Overview: what we’ll cover today

- When regulation makes headline news…..
- Part 1: overview of three regulatory regimes
- Part 2: summary of how key rules apply, including UK gold-plating
- Part 3: regulatory arbitrage? (…or evaluating choices between the models)
- Q&A
Part 1

Three regulatory regimes
MiFID2 vs AIFMD vs UCITS

- UK investment managers could be authorised under **MiFID** or **AIFMD** or **UCITS**, depending on the scope of their activities

  1. **UK MiFID firm**: firm authorised under the Markets in Financial Instruments Directive to perform one or more investment services, including portfolio management
     - *Example*: UK sub-investment manager to a US investment manager

  2. **UK AIFM**: firm authorised under the Alternative Investment Fund Managers Directive to act as an alternative investment fund manager
     - *Example*: UK investment manager to a Cayman fund

  3. **UK UCITS ManCo**: firm authorised under the UCITS Directive to act as management company to a regulated UCITS fund
     - *Example*: UK ManCo to an Irish UCITS fund

- It’s possible also to **combine permissions** – see next slide
Top-up permission and combining permissions

- Other rules impact on the permitted activities of a fund manager

- A MiFID firm **cannot** be an AIFM or a UCITS ManCo

- An AIFM or a UCITS ManCo can also elect to have **additional permission** to perform certain limited MiFID-style activities (**“top-up”**)  
  - includes portfolio management, investment advice, and reception and transmission of orders  
  - but **cannot** carry on execution of orders or dealing on own account  
  - additional permissions do **not** re-characterise the fund manager as MiFID firm

- An AIFM can also be authorised as a UCITS ManCo (**“SuperManCo”**)  

- A SuperManCo can have top-up MiFID-style permissions  

- Putting all of these principles together…..
The full range of models

- UK fund manager can be authorised in at least seven different ways:
  1. MiFID investment firm *
  2. “Pure” AIFM (AIFM without MiFID top-up permissions) *
  3. AIFM with top-ups (AIFM with MiFID top-up permissions) *
  4. “Pure” UCITS ManCo (ManCo without MiFID top-up permissions)
  5. UCITS ManCo with top-ups (ManCo with MiFID top-up permissions) *
  6. “SuperManCo” (AIFM with UCITS permissions, but no MiFID top-up)
  7. “SuperManCo plus” (AIFM with both UCITS and MiFID top-up permissions)

- MiFID2 applies differently to each structure!

- * We’ll focus on these models now
The fund is a non-EU AIF, and US Parent (not UK Firm) will be AIFM to the fund.

US Parent will **not** be required to be authorised under AIFMD and will **not** be subject to AIFMD compliance (unless it markets the fund in the EU, in which case the marketing rules apply).

UK Firm will be required to be FCA authorised as a **MiFID investment firm** (**not** an AIFM) and will be subject to MiFID2.

UK Firm’s sub-investment management activities are **not** governed by AIFMD.

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*US Parent Firm LLC, a US firm, is the investment manager of the Cayman Master Fund. UK Asset Management Firm LLP acts only as sub-investment manager to US Parent, which has oversight over UK Firm’s activities. UK Firm has no business other than acting as sub-investment manager to US Parent.*
Model (2) – “pure” UK AIFM

INVESTORS

CAYMAN MASTER FUND LIMITED (Cayman)

UK ASSET MANAGEMENT FIRM LLP (UK)

IMA

UK Asset Management Firm LLP is based in the UK. It acts as the direct investment manager of the Cayman Master Fund Limited. UK Asset Management Firm LLP has no business other than the portfolio and risk management of the Cayman fund.

ANALYSIS

- The Fund is a non-EU AIF, and the UK Firm is its UK AIFM
- UK Firm needs to be authorised as an AIFM by the UK FCA, with at least permission to “manage an AIF”
- Management of the fund is subject to fund-level compliance obligations under AIFMD
- UK Firm will not generally be subject to MiFID2 (except where the FCA gold plates)
Model (3) – UK AIFM with “top-up” permissions

INVESTORS

CAYMAN ALPHA FUND LIMITED (Cayman)

IMA (1)

UK ASSET MANAGEMENT FIRM LLP (UK)

Sub-IMA (2)

US PARENT FIRM LLC (US)

CAYMAN OMEGA FUND LIMITED (Cayman)

IMA

(1) UK Asset Management Firm LLP is based in the UK. It acts as the direct investment manager of the Cayman Alpha Fund Limited.

