts in respect of such securities; and any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.