ALTERNATIVE CREDIT COUNCIL
LENDING FOR GROWTH

AIMA

RECOVERY AND GROWTH:
THE ROLE OF THE ALTERNATIVE INVESTMENT MANAGEMENT SECTOR IN THE UK

A policy vision for 2021 and beyond

June 2021

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THE PURPOSE OF THIS PAPER

This paper has been prepared by the Alternative Investment Management Association (AIMA) and Alternative Credit Council (ACC) to explain the role that the UK's world-leading alternative investment management sector can play in supporting the Government's goals to increase economic growth, boost productivity and level up across the UK. These ambitions are particularly important as the Government seeks to guide the UK economy to recovery, following the impact of COVID-19.

In this paper, we provide an overview of the contribution that the industry already makes to the UK economy, before setting out our vision for how the UK government can further encourage the development of this sector in order to support its wider political goals.

Our policy vision is built around two core themes:

- **Supporting growth and innovation across the economy:** The alternative investment sector is ready to play a key role in supporting UK growth and innovation by providing funding to SMEs and mid-market firms to help them scale up their operations. Reforms to the regulation of the non-bank lending sector will unlock billions of pounds of finance and ensure UK businesses have access to the capital they need to invest, grow and support job creation. We also highlight how the Government's commitment to Long-Term Asset Funds (LTAF), a UK Asset Holding Company (AHC) regime, and reforms to pension rules will support the ability of SMEs to invest, scale up and innovate.
- **Supporting UK-wide job creation in the fund management sector:** The Government is committed to levelling up economic prosperity, which will require the creation of new, well-paid jobs across the UK. We believe that the fund management industry is well placed to be a source of new jobs outside of London and the South East of England, particularly if the UK can position itself as a 'one-stop shop' for professional investor fund management. We also examine the way in which regulation and the tax framework can be adapted to make the UK a world-leader in terms of the sophistication of its regulatory environment, encouraging global firms to create jobs in the UK.

By taking steps to improve the flow of capital and create new employment, the UK would also be better placed to position itself as a leader in areas such as climate change and digital transformation.

We set out in the Annex to this paper a detailed list of specific points that should be addressed to make these ambitions a reality. We wish to continue to work with the Government to support these efforts.

ABOUT THE ALTERNATIVE INVESTMENT MANAGEMENT SECTOR

- **The UK is a global leader in financial services and its dynamic alternative investment management industry is the second largest in the world**, responsible for roughly 75% of the total assets under management in Europe.[1]
- **The alternative investment management sector contributes significantly to the UK economy**, with more than 500 hedge fund managers[2] supporting over 50,000 jobs[3] across the UK. Alternative investment managers currently lend over £100bn to more than 2,000 UK businesses, many of which are high-growth, innovative SMEs and mid-market businesses.[4]
- **Alternative investment managers adhere to the highest standards of regulation.** This includes capital requirements, conduct rules, risk management processes, stress testing and detailed requirements on reporting of data to the FCA and investors. The industry was able to demonstrate its resilience through the COVID-19 market disruption.
- **Maintaining the UK's attractiveness for investment managers and their investors in a post-Brexit and COVID-19 landscape will support the UK's economic prosperity.** As well as providing direct employment and tax receipts, the alternative investment management industry offers investors superior risk-adjusted returns, allows investors to diversify their portfolios and contributes to the efficient functioning of capital markets.
- **AIMA and the ACC are keen to work with policymakers to promote and develop the UK's alternative investment management and non-bank lending sectors** to renew the UK's position as the world's pre-eminent financial centre, boost innovation and SME financing and help build a better-regulated financial services industry. Our detailed policy vision and suggested proposals are set out in the following sections.

MORE ABOUT ALTERNATIVE INVESTMENT MANAGERS

Alternative investment managers differ from "traditional" investment managers – those who primarily invest in listed equities and bonds – in three core ways:

1 They can **invest more flexibly** to tailor risk exposures and provide returns that are not correlated with the trends of the broader markets. This provides investors with a level of **insurance against investment losses.**

2 They can **invest in non-traditional asset classes**, enabling investors to potentially get better returns for a given level of risk than they can from traditional investments. Access to these assets also provides for **greater diversification** across investors' broader portfolios.

3 They **typically serve institutional investors**, such as public and private pension funds, insurance companies and university endowments, rather than individual retail investors. By providing sophisticated investment solutions, alternative investment managers are **filling the "pensions gap"** for the UK's aging demographic.

1 Source: EuroHedge data.

2 Source: Preqin data.

3 https://www.aima.org/article/global-hedge-fund-industry-employs-nearly-400-000-people-up-a-third-since-2010.html.