(2) Separately, US Parent Firm LLC, a US firm, is the investment manager of the Cayman Omega Fund Limited. UK Asset Management Firm LLP acts only as sub-investment manager to US Parent (in respect of the Omega fund), which has oversight over UK Firm’s activities for the Omega fund.

ANALYSIS

- See next slide for full analysis
Model (3) - Analysis

- **The Alpha Fund** is a non-EU AIF, and the UK Firm is its UK AIFM
  - As such, UK Firm must be **authorised as an AIFM** by the UK FCA
  - Management of the Alpha Fund is subject to **fund-level compliance obligations under AIFMD** (depositary, leverage, valuation, delegation, etc)

- **The Omega Fund** is a non-EU AIF, and US Parent (not UK Firm) will be AIFM to the fund
  - US Parent will **not** be required to be authorised under AIFMD and will not be subject to AIFMD compliance (unless it markets the fund in the EU)
  - UK Firm will be required to hold **“top-up” permission** under AIFMD to perform MiFID-style portfolio management services in respect of the Omega Fund
  - Top-up services are subject to a **limited sub-set of MiFID2 rules**
  - Top-up services are **NOT** subject to **fund-level compliance obligations under AIFMD** (in other words, **no** requirement for depositary, leverage rules, etc)
Model (5) – UK UCITS ManCo with “top-up” permissions

(1) **UK Asset Management Firm LLP** is based in the UK. It acts as the direct investment manager of the European Retail Fund, an Irish-domiciled UCITS fund.

(2) Separately, **MegaBank Platform ManCo**, a Luxembourg firm, is the management company of the Lux Platform, a Lux-domiciled UCITS platform. **UK Asset Management Firm LLP** acts only as sub-investment manager to a Sub-Fund on the platform, under the appointment of MegaBank, which has oversight over UK Firm’s activities for the sub-fund.
Model (5) - Analysis

- The **Retail Fund** is a UCITS fund, and the UK Firm is its manager
  - As such, UK Firm must be **authorised as a UCITS firm** by the UK FCA
  - Management of the **Retail Fund** is subject to **fund-level compliance obligations** under UCITS (investment restrictions, production of KIID, etc)

- The **Lux Platform** is a UCITS Fund, and **MegaBank** (not UK Firm) will be ManCo to the fund
  - MegaBank will be required to be authorised under UCITS in Lux, and will take responsibility for UCITS compliance at the fund level
  - UK Firm will be required to hold **“top-up” permission** under UCITS to perform MiFID-style portfolio management services in respect of the Sub-Fund
  - Top-up services are subject to a **limited sub-set of MiFID2 rules**
  - Top-up services are **NOT** subject to **fund-level compliance obligations** under UCITS (although MegaBank may pass these on contractually)
## Important restriction on activities of an AIFM

- **AIFMs** are subject to express restrictions on their business activities, which may be relevant to **execution-only trading** activities of UK Firm. In overview:

<table>
<thead>
<tr>
<th>Permitted activities of UK AIFM</th>
<th>Prohibited activities of UK AIFM</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Executing orders generated by a <strong>UK</strong> portfolio manager (whether for a fund or for a sub-managed portfolio) working for the UK Firm</td>
<td>• Receiving an order from a <strong>non-UK</strong> PM (working for US Parent), and directly executing that order, including by:</td>
</tr>
<tr>
<td>• Receiving an order from a <strong>non-UK</strong> PM (working for US Parent), and passing that order to a third party broker for the broker to execute the order</td>
<td>o trading on a trading venue, including a regulated market, trading platform, execution platform, etc</td>
</tr>
<tr>
<td>• Assisting a third party broker to structure an OTC trade</td>
<td>o trading OTC with a counterparty, including entering into OTC derivatives under an ISDA or other trading docs</td>
</tr>
<tr>
<td>• Negotiating terms of a private trade (but not signing the transaction docs)</td>
<td>o trading off the prop book of a market maker or other liquidity provider</td>
</tr>
<tr>
<td></td>
<td>o signing (as agent) transaction documents for a private equity or private debt trade</td>
</tr>
</tbody>
</table>

**BUT**… can be mitigated by ensuring that UK firm has sufficient discretion in relation to orders that the activity counts as portfolio management
Part 2

Summary of how key rules apply (including UK gold-plating)
### How do the directives apply under EU law?

