

Insights

PROPOSED REFORM OF UK REGIME FOR ALTERNATIVE INVESTMENT FUND MANAGERS

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SUMMARY

The Treasury (**HMT**) launched a consultation and the Financial Conduct Authority (**FCA**) published a call for input in April 2025 kick-starting a review of the UK's regulatory regime for Alternative Investment Fund Managers (**AIFMs**). The reforms seek to streamline the regulatory framework for AIFMs to reduce burdens and boost growth, whilst maintaining core protections for consumers and markets.

DIVERGENCE BETWEEN UK AND EU FRAMEWORKS

If adopted, these proposals will mark a significant shift between the UK and EU frameworks. This divergence had already started with the EU having adopted AIFMD II last year. Currently, AIFMs in the UK and EU are operating on broadly the same framework as set out in the EU's Alternative Investment Fund Managers Directive (**AIFMD**). AIFMD was harmonised across the EU in 2013 and remains the basis for the existing UK regime, after it was transposed into the UK statute book following Brexit.

The EU amendments to AIFMD known as AIFMD II are required to be implemented by EU AIFMs by April 2026. AIFMD II will introduce changes to the EU framework across a wide range of areas, including liquidity and delegation, and introduce significant new rules for funds that originate loans.

Importantly, the proposals published by HMT and the FCA do not seek to mirror the EU changes in AIFMD II. For the first time since the introduction of AIFMD, the UK and EU are embarking on substantially divergent approaches to the regulation of AIFMs.

Many investment management groups have licenced entities in the UK and also in the EU. Divergences between the two regimes risks increase the compliance costs and burdens of firms, particularly where there is delegation from an EU AIFM to a UK portfolio manager or vice versa.

A THREE-TIER UK REGIME

A key aspect of the UK proposals is a new three-tier regime. Different rules will be applied to large, mid-sized and small AIFMs based on Net Asset Value(**NAV**). To enable this, it is proposed that the lighter touch regime (which has proved very appealing to smaller and first-time managers) for “sub-threshold” or “small” UK AIFMs will be removed (see below). The FCA will instead introduce a new framework based on the following categories:

LARGE FIRMS: >£5BN NAV

- Large AIFMs would be subject to a regime similar to the current rules for full-scope UK AIFMs.
- However, the FCA intends to disapply unnecessarily burdensome rules from all firms and apply certain rules only to firms doing specific activities.
- In certain areas, such as disclosure and reporting to investors, the FCA proposes removing some detail where prescription is not necessary to achieve intended outcomes.

MID-SIZED FIRMS: £100M - £5BN NAV

The FCA anticipates that a significant number of firms that are currently full-scope UK AIFMs would become reclassified as mid-sized under the new rules. The FCA proposes to apply a simpler and more flexible regime to mid-sized firms than that applied under the current regime for full-scope AIFMs.

Mid-sized firms would be subject to rules covering all major aspects of the existing regulatory framework for AIFMs. However, the FCA plans not to impose the more detailed procedural requirements currently in the AIFMD Level 2 Regulation, except where necessary to set appropriate standards, specify exceptions or clarify expectations.

Instead, the FCA has said it proposes to set clearer expected outcomes for mid-sized firms and give firms flexibility in how they achieve those outcomes.

Done well, this could result in a useful reduction of compliance burden for UK AIFMs that fall into this category. The risk, however, is that a move away from the EU concept of proportionality to a more prescriptive (even if lighter) set of requirements, could simply result in UK AIFMs needing to introduce more, and more detailed, policies and procedures than they currently do. If the current EU Level 2 requirements are to be disapplied for mid-sized firms to give them more flexibility, it will be important for any alternative rules that are introduced not to lose sight of this principle, or they could have the opposite of the intended effect.

SMALL FIRMS: <£100M NAV

- Small firms would be subject to core requirements appropriate to their size and activity. The rules for small firms would set baseline standards essential for maintaining appropriate levels of consumer protection and market integrity. These standards would be broadly consistent with the rules that apply to larger firms.

Firms within a lower category would be able to opt-up to a higher threshold regime if they choose, similar to the framework that exists under the Senior Managers & Certification Regime for enhanced, core and limited scope firms.

IMPACT FOR UK SMALL AIFMS (REGISTERED AND SMALL AUTHORISED)

When implementing AIFMD, the UK introduced the ability for some smaller AIFMs or AIFs to obtain a registration rather than becoming a fully authorised firm. This was primarily open to the types of firm that had not required authorisation in the UK prior to AIFMD. There are still firms operating in the UK under the small registered regime, albeit a relatively low number. Under the proposed new regime, the small registered regime would be dismantled. Existing small registered firms would either need to apply for full FCA authorisation (with a large time and cost burden) or restructure their operations to partner with another fully authorised existing firm. Once authorised, they would be subject to the new tier of requirements for small firms. Accordingly, whilst the proposals are aimed at removing unnecessary regulation and creating a more proportionate regime for firms overall, the effect on small registered AIFMs will be to impose a significant additional regulatory burden.