4 Source: Preqin data and ACC research.

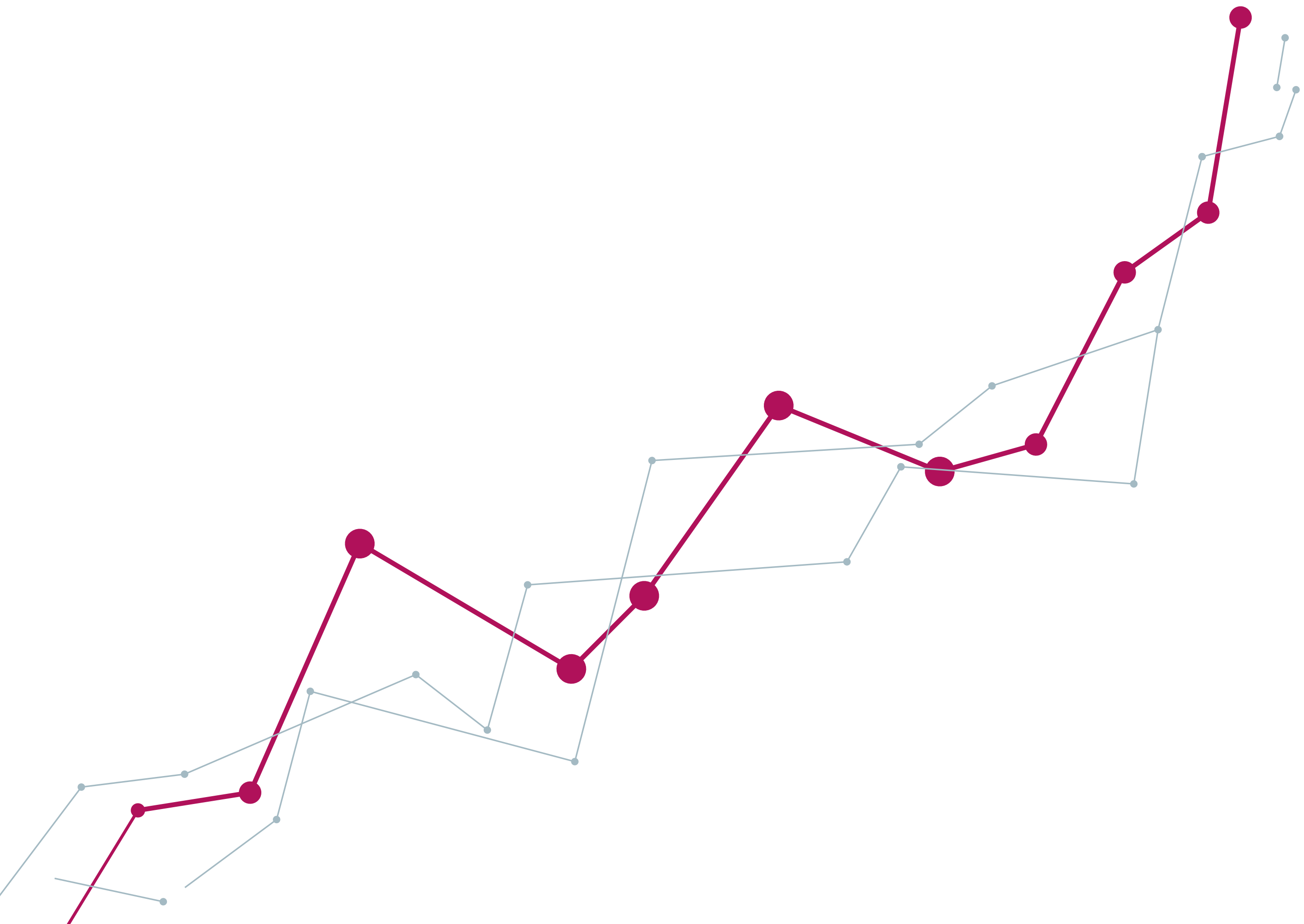
POLICY VISION

Supporting Growth and Innovation Across the Economy

THE CHALLENGE

The Government is committed to increasing economic growth and boosting productivity - ambitions that are particularly important as it seeks to guide the UK economy to recovery following the impact of COVID-19. The alternative investment sector is ready to play a key role in supporting UK growth and innovation by providing funding to SMEs and mid-market firms to help them scale up their operations. Many of these firms have struggled to access credit via traditional banks and reforms to the regulation of the non-bank lending sector could unlock billions of pounds of funding.

A thriving savings and pensions market is also important for UK growth by virtue of providing much-needed investment flows. However, the way that defined contribution (DC) pensions in the UK are currently invested, with heavy exposure to public equity markets, means that it can be difficult to invest in innovative projects and achieve the best possible returns on contributions.



SOLUTION 1: SUPPORT THE UK'S NON-BANK LENDING SECTOR

As vital providers of credit to high-growth UK SMEs and mid-market businesses, our members' lending has a disproportionately positive impact on the economy. These businesses created over half a million new jobs, compared to 191,000 by smaller businesses, between 2018-2019.[5] More than 60% of their lending is to the business and professional services, technology, media and telecommunications, or healthcare and life sciences sectors.[6] Businesses in these sectors help drive productivity, innovation and growth in line with the Government's broader agenda.

Supporting the development of new forms of financing and promoting the non-bank lending sector will boost the availability of capital to SMEs and mid-market companies as they recover from the impact of COVID-19. This will provide a new source of growth capital for companies that fall outside the risk appetite of traditional lenders despite being successful businesses. One impact of COVID-19 is that there is likely to be an increase in these types of borrowers, with losses from COVID-related lending likely to further reduce the capacity of the banking sector to provide credit. As well as being a source of new investment capital, UK private credit funds also provide borrowers with finance that is tailored to their business model, allowing UK businesses to compete in a global marketplace and support job creation and economic recovery.

AIMA and the ACC welcome the Chancellor's intention to facilitate new sources of capital for UK businesses and establish a UK Long-Term Asset Fund (LTAF). This will encourage pension funds and investors to diversify and access illiquid investments, such as private credit and infrastructure, and support levelling up across the UK. We are pleased to support the work of the Productive Finance Working Group in developing the LTAF to ensure that this is aligned with the needs of investors and supports greater investment in the UK economy. It is also necessary to provide credit managers with viable UK structuring options to support their investment strategies. A UK Asset Holding Company (AHC) regime suitable for credit investment strategies would enhance the UK's position as a leading hub for private credit managers and increase the UK's competitiveness with other investment fund domiciles. We commend HM Treasury's initiative to establish a UK AHC regime and its engagement with industry to date.

SOLUTION 2: REFORM PENSIONS RULES TO GRANT DC SCHEMES BETTER ACCESS TO ALTERNATIVE INVESTMENTS

Encouraging pension schemes to move towards alternative assets and strategies would better diversify their investments and improve returns, supporting better retirement income for UK savers. It would also mean better allocation of investment capital to the most productive and innovative businesses and opportunities across the UK.

5 https://neweconomy.bdo.co.uk/wp-content/uploads/2017/01/New-Economy-BDO-2018.pdf.

6 https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/corporate-finance/deloitte-uk-aldt-autumn-2020.pdf?nc=1.

Supporting UK-Wide Job Creation in the Fund Management Sector

THE CHALLENGE

The Government is committed to levelling up economic prosperity, which will require the creation of new, well-paid jobs across the UK. We believe that the fund management industry is well placed to be a source of new jobs outside of London and the South East of England, particularly if the UK can position itself as a 'one-stop shop' for professional investor fund management.

While many alternative investment managers are based in the UK, none of the professional investor funds that they manage are domiciled in the UK (outside of limited categories). This reflects the fact that the UK's current funds regime is overly complex, unattractive for non-UK resident investors and not targeted towards strategies solely intended for sophisticated and professional investors, such as those run by alternative investment fund managers. As a result, funds are instead domiciled in specialist funds jurisdictions within and outside of the EU, predominantly Ireland and Luxembourg. This increases costs and means that associated jobs servicing those funds are created outside of the UK, when they could instead be created across the UK.

At the same time, the UK's existing financial services regulatory framework and EU-derived reporting requirements for funds managed in the UK are not suited to the specific needs of the UK market, given that they are based on compromises made at the EU level. This stands as an obstacle to investment managers seeking to expand and do business in the UK and means that financial supervisors must base their oversight on inadequate data due to poorly designed reporting requirements.

Finally, addressing complexity and uncertainty in the tax framework would successfully promote the UK as an open, international and competitive place to do business, demonstrating that, post-Brexit, the UK is open for business.

SOLUTION 3: MODERNISE THE UK'S PROFESSIONAL INVESTOR FUNDS REGIME

AIMA and the ACC welcome the Government's call for input on reforming the UK's investment funds regime. We believe that the UK should introduce a series of flexible, suitably regulated and tax-neutral professional investor fund vehicles that can be available in corporate, limited partnership or other forms and be open or closed-ended. This would encourage the creation of new funds – and associated jobs in sectors that service those funds – in the UK.

SOLUTION 4: BUILD A BETTER-REGULATED FINANCIAL SERVICES INDUSTRY

A rethink of the scope and nature of rules for UK-managed funds would help ensure the market's long-term success, by ensuring that regulators have the data that they need and industry participants are not over-burdened by poorly conceived regulatory requirements. Domestic reform that is proportionate, principles-based, improves the quality of data provided to regulators and considers alignment with the US, where effective, would create a transparent and competitive regulatory environment that encourages innovation and facilitates cooperation between supervisory authorities globally. The process to develop regulatory guidance should be swift, transparent and consultative, with opportunities for industry participants to raise questions of interpretation. In the Annex, we address: the broad regulatory framework; reporting rules; and specific deficiencies in existing rules. We believe that the UK can adapt its rules while still seeking equivalence at EU level by focusing on the consistency of the outcomes achieved through the respective regulatory regimes.

SOLUTION 5: MAINTAIN A TAX SYSTEM THAT MAKES THE UK AN ATTRACTIVE PLACE TO DO BUSINESS

Removing elements of UK tax law that are unnecessary or burdensome while retaining those that contribute to a well-functioning tax system would ensure that the UK remains an attractive jurisdiction for investment managers to set up and expand, while also supporting investment that will be necessary for growth and innovation. In future, elements of the tax framework relevant to financial services should be considered in a more centralised, less siloed manner.