<table>
<thead>
<tr>
<th>Type of firm</th>
<th>Does MiFID2 apply?</th>
<th>Does AIFMD apply?</th>
<th>Does UCITS apply?</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) MiFID investment firm</td>
<td>✓</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>(2) Pure AIFM</td>
<td>✗</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>(3) AIFM (with top-up)</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>(4) Pure UCITS ManCo</td>
<td>✗</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>(5) UCITS ManCo (with top-up)</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>(6) Pure SuperManCo</td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>(7) SuperManCo (with top-up)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>
Detailed dive into the application of the rules…

- We’ll now focus in detail on how key rules under MiFID2 and AIFMD apply.

- Focus on models (1), (2) and (3)
  - MiFID investment firm
  - Pure AIFM
  - AIFM with top-up permissions

- But broadly the same principles apply to UCITS ManCos

- These slides look at UK application including gold-plating
  - Gold-plating is marked with *
How does MiFID2 apply as a matter of UK law? (Part 1)

<table>
<thead>
<tr>
<th>MiFID2 requirement</th>
<th>MiFID investment firm</th>
<th>“Pure” AIFM (no top-up)</th>
<th>AIFM (with top-up)</th>
<th>UK gold-plating?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 General organisational rules</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
<td>No</td>
</tr>
<tr>
<td>2 Algo trading (if relevant)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>No</td>
</tr>
<tr>
<td>3 Product governance</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Yes – AIFMs subject to PG rules as guidance</td>
</tr>
<tr>
<td>4 Information security</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
<td>No</td>
</tr>
<tr>
<td>5 “Independent” investment advice</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
<td>No</td>
</tr>
<tr>
<td>6 Telephone tapping and retention of e-comms</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Yes – all AIFMs in scope</td>
</tr>
</tbody>
</table>
# How does MiFID2 apply as a matter of UK law? (Part 2)

<table>
<thead>
<tr>
<th>MiFID2 requirement</th>
<th>MiFID investment firm</th>
<th>“Pure” AIFM (no top-up)</th>
<th>AIFM (with top-up)</th>
<th>UK gold-plating?</th>
</tr>
</thead>
<tbody>
<tr>
<td>7 Transaction record keeping</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
<td>No</td>
</tr>
<tr>
<td>8 Transaction reporting</td>
<td>✓</td>
<td>✗</td>
<td>✗</td>
<td>No</td>
</tr>
<tr>
<td>9 Post-trade transparency</td>
<td>✓</td>
<td>✗</td>
<td>✗</td>
<td>No</td>
</tr>
<tr>
<td>10 Inducements and receipt of research</td>
<td>✓</td>
<td>✓*</td>
<td>✓*</td>
<td>Yes – all AIFMs in scope</td>
</tr>
<tr>
<td>11 Best execution</td>
<td>✓</td>
<td>✗</td>
<td>✓*</td>
<td>Yes – AIFMs with top-ups</td>
</tr>
<tr>
<td>12 Transparency of Top 5 trading venues</td>
<td>✓</td>
<td>✗</td>
<td>✓*</td>
<td>Yes – AIFMs with top-ups</td>
</tr>
</tbody>
</table>
How does MiFID2 apply as a matter of UK law? (Part 3)

<table>
<thead>
<tr>
<th>MiFID2 requirement</th>
<th>MiFID investment firm</th>
<th>“Pure” AIFM (no top-up)</th>
<th>AIFM (with top-up)</th>
<th>UK gold-plating?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares – mandatory trading obligation</td>
<td>✓</td>
<td>✗</td>
<td>✗</td>
<td>No</td>
</tr>
<tr>
<td>Derivatives – mandatory trading obligation</td>
<td>✓ NB</td>
<td>✓ NB</td>
<td>✓ NB</td>
<td>No</td>
</tr>
<tr>
<td>Costs and charges disclosures</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
<td>No</td>
</tr>
<tr>
<td>Financial promotion rules (fair, clear and not misleading)</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
<td>No</td>
</tr>
</tbody>
</table>