By contrast, firms that are currently classed as small authorised AIFMs are already subject to an FCA authorisation requirement and are unlikely to face significant differences under the new regime. The FCA does not expect existing small authorised AIFMs will need to raise standards materially in order to meet the baseline requirements for small firms under the proposed framework.

OTHER PROPOSALS

The proposals by HMT and the FCA cover a number of other areas, including the following:

SIMPLIFIED RULE STRUCTURE

- The FCA proposes to group its new rules into thematic categories that reflect different business activities and phases of the product cycle. The FCA hopes to make the rules easier to understand and navigate.

STRATEGY SPECIFIC RULES?

- Included within the FCA's proposals is a suggestion that they may be open to applying and disapplying some of the more detailed provisions within AIFMD and its Level 2 measures

depending on the strategy being followed by the manager. Done with care, this could be a very useful addition for small and mid-sized managers that only pursue a small range of strategies.

- In particular, the FCA acknowledges that some of the more prescriptive rules that may be suited to hedge funds or funds that engage in regular dealing are less suitable for managers of private equity or real estate funds. This could be very good news for PE and RE managers if adopted.

EXTERNAL VALUERS

- Under the current regime, external valuers who carry out AIF valuations are liable to the AIFM for any losses caused by the valuer being negligent or intentionally failing to perform its tasks.
- This liability has made it challenging for valuers to obtain professional indemnity insurance and has made them cautious about accepting the role of valuer to the fund. This has particularly impacted funds investing in longer-term assets that may be complex to value, such as real estate.
- HMT is therefore considering removing the legal liability of external valuers in order to foster growth in the market for external valuation services. In this scenario, the external valuer would have contractual liability to the AIFM, but the ultimate legal responsibility to the fund and its investors would rest with the AIFM. This would be a welcome change if adopted and mark a useful difference from the EU AIFMD II regime.

LISTED CLOSED-ENDED INVESTMENT COMPANIES (LCICS)

It is proposed that LCICs will remain within scope of AIFM regulation. However, the FCA is considering whether it could take a more proportionate approach to the regulation of LCIC managers in certain areas, including transparency requirements, leverage and delegation.

MARKETING NOTIFICATIONS

- Currently, full-scope UK AIFMs of UK or Gibraltar AIFs must notify the FCA 20 working days prior to marketing those AIFs to professional investors. Whilst the FCA often responds in less than this time, it introduces a delay to marketing efforts and adds an administrative and timing burden on launches. The removal of this period will therefore be very welcome news to AIFMs.
- It is not clear whether they would also remove the requirement to wait a month before making a material change to marketing documents that have already been notified, but we hope that sense will prevail and that a corresponding amendment is made here also.

PRIVATE EQUITY NOTIFICATIONS (REFERRED TO AS THE ASSET-STRIPPING RULES)

- HMT is also considering removing the current requirement for full-scope UK AIFMs and above-threshold overseas AIFMs to notify the FCA regarding any AIFs they manage which acquire control of non-listed companies and issuers.

PRUDENTIAL REQUIREMENTS

- The FCA will review the regime's prudential requirements and how they apply to different sized firms. The FCA notes that since the introduction of the regime in the wake of the global financial crisis, there have been changes in the perceived balance of risks and there is potential for a recalibration of the rules to address those risks.

REMUNERATION

- The FCA will review the operation and effectiveness of the remuneration rules for AIFMs and consider whether change is required.

REGULATORY REPORTING

- The reporting regime for AIFMs has not been reviewed since it was introduced. The FCA will consider how to achieve a more effective reporting regime which is proportionate to its demands on firms.

NATIONAL PRIVATE PLACEMENT REGIME (NPPR)

- The NPPR is the marketing regime used by overseas AIFMs, and UK and Gibraltar AIFMs managing overseas AIFs, to market those AIFs in the UK. It is proposed that the NPPR will be broadly restated in new legislation.

DEFINITIONS, PERIMETER ISSUES AND JVS

- A number of definitions relevant to the regulated activity of managing an AIF are currently set out across different regulations and FCA guidance. HMT is proposing to move these within the Regulated Activities Order.
- Crucially, there are (currently, at least) no proposals to change the definitions set out in, or perimeter of, AIFMD. So the current understanding within the UK market of when a structure is, or is not, an AIF should remain intact. This will be particularly good news to firms operating joint ventures outside the AIFMD regime.

NEXT STEPS

HMT's consultation and the FCA's call for input both close on 9 June 2025. HMT will consider the responses to the consultation and depending on the outcomes, the government will publish a draft statutory instrument for feedback.

Following HMT's decisions on the future regime, the FCA plans to consult on more detailed rules in the first half of 2026, and to provide further details on the timeline for implementation. The FCA has said it plans to give firms time to adapt to the new regime, while removing unnecessary rules relatively quickly. In practice, we anticipate that significant changes are unlikely to be introduced before late 2026 at the earliest. As such, groups that contain both EU and UK AIFMs will need to keep working towards their AIFMD II implementation deadline without knowing where the UK journey will lead.

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