TECHNICAL PROPOSALS

SUPPORT THE UK'S NON-BANK LENDING SECTOR

AREA OF FOCUS	PROPOSALS	DISCUSSION
UK LTAF ! **HIGH PRIORITY**	Introduce a UK Long-Term Asset Fund (LTAF) regime.	The LTAF would be a new fund structure allowing wider access to illiquid assets such as infrastructure and private companies. It would be authorised by regulatory authorities and subject to investor protection requirements to ensure that it would be open to a range of investors, including retail investors. A well designed LTAF regime aligned with the needs of investors can support greater credit and equity investments in non-listed businesses, reduce the SME finance gap and provide DC pension schemes and retail investors with an effective way to access private markets. Despite the substantial growth of capital allocated to private credit and lending strategies by asset managers and their investors during the last decade there are currently very few options for retail investors to invest in these strategies. Introducing a UK LTAF will address this gap and create a new source of capital for UK businesses while also helping savers and pensioners access investments that are currently unavailable to them. UK LTAFs have the potential to replicate the success of US Business Development Companies (BDCs), which currently facilitate more than $100bn of capital investment into the US economy.[6] The primary beneficiaries of this investment are small and mid-sized US businesses. A well designed LTAF regime could provide UK businesses with similar levels of support while also providing savers with the opportunity to diversify their investments and potentially achieve higher returns. The design of the LTAF will be crucial to its success. We are pleased to support the Productive Finance Working Group convened by the Bank of England, HM Treasury and Financial Conduct Authority in its work on the LTAF .

6 Source: Houlihan Lokey.

AREA OF FOCUS	PROPOSALS	DISCUSSION
Creation of a UK AHC regime	Introduce legislation governing an Asset Holding Company (AHC) regime.	AHCs are companies used as intermediate entitites in investment fund structures to facilitate the flow of capital, income and gains between investors and underlying investments. There are many commercial drivers to the use of AHCs, including segregation of assets and funding and borrowing flexibility. Many private credit managers carry out their portfolio management function in the UK and a substantial amount of their European private credit lending involves UK businesses. However, many choose to use non-UK funds or AHCs to facilitate these investments. The introduction of an AHC regime suitable for credit assets would be attractive to many private credit managers and support additional UK-based activity around the administration and management of these entities. AIMA and the ACC encourage the UK to build an AHC regime based on the following key principles: • Provide a framework that is designed to preserve tax neutrality for underlying investors in private investment funds; • Make the UK regime competitive with existing regimes; • Ensure the regime is and will remain compatible with developing OECD standards; and • Treat the AHC regime as a building block to developing a comprehensive onshore regime for investment funds more generally that provides a flexible framework for the variety of private fund investment strategies that minimizes complexity and promotes tax neutrality for underlying investors. Regarding entry criteria for the regime, we suggest that the credit AHC be entirely held by qualifying investors and, where relevant, qualifying management. The introduction of the UK AHC should be regarded as an integral part of the modernisation of the UK funds and investment management sectors. Developing appropriate UK based fund structures that work with UK AHCs will encourage additional activities to be undertaken in the UK and should be included within the scope of the review of the UK funds regime previously announced by the Chancellor.

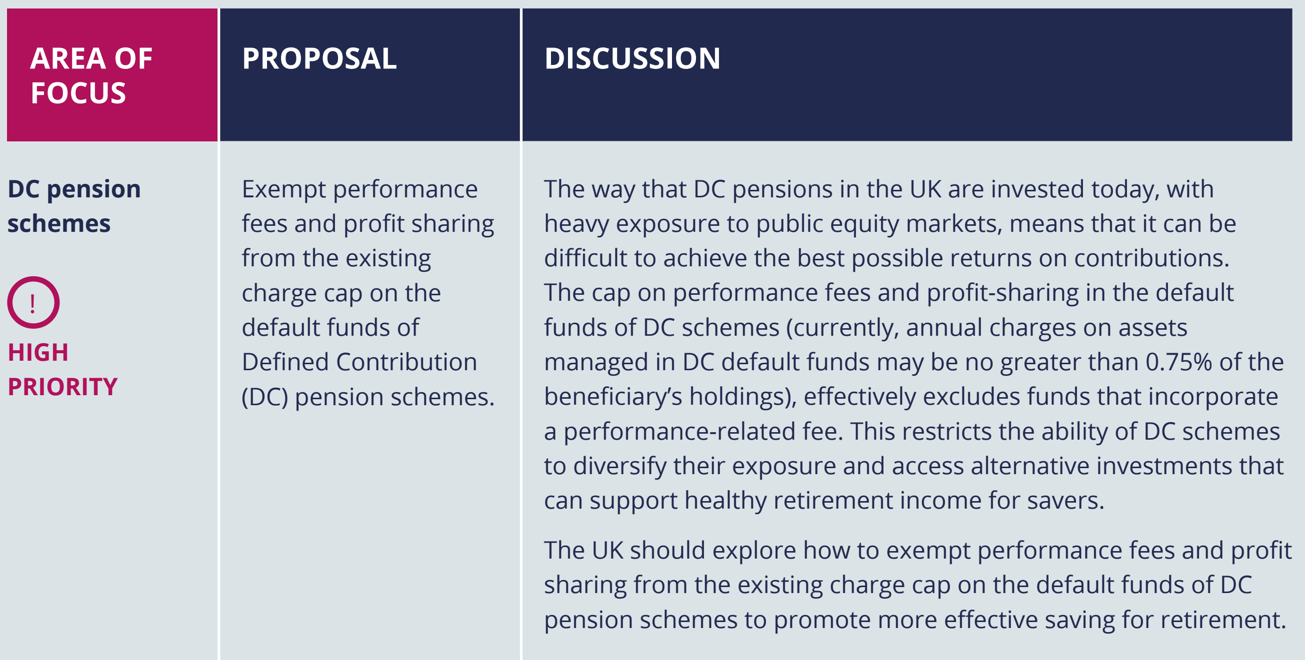
TECHNICAL PROPOSALS

AREA OF FOCUS	PROPOSALS	DISCUSSION
Securitisation	Modernise the UK securitisation rules to enhance the regime and support the UK's competitiveness.	Securitisation is the financial practice of pooling various illiquid assets, such as mortgages or loans, and selling their related cash flows to third-party investors as securities. Securitisation is an essential means by which capital markets support the flow of finance to the economy. There are several areas of the current securitisation regime which could be enhanced through targeted prudentially sound amendments and the adoption of more proportionate disclosure requirements. Particular focus should be given to improving the disclosure requirements for private securitisations and Collateralised Loan Obligation (CLO) transactions. Enhancing the securitisation regime to better align with established industry practices for CLOs and private securitisations will strengthen the connection between capital markets and the real economy. Both play an integral part in the financing of corporate borrowers and help ensure that borrowers can obtain competitive costs of financing. Differentiating the disclosure requirements and the use of no data fields for private CLO transactions and SME loans to better align with established industry practices would support a more efficient market. This would increase the flow of capital to businesses without posing greater risks to investors.
	Clarify securitisation requirements for Alternative Investment Fund Managers ("AIFMs")	When it became effective, the Alternative Investment Fund Managers Directive (2011/61/EU) (the "AIFMD") contained an article - Article 17 - focused on investments in securitisation transactions and empowered the European Commission to adopt certain additional provisions as part of a delegated regulation. When the EU's Securitisation Regulation was adopted subsequently, the provisions of the delegated regulation that corresponded to Article 17 of the AIFMD were not removed although the text of Section 17 authorising those provisions of the delegated regulation was deleted. This has created uncertainty regarding the interaction between the two pieces of legislation and requirements on asset managers involved in securitisation. The UK should specifically remove those requirements from the onshored version of the delegated regulation to clarify that they no longer apply. In addition, the UK should clarify that non-UK AIFMs and sub-threshold UK AIFMs are not intended to be included in the definition of 'institutional investors' for purposes of the due diligence requirements as they were not previously subject to the due diligence requirements imposed by Section 17 of the AIFMD.

