The Association of Real Estate Funds
Head Office: 3 Waterhouse Square
London EC1N 2SW
+44 (0)20 7269 4677
info@aref.org.uk
www.aref.org.uk

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

Response by email: AIFMRegimeCFI@fca.org.uk

9th June 2025

FCA Call for Input: Future regulation of alternative fund managers

We, the Association of Real Estate Funds[1] (AREF), welcome the opportunity to contribute to the FCA's call for input on the regulations for Alternative Investment Fund Managers (AIFM). In our response to HM Treasury's parallel consultation, we supported streamlining the regulations for AIFMs and their depositaries and making them more proportionate for different size firms.

During an open call with our members to discuss changes to the regulations for AIFM in the UK, HM Treasury and the FCA confirmed that they would be interested in hearing about anything not mentioned in their consultation and call for input, respectively, which they should take into consideration. We believe that both the Government and the FCA should consider whether the protections provided by the AIFM regulations are required for certain fund structures and in particular circumstances. A couple of examples of this are:

- An exempt unauthorised unit trust (EUUT) has a trustee and the requirement for the fund to have a depositary as well is not providing any additional protection for investors and can be seen as an unnecessary cost.
- Where a RIF has only professional investors, they may see no need for a depositary and prefer to give consent for the RIF to opt out of operating as an AIF and operate only as a CIS. This may be achieved by making an amendment to the RIF legislation in the next Financial Services and Markets Bill.

During the call with HM Treasury and the FCA it was suggested by an AREF member that, as part of the review of AIFMD, the FCA and HM Treasury should consider whether it would be more appropriate for a UK real estate investment adviser to not require FCA authorisation in certain cases where this is currently required. In a real estate context, for example, the regulatory regime could perhaps be applied in a way that is more proportionate if an investment adviser did not require authorisation where both of two conditions are met: (1) the advice is provided to a regulated UK or EEA AIFM, and (2) the advice is provided in all material respects in relation to investments that are not regulated under FSMA (i.e. bricks and mortar) and any FSMA-regulated advice is incidental (e.g. the purchase of a property that is wrapped in an existing SPV). We recognise this has wider FSMA implications, but it could help avoid undue regulatory cost.

When considering our response to this call for input, as well as our members, we liaised with other real estate and/or funds focussed associations. The responses to the questions in the consultation can be found below.

[1] The Association of Real Estate Funds represents the UK real estate funds industry and has around 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.

If you would like to discuss any aspect of our response, please contact Jacqui Bungay (jbungay@aref.org.uk), Head of Policy at AREF. Also, as our members invest in real estate and other real assets for various types of open-ended and closed-ended funds, we are always willing to assist the Government by sharing this wealth of knowledge and experience.

Yours sincerely

Paul Richards

CEO, The Association of Real Estate Funds

Responses to consultation questions

Issues with the current regulatory framework for AIFMs

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

Yes, we agree that the current "cliff edge" is an issue for small AIFMs, and we also agree with the corresponding commentary in the HMT consultation paper noting the risks of the "halo effect" of registered but not authorised AIFMs. That being said, we expect there will likely still be some unavoidable "cliff edge" effects of having AIFMs of all sizes be authorised and for those moving up a tier. [See our response to question 3 for more information.]

More generally, in terms of growing the UK asset management industry, we note that the UK relies significantly on the delegation model. We recommend that any changes, from a MiFID as well as an AIFMD perspective, be made with a view to considering whether there might be possibilities in the future to further open up UK market access to the EU , and what form of alignment might be necessary/useful for that.

Currently EU AIFMs enjoy market access to UK professional investors, UK AIFMs do not have similar market access to EU professional investors. As part of the Government's desire to reset the UK's relationship with the EU, we would like to see that market access for UK AIFMs to EU professional investors should be equivalent to market access for EU AIFMs to UK professional investors. Not only would this provide more choice for EU pension schemes; it would provide a wider market for UK AIFMs' services.

The EU is currently considering certain changes under its Savings and Investments Union plan, and working with the EU, to the extent possible, would be positive for both UK as well as EU industry. Reducing any cross-border complexity (and related costs) would be a significant achievement/ambition.

Making the rules clearer

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

The proposed thematic presentation makes sense, and having the rules grouped in this way will be more accessible for new market entrants. We question the value in moving entrenched rules for presentational reasons however – for example, it makes sense to group all of the remuneration codes within SYSC 19 as is currently the case, particularly as managers may be part of broader groups, therefore would the proposal be to keep those rules as/where they are and include relevant cross-references?

