

UK Updates Fund Management Law

Skadden

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On March 29, 2017, the U.K. updated the law pursuant to which U.K. limited partnerships are constituted. It was the same day on which the government began the Brexit process that will fundamentally change the constitution of the U.K., but for the fund management industry, the day was also significant for the shift in strategy to make the U.K. a more competitive regime for fund domiciliation.

Updates to U.K. limited partnership law have been a long time in the making; the Limited Partnerships Act 1907 (the Act) has seen very little change since it was passed into law over a century ago. In 2003, as part of a report into U.K. partnership law, the Law Commission suggested a number of changes to reform the law affecting limited partnerships, including proposing the creation of a list of “permitted activities” that limited partners may conduct without the risk of losing their limited liability. A number of these changes would have been of particular assistance to the U.K. private fund industry, where limited partnerships are commonly used as fund structuring vehicles. Fourteen years later, the U.K. has finally introduced a regime that should put U.K. limited partnerships on an equal legal footing to their competitors in the Channel Islands and other offshore jurisdictions.

Managers of existing funds structured as U.K. limited partnerships should consider whether to elect into the new regime. Fund managers who might previously have rejected the U.K. on the basis that its limited partnership laws were too inflexible should determine whether the new U.K. advantages compel a closer look at setting up future funds in the U.K.

The PFLP Regime

The new private fund limited partnerships regime (PFLP Regime) was brought into force through the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (the Final Order) passed on March 29, 2017. The impetus for change comes from the Investment Management Strategy announced by the U.K. government in the 2013 budget. One of the three main strategic commitments was to improve the regulatory environment for the investment management sector — the PFLP Regime is one part of this. In 2015, the U.K. government launched a consultation with its original proposals for the PFLP Regime. Having responded to the consultation in March 2016, the U.K. government published the draft Final Order in January 2017 with an explanatory note (the Explanatory Note).

The Final Order came into force on April 6, 2017, making certain amendments to the Act to bring the PFLP Regime into effect. The PFLP Regime reduces the legal complexity and administrative burdens that have already affected the use of U.K. limited partnerships as fund vehicles. Broadly speaking, these aims have been achieved.

The PFLP Regime will allow new and existing U.K. limited partnerships to be designated as private fund limited partnerships. It makes changes to the existing law applicable to limited partnerships, including: the introduction of a “white list” of activities that limited partners may conduct without the risk of losing their limited liability; removal of the need for limited partners to make capital contributions to the partnership; disapplication of certain statutory duties (such as a duty not to compete with the partnership); and removal or reduction of certain other administrative requirements.

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The 'White List'

Perhaps the PFLP Regime's most significant change will be the introduction of the "white list" of activities that a limited partner in a private fund limited partnership will be able to undertake without losing its limited liability. The list is non exhaustive but extensive and includes actions such as taking part in a decision regarding changes to the persons responsible for management of the partnership, and taking part in decisions relating to the acquisition or disposal of investments, or the exercise of the partnership's rights in respect of investments.

Pursuant to the Act, a limited partner in a U.K. limited partnership that takes part in the management of partnership business will be liable for all debts and obligations of the partnership incurred while it takes part in the management as though it was a general partner. English case law has provided very little additional clarity on what actions constitute "taking part in the management of partnership business." This uncertainty has made it difficult to provide investors in private funds with an appropriate level of comfort that the bespoke terms of a fund document will not present a risk that the investors will lose their limited liability. This is particularly an issue in the context of certain managed accounts, joint ventures and other arrangements where the commercial agreement is that the investor will not be entirely passive. In contrast, jurisdictions that compete with the U.K. as jurisdictions for fund establishment, such as Jersey, Guernsey, the Cayman Islands, Delaware state and Luxembourg, all have regimes that incorporate statutory white lists.

Therefore, it is unsurprising that the proposed white list gathered significant attention during the consultation and is the subject of a large proportion of the Explanatory Note. The government took into account the responses to the consultation and made changes to the white list. Although a number of these are drafting changes or consolidations, certain key clarifications also have been made. In particular, the Final Order has been amended to clarify that the white list is not an exhaustive list of activities a limited partner may undertake without being regarded as taking part in the management of partnership business. The Final Order also clarifies that the existence of the white list does not create any adverse presumptions for limited partners in other limited partnerships.