AREA OF FOCUS	PROPOSALS	DISCUSSION
Securitisation	STS certification for CLOs.	The EU's Securitisation Regulation has applied from 2019 and introduced a kitemark for "simple, transparent and standardised" (STS) securitisations. We believe this designation should be open to CLOs and NPLs where appropriate. Due to the tranching involved, CLOs fall within the remit of the Securitisation Regulation, but they are not eligible for STS certification as they are deemed to be 'actively managed' for the purposes of the Regulation. CLOs should, however, be considered eligible for STS certification for several reasons: • CLO managers are required to comply with standardised tests and criteria prescribing how the CLO should be managed rather than on a solely discretionary basis; • CLO managers typically report details of trading of underlying exposures in the context of the CLO manager's management responsibilities, providing investors with transparency; • The subordination of a proportion of the CLO manager's fees incentivises strong performance of the CLO transaction and aligns the CLO manager's interest with their investors; and • The strong performance of highly rated UK/European managed CLOs during the past decade demonstrates the resilience of the structure. The exclusion of CLOs from the STS framework acts as a brake on the provision of finance to borrowers, while also limiting the ability of banks to de-leverage their balance sheets. We would urge policymakers to amend the STS criteria to encompass transactions where active management can only occur within the portfolio criteria established by the CLO manager and their investors. This would align with the Securitisation Regulation's existing requirements for new exposures into revolving pools to meet the initial eligibility criteria and for proven servicer experience level.

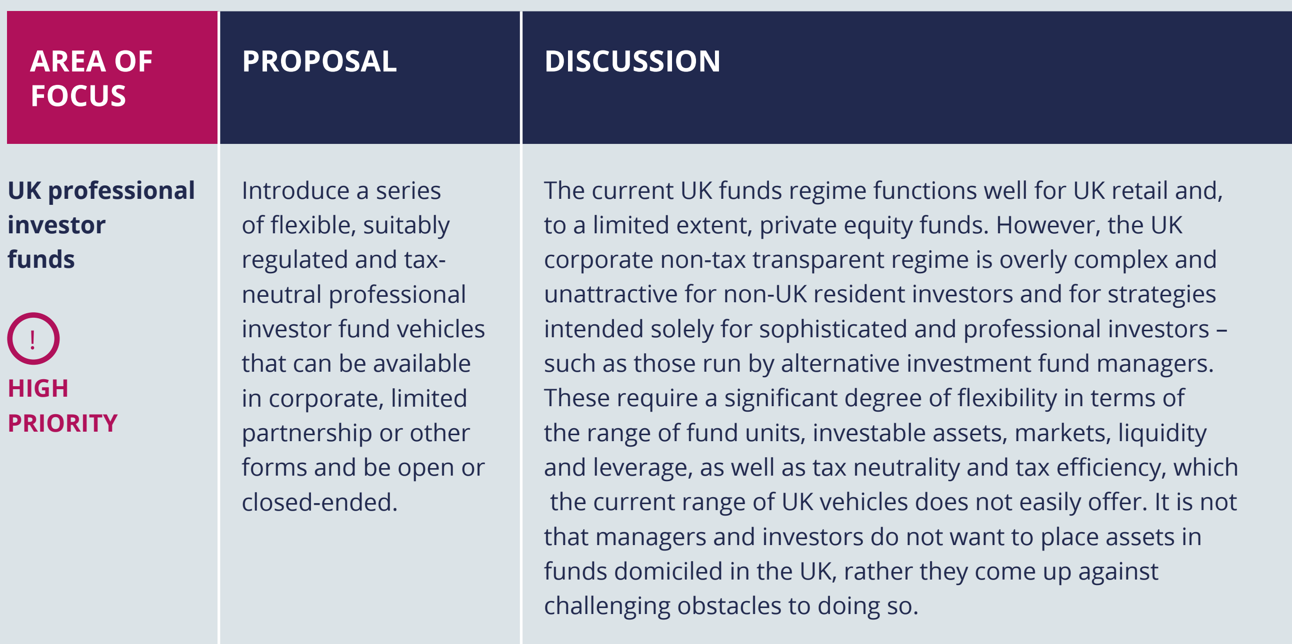
TECHNICAL PROPOSALS

REFORM PENSIONS RULES TO GRANT DC SCHEMES BETTER ACCESS TO ALTERNATIVE INVESTMENTS



AREA OF FOCUS	PROPOSAL	DISCUSSION
DC pension schemes ! HIGH PRIORITY	Exempt performance fees and profit sharing from the existing charge cap on the default funds of Defined Contribution (DC) pension schemes.	The way that DC pensions in the UK are invested today, with heavy exposure to public equity markets, means that it can be difficult to achieve the best possible returns on contributions. The cap on performance fees and profit-sharing in the default funds of DC schemes (currently, annual charges on assets managed in DC default funds may be no greater than 0.75% of the beneficiary's holdings), effectively excludes funds that incorporate a performance-related fee. This restricts the ability of DC schemes to diversify their exposure and access alternative investments that can support healthy retirement income for savers. The UK should explore how to exempt performance fees and profit sharing from the existing charge cap on the default funds of DC pension schemes to promote more effective saving for retirement.

MODERNISE THE UK'S PROFESSIONAL INVESTOR FUNDS REGIME



AREA OF FOCUS	PROPOSAL	DISCUSSION
UK professional investor funds ! HIGH PRIORITY	Introduce a series of flexible, suitably regulated and tax-neutral professional investor fund vehicles that can be available in corporate, limited partnership or other forms and be open or closed-ended.	The current UK funds regime functions well for UK retail and, to a limited extent, private equity funds. However, the UK corporate non-tax transparent regime is overly complex and unattractive for non-UK resident investors and for strategies intended solely for sophisticated and professional investors – such as those run by alternative investment fund managers. These require a significant degree of flexibility in terms of the range of fund units, investable assets, markets, liquidity and leverage, as well as tax neutrality and tax efficiency, which the current range of UK vehicles does not easily offer. It is not that managers and investors do not want to place assets in funds domiciled in the UK, rather they come up against challenging obstacles to doing so.

BUILD A BETTER-REGULATED FINANCIAL SERVICES INDUSTRY: BROAD CONSIDERATIONS

AREA OF FOCUS	PROPOSALS	DISCUSSION
UK implementation of the Investment Firm Prudential Regime (IFPR) ! **HIGH PRIORITY**	Maintain existing judgements on appropriate proportionality in remuneration.	The UK is currently assessing how to implement requirements that derive from new EU prudential rules for investment firms (Investment Firms Regulation/Directive; IFRD). With respect to the IFPR remuneration requirements, we would urge the UK to maintain the current interpretations of proportionality which determine when firms can disapply rules relating to retention, deferral, performance adjustment and the ratio between fixed and variable remuneration. We believe the current approach is more appropriately suited to the nature, scale and activities of UK asset managers affected by IFPR. It is not in the interests of the UK to replicate the more stringent IFR/D remuneration requirements which could place the UK asset management industry at a competitive disadvantage with other global investment management jurisdictions.