AREF
The Association of Real Estate Funds

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

We agree that this approach is a sensible, enabling principle. Recognising that there are very different exposures for AIFMs according to the scale of assets that managers deal with is a good starting point for assessing the risk of poor outcomes that they potentially represent to investors in their funds and, as they scale, to markets. This facilitates better definition of which requirements of AIFMD are potentially disproportionate where they manage funds with smaller AUM. The crucial feature of getting the best out of this change lies in the establishing of correct, proportionate undertakings and responsibilities associated with each level of firm. A key to the success of early stage and emerging groups that will deliver the desired increase in competition is their ability to effectively and confidently navigate the regulatory arena within which they are operating. Barriers to entry or overly costly ongoing administration and internal team requirements inhibit their ability to compete and succeed.

Easing the transition between levels is also crucial, as we have witnessed the VoP-based transition from small authorised to full-scope AIFM being an obstacle that firms struggle to grapple with or seek to delay or avoid, to the detriment of growth, competition and ultimately investor benefit. However, as a time of significant change in requirements for managers, this can be expected to be a source of considerable risk of underperformance by managers and therefore needs to be robustly overseen on a case-by-case basis. We would propose that, to avoid the shift between one level and the next being a point of inflexion and thereby elevated risk, the transition could potentially be advised, monitored, overseen and independently reported on by a depositary to the fund.

Also, with the proposed scrapping of the Small Registered Regime, which recognised that the nature of Real Estate assets is also a significant reduction of the exposures that the AIFMs must manage, there should be consideration of the asset based factors that could lead to disproportionate requirements and therefore unnecessary barriers to competitive AIF management where funds holding assets that are low risk by nature or assets are subject to an asset based review of disproportionality of requirements.

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

We agree with the proposed approach. As noted elsewhere in our response, we believe that it will be important to ensure that the rules applied to each level will be proportionate, for example ensuring that the rules for small firms do not represent a barrier to entry for existing small registered AIFMs, and also that transitioning between levels will be suitably flexible for managers.

Moving up to a higher category

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

Our view is that any authorisation process for "small firms" is as close as possible to, and no more onerous than, the light-touch small AIFM registration regime available in the EEA (in particular Luxembourg) as well as in Jersey and Guernsey (as currently exists in the UK for small registered AIFMs) – in terms of actual and time costs to complete the regulatory process.

This is in order to allow and encourage small managers of first-time funds to be able to establish in the UK and to help facilitate the UK's financial services growth and competitiveness agenda.

We agree with the proposal that moving between thresholds involves a notification rather than prior approval, as this would allow managers more flexibility when their AuM increases and they effectively have to re-classify.

Some vehicles, such as the UK's Long Term Asset Fund (LTAF) require a full-scope AIFM and would therefore require a small AIFM to 'opt-up' from the outset.

HM Treasury may want to consider how the UK AIFM regime would integrate on a cross-border basis if the EU introduces the AIFMD third country passport (which remains a possibility under AIFMD). In this scenario UK firms (of any size) may well want to access the AIFMD marketing passport and therefore need to be able to opt into a regime that is treated as being the equivalent of a full-scope EU AIFM. For small and mid-sized firms this would also involve opting up to the higher threshold regime.

Setting the thresholds

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

We would expect the "small firm" category to be the least used, and would argue that this threshold could be increased to allow more firms to fall within this category, at least to start. We agree that the NAV reference ("an AIFM's assets minus its liabilities") is more helpful than leveraged AuM. However, more guidance on what NAV means would be helpful.

We would note that the current rules that allow for "PE AIF depositaries" (by businesses such as fund administrators) would no longer apply. This relates to AIFs that have no redemption rights exercisable during the period of 5 years from the date of the initial investments and which do not generally invest in financial instruments or generally invest in non-listed companies to acquire control over such companies and is a helpful provision. The FCA may want to consider either removing the need to appoint a depositary for any firms other than large and/or reducing the legal obligations on depositaries, with the result that the AIF's costs are reduced commensurately.

The FCA would also need to consider what the reclassification process will be for existing firms, in particular the grandfathering of any small AIFMs subject to the registration-only regime.

Leverage

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

We would support additional clarity as to the FCA's expectations as to risk management by highly leveraged firms. We also agree that size and use of leverage (or certainly, use of leverage in a way that poses the risks causing concern) are not necessarily fully correlated.

The better way to provide that clarity involves - in our view - not being excessively prescriptive. Our experience is that not all "highly leveraged" firms pose the same risks, and that is particularly the case for real estate funds. The use of substantial leverage by hedge funds is noted in paragraph 2.29 of the Call for Input. "Leverage" comprises a wide range of tools and arrangements, but the types and strategies of leverage employed by hedge funds are very different in scale and in potential risk from those employed by many real estate funds.

