

Real Estate:UK response to FCA CP26/28: The UK AIFM Regime – Chapters 13, 14 and 16

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Real Estate:UK

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We connect UK and international investors with the insight, networks and opportunities that make the UK one of the world's most dynamic and investable markets.

Working closely with national governments and their agencies, as well as regional and local leaders, we promote the UK real estate sector as a premier destination for capital. Through direct engagement with ministers, policymakers and advisers, we help shape a regulatory environment that unlocks growth and builds investor confidence.

We support thriving communities across the UK through the homes, workplaces, critical infrastructure such as logistics and data centres, and retail and leisure centres our members build, maintain and operate.

Executive Summary

FCA CP26/28: The UK AIFM Regime – Discussion chapters 13, 14 and 16

RE:UK welcomes the FCA's direction of travel towards a more proportionate and flexible UK AIFM regime. Our response supports investor protection where it is necessary and effective, while emphasising that the regime should better reflect the nature of different AIFs and the investors in those AIFs.

Depositaries

We consider that a depositary should not automatically be required for every unauthorised AIF managed by a medium or large UK AIFM. Instead, the requirement should be assessed by reference to investor type, fund structure, asset class and trading frequency.

We support the FCA introducing greater flexibility in depositary models, including the ability for small UK AIFMs to appoint a depositary on an optional basis where investors want one, and the ability for AIFMs to appoint more than one depositary for the same AIF. We consider that this could improve competition, reduce costs and allow specialist depositaries to perform functions appropriate to particular assets, duties or jurisdictions.

We also ask the FCA to consider practical issues arising from overlapping or overseas depositary requirements, particularly where local rules in other jurisdictions require a depositary for marketing purposes. Responsibilities between depositaries should be clearly allocated in depositary agreements.

On cash monitoring and oversight, we support the AIFM being responsible for cash management and encourage the FCA to introduce this more efficient approach as soon as possible.

In relation to real estate assets, we reiterate the views expressed in our response to CP26/16 'Registration of authorised fund assets':

- We have concerns with depositaries increasingly widening their remit. This is resulting in them increasing their workstreams and fees, impeding fund operations, and slowing down property transactions.
- We have asked that the FCA clearly outline exactly what responsibilities remain with the depositary following depositary delegation proposed within CP26/16, and why.
- Title verification for non-custodial assets can be sufficiently protected through Land Registry restrictions preventing dealings without the depositary's prior written consent.

In relation to the Reserved Investor Fund (RIF), under current legislation the RIF must have a depositary irrespective of the size of the AIFM managing the RIF. Whereas, under the proposed FCA new rules, any other type of AIF only needs to appoint a depositary when managed by a medium or large AIFM. From a RIF investor's perspective, the cost of a small AIFM appointing a depositary may be disproportionate to any benefits received from the depositary. We encourage the FCA and HM Treasury, via legislation, to align the depositary requirements for the RIF with other unauthorised AIFs.

Removing the business restriction

We support the removal of the AIFM business restriction. We believe that the current restriction creates unnecessary complexity and cost, particularly where asset managers must set-up and maintain multiple authorised entities within the same corporate group to provide complementary services. Removing the restriction would improve the UK's competitiveness by supporting efficiency and reducing barriers to entry. The FCA can manage any residual risks through the wider UK regulatory framework and authorisation gateway.

Second consultation on the UK AIFM Regime

We look forward to contributing to the second consultation which will cover the topics within the discussion chapters of CP26/28, and the additional points mentioned in sections 13.42, 13.44 and 13.45. We welcome that this second consultation may include adjustments to the proposals in CP26/16, including a review of the definition of 'AIF custodial asset', after considering the feedback to both consultations.

Please find below our full response to the consultation questions relating to the Discussion chapters 13, 14 and 16 in FCA CP26/28.

Response to consultation questions

Chapter 13 Discussion chapter: Depositaries

Question 28 Should all large and medium UK AIFMs continue to appoint a depositary for each unauthorised AIF they manage? If not, why not?