TECHNICAL PROPOSALS

AREA OF FOCUS	PROPOSALS	DISCUSSION
UK AIFMD framework	Do not adjust pre-marketing guidance in effect today in light of the EU's cross-border distribution of investment funds package.	Our understanding is that the UK is not intending to transpose/ implement the cross-border distribution of investment funds package that takes effect in August 2021 at EU level. We believe this is an appropriate decision in light of Brexit. One of the central features of the EU's new rules is to require member states to permit fund managers to gauge interest in new and potential funds (i.e. pre-marketing) before they are required to take the additional regulatory steps associated with marketing in that member state. The FCA Handbook has permitted pre-marketing as part of the FCA's perimeter guidance for years and addresses pre-marketing in a more thorough way than the new EU requirements. In the event that consideration is being given to potential changes to the UK's pre-marketing requirements in light of the EU's new requirements, we would like to register our opposition to any such changes on the grounds that the current FCA requirements are appropriately gauged and pre-marketing permissiveness in the UK in no way impacts on the EU. Moreover, the FCA's pre-marketing requirements have helped to assure that UK investors have access to the investment products they want without increasing the FCA's burden with regulatory filings about funds UK investors do not want.
	Provide a more proportionate approach for smaller managers.	Given the UK's robust approach to financial regulation, most industry participants expect that the UK framework will remain similar to the AIFMD (rather than creating a lighter-touch framework for firms that focus on UK domestic client business and/or on the rest of the world other than the EU). While a parallel regulatory approach might benefit some firms, it could create the unattractive prospect for firms pursuing a global business plan of having to comply with two UK regimes simultaneously, increasing complexity and costs of compliance for these firms. We do, however, see a strong case for more proportionate rules for smaller firms based on the nature, size and complexity of their operations. This would require a cross-cutting analysis of existing requirements but could substantially ease barriers to entry and attract new entrants to the UK market. A concrete example here would be the requirements for functional and hierarchal separation of risk management, which creates a structural requirement for start-up managers to have to hire a separate risk manager from Day 1. This is a significant cost for small managers in terms of fixed expenses and increased capital requirements. A more proportionate approach would reduce barriers to entry.

AREA OF FOCUS	PROPOSALS	DISCUSSION
UK AIFMD framework	Do not require depositary lite services for UK AIFMs.	Prior to Brexit, AIFMs domiciled or having the registered office in the EEA (“EEA AIFMs”), a group which included UK AIFMs, were required to ensure that any alternative investment funds (“AIFs”) domiciled or with their registered office outside the EEA (“non-EEA AIFs”) appointed a provider to perform a sub-set of the duties required for a depositary of an AIF domiciled or with its registered office in the EEA (the “depositary lite requirement”) before the non-EEA AIF could be marketed in any member state. Under the onshored AIFMD requirements at Regulation 59 of the UK Alternative Investment Fund Managers Regulations 2013 (“AIFMR”), as amended, post-Brexit UK AIFMs that want to market non-UK AIFs in the UK are still subject to the depositary lite requirement, however, the AIFMD’s depositary lite requirement no longer applies when the UK AIFM wants to market that non-UK AIF in the EEA. Nor does the depositary lite requirement apply any longer to EEA AIFMs that want to market non-EEA AIFs in the UK. AIFMs domiciled or with their registered office outside the UK and outside the EU were never subject to a depositary lite requirement. As a result, UK AIFMs are at a competitive disadvantage as their non-UK AIFs will always be more costly to run due to the additional requirements. We believe this competitive disadvantage should be removed. We are not suggesting, however, that the types of responsibilities and duties undertaken as a result of the depositary lite requirement should not be carried out, but rather that the requirements should be aligned to allow greater operational flexibility as to how these are carried out.

TECHNICAL PROPOSALS

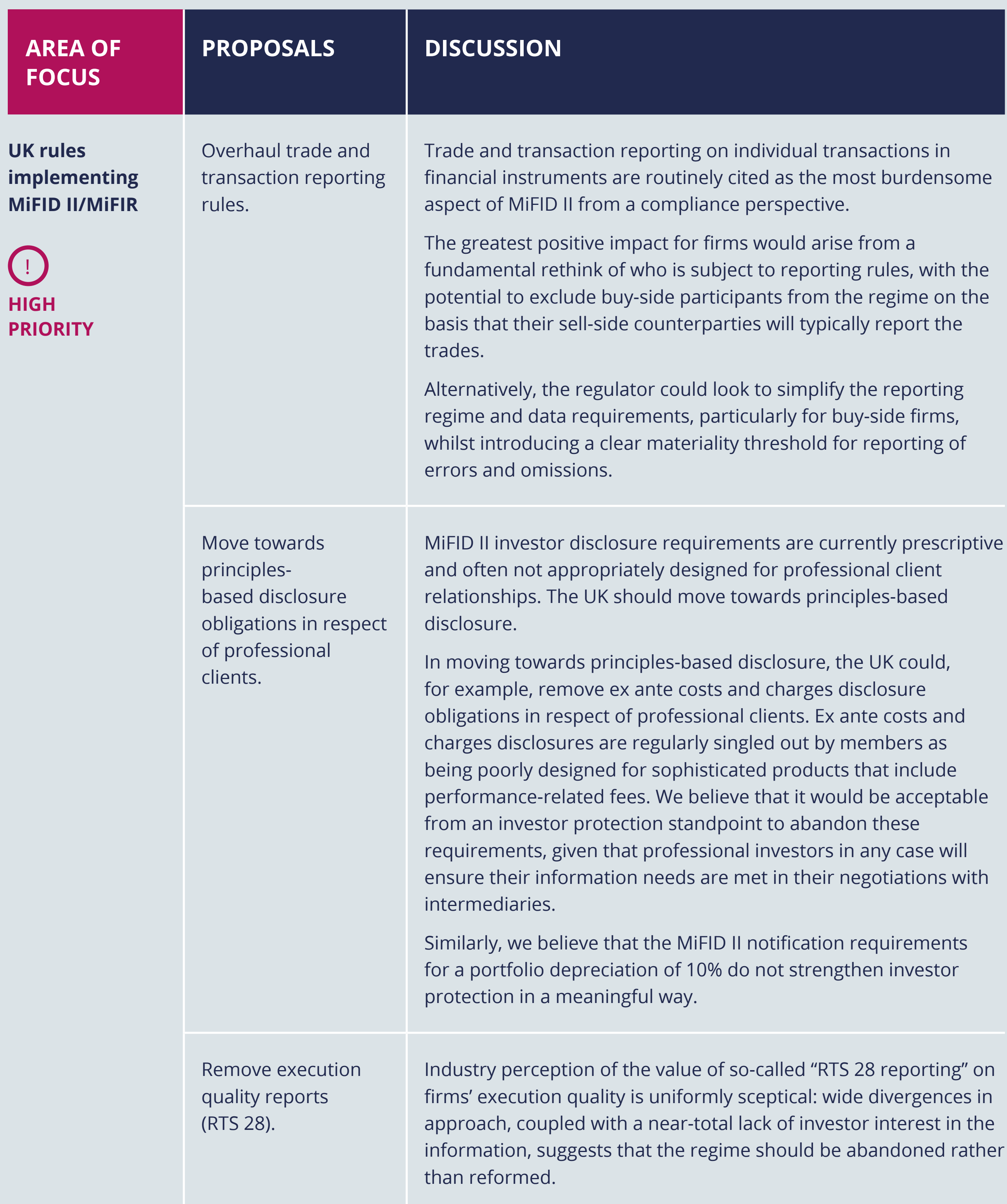
AREA OF FOCUS	PROPOSALS	DISCUSSION
UK rules implementing MiFID II/MiFIR	Build a more accommodating client classification framework.	Rules on client classification are an important determinant of which investors professional fund managers are able to provide services to. We believe the existing client categorisation framework that derives from MiFID II could be helpfully modified to give 'semi-professional' investors greater ability to access more sophisticated products and to better accommodate the staff of firms who offer or require co-investment (often to meet regulatory requirements on alignment of interests). We have suggested the following in the context of European work to review MiFID II: • Adding to the list of professional clients natural and personals and non-institutional investors with a committed investment amount of EUR 5,000,000. • Adding to the list of professional clients identified risk takers and other employees of the firm making the classification decision. • Adding to the list of elective professional clients those clients with a committed investment amount with the investment firm of at least EUR 100,000. • Amending the opt-up process for elective professionals so that only one of the tests of MiFID Annex II.1 must be met (while maintaining the qualitative test of the third sub paragraph in Annex II.1). The benefits of building a more accommodating client classification framework should materialise as the approach leads to a wider range of investment mandates over time.
UK rules implementing MiFID II/MiFIR	Replace the existing commodity derivatives position limit framework with a clear, harmonised position management framework at the level of trading venues.	The MiFID II position limits framework (that governs the size of positions that firms can take with respect to commodity derivatives) is largely ineffectual in that it does little to support proper market functioning, but does stifle contractual innovation, while creating an ongoing monitoring burden for firms that must track the size of their portfolio relative to limits. Creating a new regime centred on exchanges' position management controls would reduce the compliance burden on commodity market participants and foster innovation, without compromising market soundness. Any complexity for firms in not being able to implement a single monitoring framework for commodities trading is likely to be outweighed by the positive impact associated with transferring monitoring duties to venues.