Many real estate funds, even those managed by AIFMs who would be classed as large under the new rules, primarily use leverage by borrowing under facility agreements to fund their operations with perhaps some limited hedging for efficient portfolio management. The funds' exposure under those borrowing arrangements is already controlled by market expectations, both from lenders in terms of loan to value and other covenants, and in terms of investors' requirements as to borrowing limits, cross collateralization and so on. That is very different from a hedge fund investing in derivatives and other products for speculative purposes or as their core strategy. We do not think that the sort of strategy used by most real estate funds ordinarily poses material systemic risk. The FSB's publications on their recommendations note that eventual measures need to be proportionate, and that should apply equally here.

We therefore consider that while it is important that the FCA has the ability to monitor and manage the actual risks associated with leverage amongst the full universe of UK AIFMs, and that it has information gathering rights appropriately, expectations as to risk management by AIFMs should still be commensurate with its actual leverage strategy.

A couple of other specific observations:

- Carefully considered rules on what constitutes a "highly leveraged" fund (and what arrangements should be included in that calculation or indeed in leverage generally, given the above) would be useful.

- The recent changes in the EU's AIFMD II Directive have attracted attention, especially the caps on leverage of loan originating funds, which have caused concern amongst many fund managers. The reaction has shown that fixed caps on leverage generally, which are potentially arbitrary given everything we have said above, can cause disproportionate issues which could be remedied via other means. Caps could actually be counterproductive if AIFMs need to cause funds to divest from positions to comply, which as the FSB as noted in itself causes market instability.

Applying the rules to firms undertaking different activities

- **Venture Capital and growth capital**

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

N/A

- **Listed closed-ended investment companies (LCICs) (investment trusts)**

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

We welcome the FCA's recognition of the unique structure and characteristics of LCICs, and the regulatory framework in which they operate, in considering the application of the future regulation of AIFMs in respect of LCICs.

The Call for Input refers to LCICs being subject to the UK Listing Rules (UKLRs). However, we would observe that the UKLRs specifically only apply to investment companies listed in the closed-ended investment fund category of the LSE's Main Market, whose shares are listed on the FCA's Official List.

A significant number of investment companies are currently admitted to trading on the Specialist Fund Segment (SFS) of the London Stock Exchange's Main Market and some are also admitted to trading on the Alternative Investment Market (AIM). Such companies are not required to comply with the UKLRs. Indeed, the reduction in costs and increase in flexibility associated with this lower regulation is one of the primary reasons an investment company may be listed on the SFS or AIM rather than the closed-ended investment fund category. Because of this lower degree of compliance and regulatory oversight, the London Stock Exchange is clear that the SFS is targeted at institutional, professional, professionally advised and knowledgeable investors.

It is worth noting that the DTRs, UK MAR, Prospectus Regulation Rules and other regulations apply equally to SFS and AIM listed LCICs and other LCICs admitted to trading on the Main Market.

We would welcome the final AIFM regulations including a clear definition of LCICs to which modified rules apply which specifically addresses the status of companies traded on the SFS and AIM.

In our view, it may well be appropriate for investment companies listed on the SFS to be subject to the modified regime for LCICs because the more restricted target market for the SFS means that consumer protection is less of a concern. In addition, many investment trusts listed on the SFS are certified as investment trusts by HMRC (and, accordingly, are required to comply with applicable rules to effectively spread investment risk). It is also common practice in the market for investment companies listed on the SFS or AIM to commit to their shareholders to comply with most of the UKLRs applicable to closed-ended investment funds on a voluntary basis, and it is not uncommon for investment companies whose shares are initially listed on the SFS or AIM to transfer to a listing in the closed-ended funds category of the LSE's Main Market (at which point they would become subject to the UKLRs).

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

We support the use of NAV as the metric to determine the legislative thresholds. NAV is a standard industry measure used to measure the size/value of an LCIC's investment portfolio and is universally understood.

We would, however, draw the FCA's attention to the fact that the UKLRs, DTRs, UK MAR, the Prospectus Regulation Rules, CCI regime and other laws and regulations apply to in-scope LCIC's regardless of their size – it is the admission to trading on a relevant market which triggers compliance. Accordingly, the protection offered to consumers by these regulations applies to investors in all relevant LCICs regardless of size.

Moreover, the risk to investors in an LCIC does not necessarily increase in line with the size of the LCIC in question. In fact, to the extent the NAV of an LCIC increases as a result of share issuances, that increase in size and scale decreases the risk profile of the LCIC as liquidity for investors increases correspondingly. In addition, the requirement for LCICs subject to the UKLRs to effectively spread investment risk means that a larger NAV may well represent a more diverse portfolio, meaning less concentration risk and lower volatility for investors.