We echo the FCA's sentiment that the existing depositary rules derive from the EU UCITS regime and so were designed to cater for open-ended vehicles investing in liquid custodial assets. As a result, the regime is ill-suited for the needs of funds investing in real estate.

We appreciate the FCA's view that depositaries can strengthen investor protection for large and medium UK AIFMs. However, we question the overall value of depositaries given that many of the functions typically undertaken by depositaries are of limited value to real estate funds. For such funds, typically cash-flow monitoring is conducted by independent administrators; fund managers conduct their own checks for compliance with a fund's investment restrictions with the assistance of legal counsel (and often by investors themselves); and auditors will verify portfolio holdings during annual audits. As a result, we do not believe that AIFMs (of any size) should be required to appoint a depositary unless there is a commercial reason to do so, for example in response to investor appetite. (Please see our response to Question 29).

Instead, we believe that the FCA should introduce a regime where AIFMs, of any size, are free to appoint a depositary should they see a commercial benefit in doing so.

Question 29 Could the depositary regime be made more proportionate for certain types of unauthorised AIF, and if so how?

If the FCA chooses to maintain the current requirement for AIFMs to appoint depositaries, we encourage the FCA to develop a more tailored regime. We believe this regime should adopt a proportionate approach to whether, for some unauthorised AIFs, the full services of a depositary are required and for some AIFs, whether a depositary is required at all. The appointment of a depositary should depend upon whether the investors in an AIF are professional or retail investors, whether the AIF is closed or open-ended, the type of assets being held by the AIF, and how often they are traded. An example is a closed-ended real estate fund, with a small number of sophisticated institutional investors, such as pension funds, which holds a few properties for the duration of the fund's life. For this type of fund, the oversight functions performed by a depositary are either not necessary or are usually carried out by other service providers. The requirement for all AIFs to have a depositary adds costs for a service that is not necessarily required, and these costs are often passed on to end investors.

Under current legislation, Reserved Investor Funds (RIFs) must have a depositary irrespective of the size of the AIFM managing the RIF. Whereas, under the proposed FCA new rules, any other type of AIF only needs to appoint a depositary when managed by a medium or large AIFM. From an RIF investor's perspective, the cost of a 'small AIFM' appointing a depositary (which is to be paid by the fund and effectively a fund investor cost) may be disproportionate to any benefits from the depositary. We encourage the FCA and HM Treasury, via legislation, to bring the depositary requirements for the RIF in alignment with those that apply to other unauthorised AIFs.

Question 30 Should a small UK AIFM not be required to appoint a depositary for each unauthorised AIF it manages, but be able to opt to do so?

As set out in our answer to Question 28, we totally agree that there should be an option for small UK AIFM to appoint a depositary if their investors wish them to.

Question 31 Should an AIFM be able to appoint more than one depositary for the same AIF so that they can carry out different functions? What impact might this have on competition?

We support the introduction of a rule allowing AIFMs to appoint more than one depositary for an AIF. We believe this would provide much needed flexibility for an AIFM to appoint the appropriate depositaries for the duties they are undertaking. Also, this will bring more competition for depositary services and lower costs.

In our response to the consultation on 'Registration of authorised fund assets' (CP26/16), we mentioned that funds have found that some depositaries are over-reaching on their depositary duties. Some are insisting on day to-day control, direction and safeguarding which is slowing down property transactions. As well as ensuring depositaries are only appointed when required, we want to ensure there is not any 'depositary creep', by depositaries of AIFs holding real estate. By allowing AIFMs to appoint more than one depositary, AIFMs could be more discerning and appoint depositaries that adopt a more commercial approach to undertaking their duties.

Question 32 Does our analysis of how responsibilities could be shared between depositaries performing functions for the same AIF capture all relevant aspects? Is there anything else that we should consider?