AREA OF FOCUS	PROPOSALS	DISCUSSION
	Amend data provision rules.	There is broad recognition at European level that the existing MiFID II rules on data provision by trading venues have failed to address the excessive cost of market data that shuts smaller firms out of the market and disincentivises firms that might be considering expanding the range of instruments that they trade (noting the central importance of trade data in the context of designing an investment strategy and fulfilling regulatory reporting obligations). The UK should support and reflect changes proposed by ESMA to ensure that data is provided on a reasonable commercial basis by: • Creating a published production cost benchmark; • Standardising cost disclosures; and • Taking a more assertive supervisory stance vis-à-vis trading venues when it comes to their pricing schedules for market data. This would have a strong positive impact for firms that obtain market data from UK trading venues.

TECHNICAL PROPOSALS

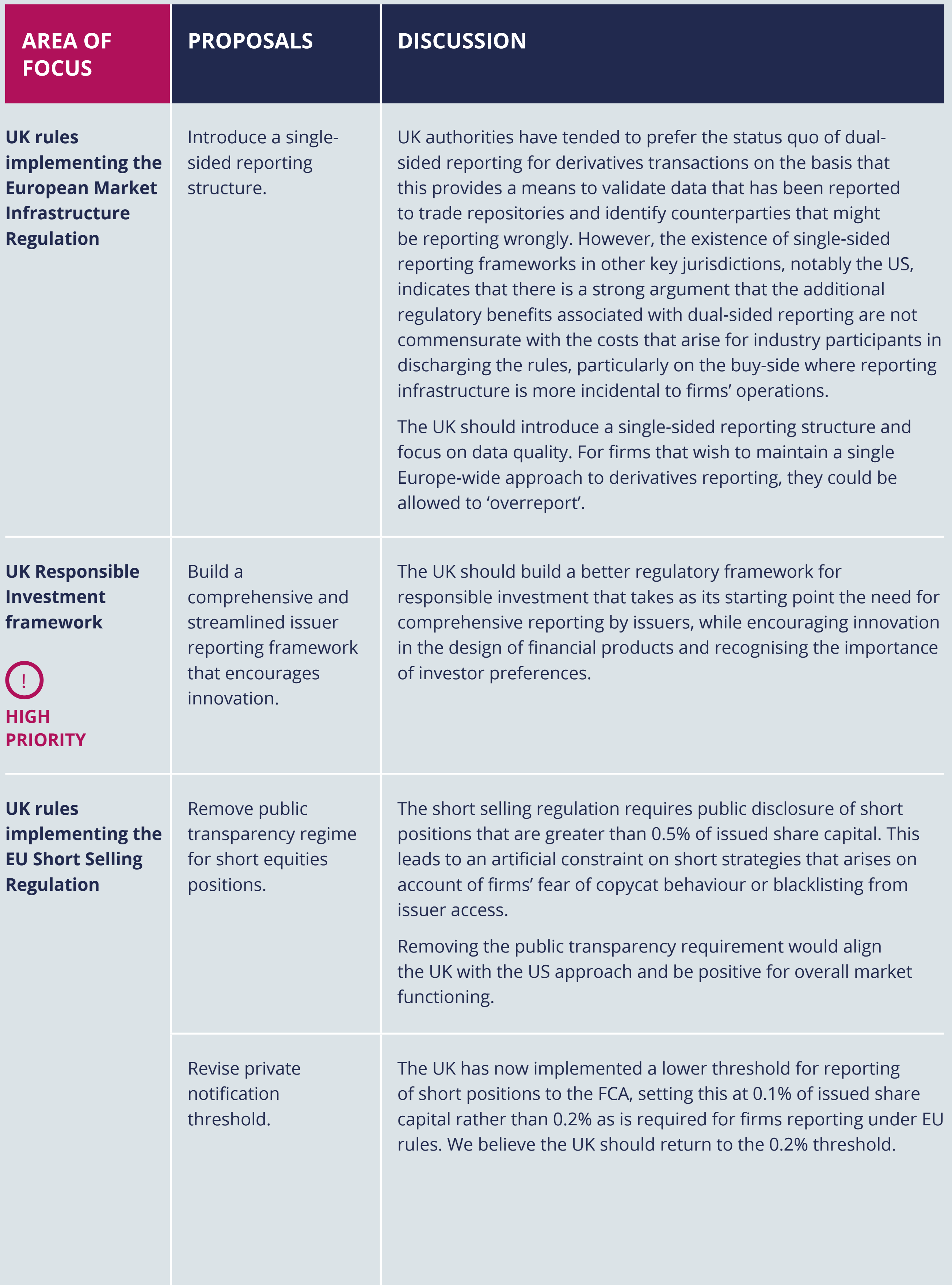
BUILD A BETTER-REGULATED FINANCIAL SERVICES INDUSTRY: REGULATORY REPORTING FOR FUNDS MANAGED IN THE UK