Accordingly, it would be worth considering further what, if any, additional requirements it is appropriate to impose on larger LCICs as compared to those with lower NAVs.

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

We agree that the relationship and interaction between the board of directors of an LCIC and its external AIFM is an area which would benefit from clarification and should be addressed in the modified AIFM rules which the FCA intends to apply in respect of LCICs.

We agree that the delegation provisions are the key area in which clarification would be welcome. There is frequently confusion in practice in the context of LCICs where the majority of the ancillary AIFM management functions set out in FUND 1.4.7G (2) are in practice (and often as a matter of company law) the responsibility board of directors. In practice, the board is supported in performing these functions (or may itself delegate such functions) to third party service providers who are appointed directly by the LCIC. Because an externally managed LCIC typically has no employees, the external AIFM also has a role in performing these functions alongside such third parties and liaising with them on behalf of the LCIC. However, it is not usual market practice for appointments of third party service providers by an LCIC to be by way of a tripartite arrangement to which the AIFM is a party alongside the third party and the LCIC itself. Accordingly, the AIFM has no contractual nexus with or direct ability to supervise such third parties and may not even be involved in discussions between the board and the service providers in question. This can cause confusion and conflict between an LCIC, its AIFM and the third party service provider as to whether the arrangement in questions falls within FUND 3.10 and who has ultimate responsibility for the function in question.

Some examples of AIFM management functions in respect of which clarification would be welcome include:

- distribution of income and share issues
- maintenance of the shareholder register
- regulatory compliance monitoring
- approving net asset value
- marketing , which may be undertaken by the LCIC itself, the AIFM and/or by brokers, placing agents or other market intermediaries acting directly on behalf of the LCIC.

We are aware of several instances where there has been confusion and conflict between the board of directors of an LCIC and its external AIFM as to who should have ultimate responsibility for these functions and to what extent there has been a delegation by the AIFM in respect of which FUND 3.10 applies or not

(e.g. in relation to valuation, where the board must, from a corporate law perspective, have ultimate responsibility for approving the value of the LCIC but where the AIFM believes it must treat this as a delegation to the board subject to the oversight and control of the AIFM in accordance with FUND 3.10.2A.)

We agree that leverage limits is another area on which clarity should be given. The current requirement for the AIFM to set a maximum leverage limit, in addition to the UKLR requirement for an LCIC's investment policy to include limits on leverage, is typically addressed by having a higher limit set out in the investment policy with a lower "day to day" limit set by the AIFM from time to time, but this is done only to comply with the letter of the AIFM regulations. This could be confusing for investors and the FCA.

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

In addition to our comments above, we support the FCA's proposed approach of disapplying any sections of the AIFM regulations which are duplicative of other regulations which apply to LCICs. We agree that the provisions in FUND 3.2 (Investor information) and FUND 3.3 (Annual report of an AIF) could be disapplied as compliance with these requirements typically involves an LCIC's AIFM producing an additional disclosure document which cross refers to information already available to investors elsewhere.

We are also in favour of the FCA's proposal to disapply liquidity risk management requirements for most LCICs who do use only insignificant leverage, which recognises that LCICs do not present liquidity risk unless they employ a more than insignificant amount of leverage.

We suggest what represents an "insignificant" amount of leverage should be based on the borrowing restrictions which are included in an LCIC's investment policy, rather than the amount of leverage employed from time to time, in order to give greater certainty to LCICs and their investors and AIFMs.

Depositaries

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

Our members have mixed views in relation to the value of depositaries. These mirror the comments in paragraph 2.57 of the call for input: "*Given an increasing focus on private markets as a source of growth, some investors may see appointing a depositary as a proportionate measure to protect the integrity of private assets. We think this process has consumer protection benefits, although we acknowledge that some institutional and professional investors in unregulated AIFs may not place great value on this protection*."

We agree that some investors would expect mid-level and full scope AIFMs to appoint a depositary. On a fundamental level, the responsibilities of depositaries are an extension of the funds and managers that they are appointed to and oversee. Consequently, on the back of changes proposed for AIFMs, there should be a naturally more pragmatic and proportionate approach to depositary requirements. It might also be considered that certain depositary responsibilities could, over time, taper based on the nature of the AIF, the complexity of its assets, and even its stage in the fund lifecycle. While administering this model may require a more considered approach, the outcome should be more effective and targeted. Crucially, the depositary's role would remain constant — with the focus and intensity of its role calibrated according to actual risks that the fund and its fund manager face.