Consultation Responses

In addition to the changes to the white list, there were other issues raised during the consultation phase that the Final Order addresses:

- **One-Year Transition.** The proposed one-year transition has been removed so that any limited partnership, whether existing or as part of its initial registration, can apply for designation as a private fund limited partnership at any time. Once a limited partnership is designated as a private fund limited partnership, it cannot remove that designation.

- **Registration Process.** In order to designate a new or existing limited partnership as a private fund limited partnership, Companies House will require confirmation that the limited partnership meets the "private fund conditions" (see below). This confirmation can now be given by the general partner of the limited partnership rather than by a solicitor, as originally proposed — the government acknowledged that requiring confirmation from a solicitor would be unduly burdensome.
- **Collective Investment Schemes.** There are two "private fund conditions": The limited partnership must be constituted by a written agreement and be a collective investment scheme as defined by the Financial Services and Markets Act 2000. The second condition, in a change from the original proposals, can be satisfied by a limited partnership whether or not it is subject to an exemption from the statutory collective investment scheme definition. This change was made from the original proposals to address a concern that the scope of the PFLP could be limited by the burden of proving that none of the exemptions applied to a particular limited partnership.

Other Elements

Other benefits to the new PFLP Regime, as distinct from ordinary U.K. limited partnerships, include:

- **Capital Contributions.** A limited partner in a private fund limited partnership will not be required to make any capital contribution to the partnership. If it does make a contribution, it will be able to withdraw it without being liable, under the Act, to return it. For existing limited partnerships, this will only apply to contributions made after designation as a private fund limited partnership.
- **Winding Up.** Limited partners in a private fund limited partnership will not be required to obtain a court order to wind up a limited partnership that has no general partner.
- **Statutory Duties.** Limited partners in a private fund limited partnership will be exempt from certain duties applicable to partners under the Partnership Act 1890, including the duty to render accounts to the partnership and the duty not to compete with the partnership (although these duties have traditionally been disapplied by the limited partnership agreement).
- **Transfers of Interests.** It will not be necessary to publish a notice in the Gazette (the U.K.'s official public record) in order to give effect to a transfer of a limited partnership interest in a private fund limited partnership. Certain other changes to a private fund limited partnership (for example, changing the status of a general partner to a limited partner) will continue to require a Gazette notice.

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Next Steps

The PFLP Regime is likely to benefit fund managers in respect of both existing U.K. limited partnerships and new structures.

Fund managers with existing U.K. limited partnerships should consider the benefits of designating such limited partnerships as private fund limited partnerships. Given the changes may largely benefit investors, managers also may wish to consider whether they are under any duty, pursuant to the fund documents or otherwise, to make such changes and whether they have the requisite power and authority to pursue such a change without investor consent.

For fund managers structuring new funds, the U.K. should be increasingly attractive when considering other benefits alongside the new PFLP Regime. For example, London accounts for a significant proportion of the private fund management industry in Europe, and English law also provides a well-established legal system for interpreting and resolving disputes relating to fund agreements. There also appears to be an ongoing drive from both legislators and certain investors to locate fund structures

“onshore.” In addition, the U.K. Financial Conduct Authority is generally regarded as taking a suitably pragmatic approach to regulating the fund industry, including through its implementation of European directives.

While Brexit may be the source of some uncertainty in many financial services sectors, for private funds using the U.K., Brexit should be less of a concern. The U.K. and the European Union (EU) may agree on a transitional arrangement that maintains the status quo for private funds in the U.K. after Brexit. In any event, if the third-country passport becomes available under the Alternative Investment Fund Managers Directive (AIFMD), it would seem reasonable to expect that the U.K. (having already implemented the AIFMD in full) would be equivalent to the EU regime in this respect. Even without the third-country passport, private fund managers outside of the EU have grown used to utilizing the national private placement regimes in the U.K. and Europe, while reverse solicitation can enable large European institutional investors to continue to invest in the global private fund market.