AREA OF FOCUS	PROPOSALS	DISCUSSION
UK AIFMR framework HIGH PRIORITY	Revisit the scope and nature of the risk reporting requirements applicable to AIFMs.	The UK should revisit the regulatory reporting requirements for AIFMs to better understand systemic risks posed by AIFs and to be able to better implement the recently agreed IOSCO approach to assessing leverage and systemic risk in investment funds which would involve first reviewing the data on an asset class by asset class basis to allow the FCA to distinguish between AIFs with exposure to higher risk assets and those with exposure to lower risk assets and only then selecting AIFs for further risk assessment. We have previously provided HM Treasury and the FCA our comments made to the European Commission, ESMA and other European stakeholders with respect to potential changes to the template used to collect data about an AIF's leverage, liquidity profile and other potential systemic risks. We believe this to be the minimum level of change required but would encourage HM Treasury and the FCA to be more ambitious. The UK should consider alignment with US regulators on matters such as systemic risk reporting reviews and leverage measurements as appropriate given US market share and dominance of a combined US/UK position.
	Reconsider leverage cap setting and disclosure.	AIFMR requires managers to set limits on the amount of leverage managers employ. Currently there is little guidance about how managers should set their leverage limits and how the FCA will approach the level setting from an approvals standpoint. AIMA members have noted that it is easy to accidentally exceed artificially set levels, and this leads to managers selecting and disclosing a limit that is significantly higher than normal levels of leverage in the fund. Investors would benefit more from a disclosure rule that requires periodic disclosures of actual levels of leverage and the obligation to provide the then-current level of leverage to investors upon their request.



AREA OF FOCUS	PROPOSALS	DISCUSSION
UK rules implementing MiFID II/MiFIR ! HIGH PRIORITY	Overhaul trade and transaction reporting rules.	Trade and transaction reporting on individual transactions in financial instruments are routinely cited as the most burdensome aspect of MiFID II from a compliance perspective. The greatest positive impact for firms would arise from a fundamental rethink of who is subject to reporting rules, with the potential to exclude buy-side participants from the regime on the basis that their sell-side counterparties will typically report the trades. Alternatively, the regulator could look to simplify the reporting regime and data requirements, particularly for buy-side firms, whilst introducing a clear materiality threshold for reporting of errors and omissions.
	Move towards principles-based disclosure obligations in respect of professional clients.	MiFID II investor disclosure requirements are currently prescriptive and often not appropriately designed for professional client relationships. The UK should move towards principles-based disclosure. In moving towards principles-based disclosure, the UK could, for example, remove ex ante costs and charges disclosure obligations in respect of professional clients. Ex ante costs and charges disclosures are regularly singled out by members as being poorly designed for sophisticated products that include performance-related fees. We believe that it would be acceptable from an investor protection standpoint to abandon these requirements, given that professional investors in any case will ensure their information needs are met in their negotiations with intermediaries. Similarly, we believe that the MiFID II notification requirements for a portfolio depreciation of 10% do not strengthen investor protection in a meaningful way.
	Remove execution quality reports (RTS 28).	Industry perception of the value of so-called “RTS 28 reporting” on firms’ execution quality is uniformly sceptical: wide divergences in approach, coupled with a near-total lack of investor interest in the information, suggests that the regime should be abandoned rather than reformed.

TECHNICAL PROPOSALS



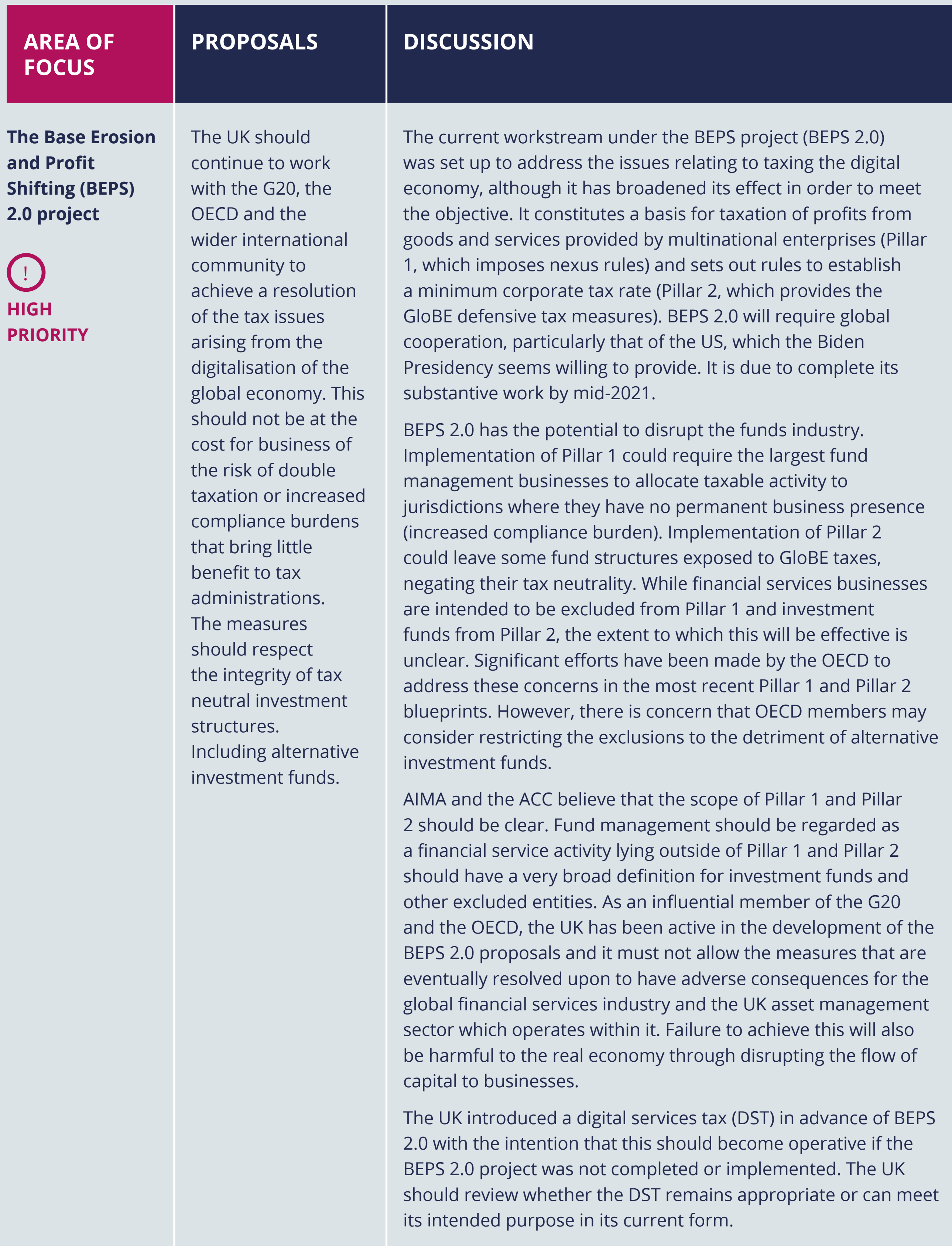
AREA OF FOCUS	PROPOSALS	DISCUSSION
UK rules implementing the European Market Infrastructure Regulation	Introduce a single-sided reporting structure.	UK authorities have tended to prefer the status quo of dual-sided reporting for derivatives transactions on the basis that this provides a means to validate data that has been reported to trade repositories and identify counterparties that might be reporting wrongly. However, the existence of single-sided reporting frameworks in other key jurisdictions, notably the US, indicates that there is a strong argument that the additional regulatory benefits associated with dual-sided reporting are not commensurate with the costs that arise for industry participants in discharging the rules, particularly on the buy-side where reporting infrastructure is more incidental to firms' operations. The UK should introduce a single-sided reporting structure and focus on data quality. For firms that wish to maintain a single Europe-wide approach to derivatives reporting, they could be allowed to 'overreport'.
UK Responsible Investment framework ! **HIGH PRIORITY**	Build a comprehensive and streamlined issuer reporting framework that encourages innovation.	The UK should build a better regulatory framework for responsible investment that takes as its starting point the need for comprehensive reporting by issuers, while encouraging innovation in the design of financial products and recognising the importance of investor preferences.
UK rules implementing the EU Short Selling Regulation	Remove public transparency regime for short equities positions.	The short selling regulation requires public disclosure of short positions that are greater than 0.5% of issued share capital. This leads to an artificial constraint on short strategies that arises on account of firms' fear of copycat behaviour or blacklisting from issuer access. Removing the public transparency requirement would align the UK with the US approach and be positive for overall market functioning.
	Revise private notification threshold.	The UK has now implemented a lower threshold for reporting of short positions to the FCA, setting this at 0.1% of issued share capital rather than 0.2% as is required for firms reporting under EU rules. We believe the UK should return to the 0.2% threshold.