In a real estate context, the depositary requirement for professional only funds without custody assets is not necessarily required. For these types of UK domiciled funds, the requirement for a depositary is a significant cost compared to offshore alternatives resulting in a competitive disadvantage for the UK funds.

Some of our members believe that in practice the greatest oversight value would be delivered to smaller AIFMs (c100m+) i.e. those newly transitioned to full scope. This is often where depositaries identify the most significant findings — typically relating to control weaknesses that could compromise the safeguarding of investor assets. The depositary can play a critical role here, adding material value with guidance and insight into the new requirements that small AIFMs will have limited experience in. There could be a requirement for small AIFMs approaching the lower threshold to engage the depositary identified to act for their funds ahead of reaching it and, as the level of systematic risk is likely to be low given their scale of operation, to require the depositary to report on the AIFM's planned preparations for readiness so as to be compliant within an agreed time of the expected crossing of the threshold.

On the other hand, larger AIFs (£5bn+) tend to have the resources and infrastructure to maintain strong internal controls and oversight. These firms can effectively implement and manage frameworks to support compliance. Such firms do pose greater potential for systemic risk but the Level 2 requirements and other demands of full scope status, while potentially somewhat unfamiliar, would be fixed and anticipated well in advance. Allowing for the necessary preparations in good time before coming into effect, so they should not represent a challenge that introduces unmanageable risk for an organisation of this scale. To ensure this, and given the systematic risks potentially involved, the upgrading of the systems, controls and reporting capabilities of the AIFM could be a special focus by the depositary who could report on readiness to the FCA as part of the notification procedure ahead of the AIFM reaching the upper threshold.

Equality and diversity considerations

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

N/A

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

N/A

Risk Management Rules (Annex 1)

Question 16: Do you have any comments on the approach to the risk management rules outlined in annex 1?

We broadly support the FCA's intention to reform risk management rules in a more proportionate and activity-specific way, as proposed in Annex 1. A more nuanced framework that differentiates between firm size, leverage profile, and investment strategy is long overdue and welcome.

1. **Proportionality and Clarity**: The current regime's "one size fits all" approach creates a disproportionate compliance burden for many AIFMs, especially those managing illiquid, long-term assets, who must adhere to rules that were clearly designed with liquid, short-term trading strategies in mind. Tailoring requirements to the nature of a firm's activities (e.g., private equity vs hedge funds, holding real estate assets vs higher risk assets) would allow risk management frameworks to be more meaningful and operationally effective. The move toward clearer, principles-based expectations will support better alignment between regulatory objectives and business models while maintaining appropriate levels of protection against risks in the respective levels.

2. **Risk Management by Activity and Strategy**: The distinction between firms managing transferable securities and those investing in real assets or private markets is particularly well-drawn. We agree with the suggestion that rules such as those requiring specific market/credit risk limits or real-time portfolio monitoring may be inappropriate, or at least unnecessary, for firms managing long-term, illiquid assets. Similarly, we support the approach of reinforcing the requirement for investment due diligence policies for private markets managers while easing the obligation for hedge funds where liquidity and diversification are more central to portfolio construction and risk management.

3. **Tiered Approach Based on Firm Size**: Applying the Level 2 Regulation's risk rules in full only to the largest firms makes sense and reflects the greater potential for systemic harm posed by those firms. For mid-sized firms, we support the use of high-level obligations with supporting guidance that evolves as they move toward full scope and resource up accordingly. This strikes the right balance between consistency of standards and operational flexibility. For small AIFMs, general principles should suffice. Importantly, this approach should be accompanied by clear guidance on supervisory expectations to avoid a de facto "gold-plating" of requirements in practice.

4. Specific Comments on **Annex 1 Table**:

    - **Articles 39–42**: The proposal to adopt a more flexible interpretation of provisions relating to risk management structure and reporting frequency is sensible and aligns well with the SYSC regime.

    - **Article 43**: We support maintaining this obligation across all firm types. However, for small and mid-sized AIFMs with limited functional separation, the FCA should clarify that proportionate, documented internal controls will suffice. The objective should be effective oversight, not structural formalism.

- **Articles 44–45**: Disapplying risk limit-setting and certain risk quantification requirements for managers of private equity or real estate strategies reflects a practical and accurate understanding of how these business models operate.
- **Monitoring requirements and escalation pathways** should remain core obligations across all tiers to ensure senior accountability and effective oversight, regardless of firm size.

5. **Implementation Considerations**: While the proposed framework is strong conceptually, we would encourage the FCA to develop illustrative case studies or examples (particularly for mid-sized firms) when drafting detailed rules. This will help to ensure consistency in how proportionality is applied and reduce interpretative uncertainty during implementation.