

Doing deals in difficult times : Extendable ‘see before you buy’ umbrella funds; interim management services by Paxiot Limited and our support for business angel syndicates.

We are doing business in difficult times.

Extendable ‘see before you buy’ umbrella funds

If it is difficult to raise blind investment funds and easier to raise capital only on a deal-by-deal basis once investments have first been promoted to potential investors before they invest, a fund manager may have to grapple with what it means to undertake the regulated activity of arranging deals rather than managing a fund and, additionally, if ongoing management of an EIS investment is to be provided, how to avoid arrangements for its management constituting a collective investment scheme (“CIS”).

To both these issues I say that the halfway house solution of an extendable ‘see before you buy’ umbrella fund cures all ills.

I have three scenarios in mind.

The first, is the fund manager that is FCA authorised to manage a fund but is not separately authorised to arrange side deals. Here the solution is to bring the deal under the AIFM authority from the outset; the question is how?

Second is the person who aspires to be a fund manager and intends to complete his deals through the offices of a regulated AIFM. Here, again the solution is also one of timing, to ensure that arrangements for such introductions should be in place from the very outset; the question is why?

The third scenario is the fully authorised AIFM that manages EIS investments with a natural concern to secure an ongoing monitoring role in respect of the investment; - also a concern of course for the AIFMs in my first two scenarios, but for the fully authorised EIS AIFM too, a ‘see before you buy’ umbrella fund structure should be in its tool kit if the AIFM is to avoid the management of a CIS.

Arranging deals in investments

The technical problem for the first two scenarios is the very wide definition of what it means to be arranging deals in investments.

A quick explainer.

Simply agreeing to make such arrangements is a regulated activity.

Arrangements that bring about a deal - for example, the negotiation of an investment agreement – will also be a regulated activity if a deal is done, as you would expect.

The danger zone is that even before any deal is done, a person will also be undertaking a regulated activity if they merely engage in the activity of making arrangements with a view, in their own mind, to a person, even a single person, making an investment.

This is about as wide as it gets.

This last category of the arranging deals in investments activity has been criticised as being far too wide and ambiguous a restriction to warrant a breach as a criminal offence, but this is the case. It is a 'catch all'. Very useful to the FCA when it wants to close down boiler room operations or to prevent other nefarious arrangements, but it is very wide.

That said, I would be very surprised if the FCA were ever to take action against a bona fide authorised fund manager who arranges side deals.

I would also be surprised if the FCA were ever to take action against the aspiring but unauthorised manager who starts to make arrangements before it has identified an authorised fund manager to whom it will introduce all its deals.

The real risk is the possibility that if investors lose money on side deals that don't meet expectations, they might claim compensation for losses incurred if they think they can show that the arranger was acting in breach of financial regulation.

PERG guidance

This is where FCA guidance in PERG is so very helpful. FCA guidance is important because if a person acts in line with it the FCA will proceed on the footing that the person has complied with the aspects of the requirement to which the guidance relates.

FCA PERG guidance tells us that the activity of making arrangements with a view to a person, even a single person, making an investment is only a regulated activity if this is done as part of an ongoing arrangement made with a view to transactions taking place from time to time as a result of persons having taken part in in the arrangements.

Additionally, and this is relevant for aspiring but unauthorised new managers who want to work with an AIFM, regulated arrangements do not cover one-off introductions or introductions that are not part of an ongoing pre-existing arrangement between introducer and introducee.

So the authorised manager with no separate authority to arrange deals can get things started by making a one-off promotion to investors to undertake a one-off investment transaction on the basis that the AIFM will wrap up this first investment in a standalone but extendable 'see before you buy' fund structure.

The aspiring unauthorised manager is let off the hook under the 'introducing' exemption if the arrangements it makes with investors also include, from the very outset, arrangements where it will introduce its investors to an identified authorised AIFM who can provide an independent exercise of discretion in relation to investments generally.

An extra umbrella extension clause

In both cases the umbrella fund documentation will give investors a pre-approval 'see before you buy' right on the deal but in both cases, there will also be an extra umbrella extension clause - which says that further deals may be introduced on the same umbrella fund basis and managed within a separate and new investment compartment of the same AIF.

With this bolt on umbrella extension clause there is then no longer any need to rely on the FCA guidance on one-off introductions for subsequent deals. There is a fund in place, an extendable 'see

before you buy' umbrella fund; just one where investors have an approval right on what deals are done.

When subsequent investments are transacted in my first two scenarios they are not made as a result of a person arranging deals in investments on an unregulated basis, they are made by an AIFM whose FCA authority necessarily includes the making of arrangements when and during the course of managing a fund.

In my third scenario of the fully authorised AIFM EIS manager, if it includes a bolt on umbrella extension clause in its investor agreements so that it covers the possibility of other deals being done within the same umbrella fund, the AIFM's ongoing management arrangements in respect of the first and subsequent investments should benefit from the same exemption from CIS categorisation as applies to blind EIS funds.

Why? Because the CIS exemption envisages that a number of investments will be made by a 'complying fund', all of which will qualify for EIS relief, and this will be as true of an extendable 'see before you buy' EIS umbrella fund, that contemplates a number of investments being made, notwithstanding the investor's approval right, just as it is of a blind pool EIS fund.

Contractual acknowledgment and FCA notification

In all scenarios investor should sign a contractual acknowledgement that a fund exists from the first promotion. The AIFM will also need to file a fund notification with the FCA in anticipation of the first deal and also of separate investment compartments when subsequent deals are done.

In summary

So, in summary, when raising capital on a deal-by-deal basis in difficult times, the use of an extendable 'see before you buy' umbrella fund structure, with a separate compartment for each deal, should be considered.

Paxiot Limited

A quick promotion on behalf of our FCA authorised vehicle, Paxiot Limited.

Paxiot Limited provides interim management regulatory cover to aspiring but as yet unauthorised EIS fund managers who have no FCA authorisation at all and want to establish 'see before you buy' EIS Funds.

As a non-voting member of the Paxiot investment advisory committee the fledgling fund manager who works with Paxiot would not need to become an appointed representative of Paxiot as an arranger, nor would they need to advise Paxiot, given that investors would have a deal-by-deal approval right, as Paxiot, once the investment has been made, will exercise independent discretion in relation to investments within the umbrella fund wholly within the introducing exemption from the regulated activity of arranging investments.

Once a fledgling fund manager has obtained their own FCA authorisation Paxiot will hand over management of the umbrella AIF to the new manager pursuant to pre-agreed terms with the investors.

Paxiot support to the leaders of business angel syndicates

Not being seen to be arranging deals in the regulated sense is also important to leaders of business angel syndicates. If their leadership is not carried on by way of business then there is no problem.

There is also an important exemption that applies even if the syndicate leader is to be remunerated provided: they are member of a joint enterprise, not concerned with a regulated activity, and also invests alongside other members of the syndicate; they don't hold themselves out as buying and selling securities; and they don't solicit members of the public.

A syndicate leader should of course also take care to ensure that they aren't running a collective investment scheme if they intend to provide ongoing oversight on behalf of their syndicate. Paxiot would be pleased to work with business angel syndicates where this might be a risk. Again, the real issue may not be of an FCA intervention, but of disappointed investors seeking compensation from syndicate leaders if investments go awry.

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