BUILD A BETTER-REGULATED FINANCIAL SERVICES INDUSTRY: ADDRESSING UNNECESSARY REGULATORY COMPLEXITY

AREA OF FOCUS	PROPOSALS	DISCUSSION
UK AIFMD framework	Remove regulatory complexity created by FUND 1.4.3.R.	Given the trend towards consistency of regulatory outcomes regardless of how a firm is authorised, we suggest expanding the list of MiFID II regulated activities a UK AIFM may undertake to be the same as the activities that can be undertaken by an investment firm subject to the MiFID II requirements (“MiFID Activities”) and repealing the requirement that a UK AIFM must have a permission for collective portfolio management before it can have a permission for any of the other activities UK AIFMs may undertake.
	Improve own funds interpretations.	A number of technical adjustments could improve the calculation of own funds with respect to AIFMs. For example, the ability to net positions would help own funds calculations better reflect actual risks. We would also suggest reconsidering whether professional indemnity insurance ought to sit within the prudential requirements for AIFMs.
	Remove asset stripping protections.	Existing UK company law covers the types of protections provided for in the asset stripping protections of the AIFMD. As a result, these duplicative provisions can and should be removed to remove unnecessary regulatory complications.
UK rules implementing MiFID II/MiFIR	Refine the MiFID II Share Trading Obligation (STO).	The STO sets obligations for firms to trade certain securities on trading venues or through brokers that are designated as systematic internalisers under MiFID due to the scale of their brokerage activities. Given the potential for clash between the respective EU/UK STO obligations, we believe that the UK should limit the scope of its obligation to shares with UK ISINs and should take a permissive approach to which venues, including those in the EU, can be used to satisfy the obligation (reflecting the approach taken by the FCA using its Temporary Transitional Power).

TECHNICAL PROPOSALS

MAINTAIN A TAX SYSTEM THAT MAKES THE UK AN ATTRACTIVE PLACE TO DO BUSINESS



AREA OF FOCUS	PROPOSALS	DISCUSSION
The Base Erosion and Profit Shifting (BEPS) 2.0 project ! HIGH PRIORITY	The UK should continue to work with the G20, the OECD and the wider international community to achieve a resolution of the tax issues arising from the digitalisation of the global economy. This should not be at the cost for business of the risk of double taxation or increased compliance burdens that bring little benefit to tax administrations. The measures should respect the integrity of tax neutral investment structures. Including alternative investment funds.	The current workstream under the BEPS project (BEPS 2.0) was set up to address the issues relating to taxing the digital economy, although it has broadened its effect in order to meet the objective. It constitutes a basis for taxation of profits from goods and services provided by multinational enterprises (Pillar 1, which imposes nexus rules) and sets out rules to establish a minimum corporate tax rate (Pillar 2, which provides the GloBE defensive tax measures). BEPS 2.0 will require global cooperation, particularly that of the US, which the Biden Presidency seems willing to provide. It is due to complete its substantive work by mid-2021. BEPS 2.0 has the potential to disrupt the funds industry. Implementation of Pillar 1 could require the largest fund management businesses to allocate taxable activity to jurisdictions where they have no permanent business presence (increased compliance burden). Implementation of Pillar 2 could leave some fund structures exposed to GloBE taxes, negating their tax neutrality. While financial services businesses are intended to be excluded from Pillar 1 and investment funds from Pillar 2, the extent to which this will be effective is unclear. Significant efforts have been made by the OECD to address these concerns in the most recent Pillar 1 and Pillar 2 blueprints. However, there is concern that OECD members may consider restricting the exclusions to the detriment of alternative investment funds. AIMA and the ACC believe that the scope of Pillar 1 and Pillar 2 should be clear. Fund management should be regarded as a financial service activity lying outside of Pillar 1 and Pillar 2 should have a very broad definition for investment funds and other excluded entities. As an influential member of the G20 and the OECD, the UK has been active in the development of the BEPS 2.0 proposals and it must not allow the measures that are eventually resolved upon to have adverse consequences for the global financial services industry and the UK asset management sector which operates within it. Failure to achieve this will also be harmful to the real economy through disrupting the flow of capital to businesses. The UK introduced a digital services tax (DST) in advance of BEPS 2.0 with the intention that this should become operative if the BEPS 2.0 project was not completed or implemented. The UK should review whether the DST remains appropriate or can meet its intended purpose in its current form.

AREA OF FOCUS	PROPOSALS	DISCUSSION
UK approach to VAT on financial services ! **HIGH PRIORITY**	The VAT treatment of fund management services - and of financial services generally - should be reviewed to ensure that the industry is competitive globally.	The Government has announced a review of VAT and fund management in conjunction with its review of the UK funds sector as well as a broader review of VAT and financial services. Because of the structure of the EU VAT system, a delicate balance has been created between the treatment of funds offered in the UK retail market (the special investment fund (SIF) exemption) and those for investors outside the UK (outside the scope with recovery of input tax (OSR)). This has enabled UK managers of alternative investment funds to operate on the same terms as managers in other jurisdictions. Any move to extend the SIF exemption would not be levelling the playing field as these are two separate markets. It would disadvantage the UK management of offshore funds. It will also be necessary to resolve the VAT treatment of fund management services provided to the Government's proposed range of UK professional investor funds. These funds will be competing with equivalent offshore funds, not funds within the UK retail market, so that an OSR treatment rather than the SIF exemption would assist the UK's competitive position.
UK approach to taxation of investment management businesses	Review and simplify the multiple tax regimes which apply to asset management businesses, particularly those operating as limited liability partnerships (LLPs).	The Government should ensure that there is a clear and stable tax environment for UK businesses, their owners and employees which is competitive with other asset management jurisdictions. Individuals working in the fund management industry (especially those who are 'partners' in a LLP) are subject to a variety of tax regimes. These include salaried member rules, mixed member rules, disguised investment management fees rules, carried interest rules, income-based carried interest rules and other partnership tax changes. The measures have become excessive and duplicative so that they increase the compliance burden for businesses setting up and operating in the UK. They do not meet the requirements of simplicity and certainty that the UK should offer and deter businesses from choosing the UK as an operating location.

ABOUT AIMA

The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

ABOUT THE ACC

The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 200 members that manage over $450bn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business.

The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

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