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FUTURE REGULATION OF UK ALTERNATIVE FUND MANAGERS - TOWARDS A MORE PROPORTIONATE REGIME

1. Future regulation of alternative fund managers: the Treasury and FCA's proposals

1.1 Background to reform

The UK's asset management sector has been a core part of the City's success; second only in size to the asset management sector of the United States, it is able to draw from deep pools not only of capital but of talent. Alternative investment fund managers ("**AIFMs**") have a prominent role in financial services, managing tens of billions in assets and playing a key role in capital formation for the UK economy.

The regulatory regime for AIFMs in the UK is derived from the European Union's Alternative Investment Fund Managers Directive ("**AIFMD**"), and there have been few major divergences from the European regime following the UK's departure from the European Union in 2016. But with financial services at the heart of the Labour government's growth agenda, and with a formal Treasury framework in place for developing a freestanding UK regulatory regime, reform of the AIFMD as implemented in the UK ("**UK AIFMD**") has been long-anticipated.[1]

1.2 Proposals for change

On 7 April 2025, the Treasury and the FCA announced proposals to simplify the regulatory regime applicable to all but the largest AIFMs in the UK.[2] This is primarily achieved by dispensing with the legislative threshold that determines when a firm is subject to the full UK AIFMD regime, enabling the FCA to determine proportionate rules for AIFMs of all sizes, having regard to their investment activities and investor base. This approach avoids 'cliff-edge' risks whereby sub-threshold AIFMs are subject to minimal requirements and growth (which could result in an immediate and significant increase in regulation) is disincentivised.

Under these proposals, which we consider in more detail below, only the largest firms will be subject to a regime similar to the current rules for full-scope UK AIFMs (and even for these firms, some of the prescriptive detail may be removed).

In addition, the Treasury and the FCA are proposing a range of smaller but significant improvements to UK AIFMD which will make doing business simpler and quicker for smaller UK fund managers in particular.

1.3 Next steps

Responses to both the Treasury's consultation and the FCA's Call for Input are invited by 9 June 2025. The FCA states that, subject to feedback and to decisions made by the Treasury on the future regime, the FCA plans to consult on detailed rules in the first half of 2026.

In its Call for Input, the FCA further signals that it is considering the potential benefits of creating a bespoke regime for venture capital and growth capital funds, and that the following areas are open for review: AIFM remuneration, reporting, conduct and prudential requirements, and the AIFM business restrictions. For the purposes of this briefing, we focus on the more immediate and concrete proposals.

2. A three-tier regulatory system

At the core of the Treasury and FCA's proposals is a tiering of how UK AIFMD applies to fund managers. For firms with a net asset value ("**NAV**") in excess of £5bn (so-called "larger firms"), the full existing UK AIFMD regime will continue to apply. The FCA states that this captures 64

[1] See FCA Discussion Paper (DP23/2), Updating and improving the UK regime for asset management (February 2023).

[2] HM Treasury, Regulations for Alternative Investment Fund Managers Open Consultation (April 2025); FCA Call for Input, Future regulation of alternative fund managers (April 2025).

AIFMs in the current regime. AIFMs whose NAV falls below £5bn will either be "small firms" (where their NAV is less than £100m), or fall within a new tier of "mid-sized firms" (where their NAV falls between £100m and £5bn). As a measure of scale, firms will find NAV more user-friendly and understandable than the current metric of leveraged assets under management.

The FCA's proposal for small and mid-sized firms is focused on proportionality and avoids imposing unnecessarily burdensome compliance requirements upon smaller firms. Mid-sized firms would continue to comply with the broad requirements currently applicable, but the FCA does not plan to impose more detailed procedural requirements typically contained in the so-called Level 2 Regulation (Commission Delegated Regulation (EU) No 231/2013, as it applies in the UK) except where necessary. As an example of how the FCA might tailor Level 2 provisions in this context, the FCA suggests that it could disapply certain rules in respect of AIFMs whose funds invest in assets other than transferrable securities (which would be of assistance to private equity managers).

Whilst there is already a "small authorised AIFM" regime, the Treasury and FCA's proposals would transform this from a standalone regime to the third tier of application of UK AIFMD. Small AIFMs will be subject to an even lighter regulatory regime focused on encouraging early-stage growth, and it is suggested that the requirements in the Level 2 Regulation would not apply to such firms in most cases. Firms that are currently full-scope UK AIFMs, and who become reclassified as small under the new rules, would see a significant reduction in detailed and prescriptive requirements.

3. Bringing small registered AIFMs into the regulatory perimeter

In addition to the "small authorised AIFM" regime currently in place, there is also a separate "small registered AIFM" regime which applies to three categories of sub-threshold AIFM and exempts them from an authorisation requirement.[3] The Treasury is proposing to remove this regime (with concerns about a misleading "halo effect" cited) and to bring many of these firms into the regulatory perimeter. Although this would require them to seek authorisation, the vast majority of these firms would be "small AIFMs". The Treasury acknowledges that this will result in up-front costs for managers and welcomes reflections on the impact of this.

4. Investment trusts

The Treasury is proposing that UK investment trusts (or listed closed-ended investment companies) will continue to remain subject to UK AIFMD. In combination with the removal of the "small registered AIFM" regime mentioned above, this proposal will have the effect of bringing many small internally-managed investment trusts—which would previously have been below the threshold—into the scope of UK AIFMD with the accompanying need for authorisation.

The FCA is also looking at a number of reforms to investment trust regulation. Of particular significance is its suggestion that it may disapply certain regulatory liquidity requirements in relation to investment trusts which use *de minimis* amounts of leverage, and develop a delegation regime which is tailored to the structure of investment trusts.

5. Improvements around the margins

Whilst headlines have been dominated by the tiering approach proposed by the Treasury and FCA, a number of other smaller but helpful changes are also being proposed. For example, the Treasury is considering reforming rules requiring various notifications to be made when an AIFM acquires control of a non-listed company (which in particular impact highly-acquisitive private equity funds). These notifications can often be complex and time-consuming, and do little to improve overall outcomes for stakeholders; firms will be relieved to see changes being made.

6. The wider context

Growth is at the core of the Labour government's agenda, and given the UK's historical strength in asset management it is unsurprising that improvements to UK AIFMD are a major part of the government's push to promote growth across the economy.

The proposed changes are not revolutionary—the FCA's modelling suggests that 74% of the total NAV of the UK asset management sector will continue to be managed by firms subject to the highest levels of regulation—but they are particularly significant for smaller and/or newer AIFMs. Their intention is clearly to make the UK a more attractive place to start and scale an AIFM, and to build the UK fund management sector into a dynamic engine of growth for the British economy more generally. Market stakeholders are likely to be encouraged by this direction of travel for the sector's regulation.

[3] The three categories of firm are managers of Social Entrepreneurship Funds and Registered Venture Capital Funds; managers of Unauthorised Property Collective Investment Schemes; and managers of 'Internally Managed Companies'.

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