**NB** – application depends on EMIR status
How does MiFID2 apply as a matter of UK law? (Part 4)

<table>
<thead>
<tr>
<th>MiFID2 requirement</th>
<th>MiFID investment firm</th>
<th>“Pure” AIFM (no top-up)</th>
<th>AIFM (with top-up)</th>
<th>UK gold-plating?</th>
</tr>
</thead>
<tbody>
<tr>
<td>17 Remuneration</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
<td>No</td>
</tr>
<tr>
<td>18 Commodity derivative position limits</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>No</td>
</tr>
<tr>
<td>19 INDIRECT: Direct electronic access</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>N/A</td>
</tr>
<tr>
<td>20 INDIRECT: Dark pools / double-volume cap</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>N/A</td>
</tr>
<tr>
<td>21 INDIRECT: Sell-side offering placings</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>N/A</td>
</tr>
<tr>
<td>22 INDIRECT: Transparency in non-equity markets</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>N/A</td>
</tr>
</tbody>
</table>
How does AIFMD apply as a matter of UK law?

<table>
<thead>
<tr>
<th>AIFMD requirement</th>
<th>MiFID investment firm</th>
<th>“Pure” AIFM (no top-up)</th>
<th>AIFM (with top-up) – for AIF management</th>
<th>AIFM (with top-up) – for sub-management</th>
</tr>
</thead>
<tbody>
<tr>
<td>23 Depositary</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>24 Leverage</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>25 Valuation</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>26 Liquidity management</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>27 Risk management</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>28 Marketing rules (including transparency and reporting)</td>
<td>(x)</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
</tbody>
</table>
Part 3

Regulatory arbitrage?

(...or evaluating choices between the models)
Why are there arbitrage opportunities?

Regulatory Burden


Manager level | Fund Level | Manager level | Fund Level | Manager level | Fund Level
Choices between the two regimes

- In 2013, there was very little arbitrage opportunity
  - broadly **similar** manager-level compliance between AIFMD and MiFID
  - but AIFMD introduced new **fund-level compliance** obligations
  - certain UK-headquartered managers structured **into MiFID** where they would otherwise have been caught by AIFMD (for example, introducing an **offshore manager**)

- Looking **ahead to MiFID2**, there are now **meaningful advantages and disadvantages** between the two regimes
  - **AIFMD**: fewer manager-level compliance obligations, but in-scope of the fund-level compliance rules
  - **MiFID2**: more manager-level compliance obligations, but avoid AIFMD’s fund-level compliance rules

- Cost / Benefit Analysis between the two…. 
## Potential factors in cost / benefit analysis

### MiFID2

**ADVANTAGES:**
- No requirement to comply with AIFMD fund-level rules
- Not subject to AIFMD business restrictions (can do execution-only trading)

**DISADVANTAGES:**
- Subject to all MiFID2 manager-level compliance rules, including transaction reporting and post-trade transparency
- Cannot be the investment manager of a fund (there must always be another AIFM identified)
- No access to EU marketing passport

### AIFMD with top-up

**ADVANTAGES:**
- Avoid some of the most onerous MiFID2 manager-level compliance rules (especially transaction reporting and post-trade transparency)
- Can be combined with UCITS permissions to be SuperManCo
- Access to EU marketing passport if managing EU fund (pre-Brexit)

**DISADVANTAGES:**
- Must comply with AIFMD fund-level rules
- Subject to AIFMD business restrictions (cannot do execution-only trading)
Factors when considering a MiFID to AIFMD conversion

- Conversion process
  - In UK: variation of permission (VoP) application to FCA
  - Cost
  - Timing
  - Even if you start today, very unlikely to have permission by January

- Identifying as the AIFM of at least one fund
  - Restructuring of fund and legal documentation
  - But… don’t have to be AIFM of all funds
  - Possibility to remain sub-investment manager to other funds with a separate AIFM

- Future-gazing
  - AIFMD2 to even-up the differences?
  - Impact of Brexit?