In Section 13.22 of CP26/28 it says that the depositaries must be 'established in the UK and hold part 4A permission of acting as an AIF depositary'. The FCA's rules are premised upon an assumption, when appointing more than one depositary, that they would be responsible for different duties and that the depositaries would all be UK based. However, we note that when marketing a fund in some jurisdictions, there is a requirement for an AIF to appoint a depositary in that jurisdiction. Therefore, we encourage the FCA to confirm that it would be possible for a depositary to split its role by reference to, for example, geography. If it isn't possible for UK AIFs to have overseas depositaries as well as UK depositaries, and for those depositaries to have some degree of duplicated or overlapping duties, this could stop them from marketing in some countries.

There should be consideration to how the inter-action between depositaries would work. Depositary agreements should clearly set out who is responsible for what services and, where appropriate, the jurisdiction to which they relate.

Question 33 Do you agree with our proposed approach to the cash monitoring function? Please explain any pros and cons. Would allowing greater flexibility in depositary models be beneficial to the market for providing oversight services? If not, why not?

We support the requirement for just the AIFM to be responsible for the cash management function, without the requirement for duplication of this function by the depositary. We consider that this is more efficient as it reflects the existing reality that these actions are typically already undertaken by the AIFM and/or fund operator. We would advocate for this to be introduced as soon as possible.

Question 34 Would allowing greater flexibility in depositary models be beneficial to the market for providing oversight services? If not, why not?

We agree that there should be greater flexibility available in the depositary models for providing oversight services and welcome the FCA's recognition that a single depositary model is restrictive.

In regard to the depositary oversight duty of verifying title to non-custodial assets, we refer to our response to CP26/16:

- We are concerned that depositaries are in practice increasingly impeding fund operations including when property transactions are being undertaken by the funds. There is “depositary creep”: when, from a regulatory perspective, the depositaries should have an ultimate control, direction and safeguarding role, depositaries are in practice (and unjustifiably) insisting they have must have a day-to-day control, direction and safeguarding role. This is resulting in increasing their workstreams and fees, and slowing down property transactions.

- We request the FCA to clearly outline exactly what responsibilities remain with the depositary following depositary delegation proposed within CP26/16, and why.
- We believe that the depositary's role can be more than adequately protected by way of restrictions at the Land Registry that prohibit any dealing without the prior written consent of the depositary.' We encourage the FCA to liaise with the Government to amend primary legislation to enable this to happen as early as possible.

We also encourage the FCA to recognise that some of the benefits of a split depositary model may be undone by the requirement to ensure that there is an oversight depositary which retains the single record of assets. In our view this would introduce additional complexity and cost to the regime as depositaries would need to document the exchange of information between them.

Chapter 14 Discussion chapter: Prime brokers

Question 35 Do you agree with our intention to broadly retain but simplify the existing requirements for prime brokers, subject to any changes we make to the depositary regime? Is there anything else relevant that we should consider?

Our members typically do not appoint prime brokers for their AIFs. We do not have a response to this question.

Chapter 16 Discussion chapter: Removing the business restriction

Question 38 What are your views on the options we have presented on the AIFM business restriction? Are there other approaches that we should consider?

We strongly agree with Option 4, to remove the AIFMD business restriction in its entirety. The current AIFM business restrictions limit the ability of firms to offer complementary services under a single authorisation. In practice larger asset managers are forced to set up more than one FCA authorised entity. This adds complexity and additional costs for these firms with no additional benefits and creates a barrier for entry to smaller asset managers. Asset managers usually have in practice a range of potential investment

proposals and clients who want products that are and are not AIFs, and which require different services. There is not an obvious risk being contained by not allowing them to manage vehicles which fall one side or another of the definition of an AIF.

As mentioned in the consultation paper, there is a wider regulatory framework in the UK that enables the FCA to manage risks associated with the activities of AIFMs. We agree with the FCA assessing any potential risks at the authorisation gateway and then subsequently at the time of, for example, a Variation of Permission.

We encourage the FCA to consider bringing in this change as soon as practicable.

End of response