

Investment Funds Alert

February 13, 2014

FCA Guidance on Modification of the Funds Under Management Rule for AIFMs

The Financial Conduct Authority (FCA) has issued guidance on the application procedure for modifying the “funds under management” rule. This modification will allow alternative investment fund managers (AIFMs) that use derivatives in their strategies to value those derivatives at their market value for the purposes of calculating their regulatory capital requirements.

The implementation of the Alternative Investment Fund Managers Directive (AIFMD) has changed the basis for calculating regulatory capital requirements for firms registering as AIFMs. Apart from an expenditure-based requirement, these firms will, in future, have regulatory capital requirements calculated with reference to their “funds under management.”

Under the current definition of “funds under management” in the FCA Glossary, UK AIFMs are required to convert all derivative positions into equivalent positions in the underlying investments in accordance with the formulae set out in Annex II of the Delegated Regulation (EU) No 231/2013 (“Level 2 Regulation”) made under AIFMD. The “funds under management” figure is then used as the basis for calculating the “own funds” requirement of 0.02 per cent of the value of portfolios under management which an AIFM must hold on an ongoing basis under AIFMD.

This method has led to potentially significant increases in regulatory capital requirements. Calculation of “funds under management” results, for many managers, in a much higher figure, as compared to the amount produced by a more traditional net asset value (NAV) methodology. The effects of the conversion method are at their most extreme when applied to managed futures strategies, although certain fixed income and other strategies also produce very high ratios of “funds under management” to NAV. Some managers have reported that their “funds under management” figure is more than 10 times the NAV.

The guidance on the modification by consent is a temporary measure taken by the FCA in response to months of active engagement by AIMA, individual asset managers, and their advisers with the FCA’s prudential policy team.

The FCA announcement was welcomed by many managers affected by the conversion method, as this will mean they no longer need to inject substantial amounts of additional capital into their businesses to meet the new regulatory capital requirements.

The [modification direction](#) available on the FCA website sets out the form of the changes to the “funds under management” rule. To take advantage of the modification by consent, affected AIFMs should apply to the FCA waivers team with a request for modification by consent. The FCA will then write to the AIFM to confirm that the modification has been granted and publish a notice of the modification direction on its

website. This modification will be valid until January 31, 2015 or until the Glossary definition of “funds under management” is changed.

We understand that the FCA plans to consult on the permanent changes to the FCA Glossary definition of “funds under management” in its quarterly consultation to be released in March 2014. The Level 2 Regulation does not prescribe a method for calculating funds under management for the purposes of the 0.02 per cent “own funds” requirement, so the FCA will not be constrained by the EU legislative texts in its ability to modify this rule or issue additional guidance.

For lack of a method prescribed in AIFMD, the FCA had copied the conversion method from Annex II of the Level 2 Regulation when it originally implemented the AIFMD “own funds” requirement into its rules. Under the Level 2 Regulation, the Annex II method applies to determining whether an AIFM is below the AIFMD assets under management threshold (and, accordingly, outside its scope), but is not referenced in the “own funds” rules.

The FCA is currently looking for input and worked examples from the affected AIFMs for the purposes of its consultation on changing the “funds under management” rule. Managers interested in raising any additional points related to the “funds under management” calculation (e.g., netting) with the FCA should get in touch with their usual contact at Akin Gump or Anna Maleva-Otto (using the contact details below).

Contact Information

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