



ADVISORY
Industry Information

UK Treasury Consultation on the Proposed Overseas Funds Regime

Implications for post-Brexit Distribution of Investment Funds

November 2020

The UK government has recently introduced the Financial Services Bill (the “Bill”) into the UK Parliament. The Bill is intended to ensure the UK’s regulatory framework continues to function effectively for the UK after leaving the EU. Among the measures introduced by the Bill of interest to fund managers will be the details of new equivalence regimes for retail investment funds and money market funds (“MMF”), which are designed to simplify the process for distribution of investment funds domiciled overseas to UK consumers. The UK Treasury (the “Treasury”) recently published conclusions on its post-Brexit overseas funds regime (“OFR”) summarising the responses to its March 2020 consultation paper (the “Consultation”) and after considering respondents’ views explained the government’s approach to legislating for the OFR.

Current Regime

Figures from 2019 show 3,547 Irish investment funds authorised under the EU’s Undertakings for Collective Investment in Transferable Securities (“UCITS”) and Alternative Investment Fund Managers Directive (“AIFMD”) regimes are registered for sale in the UK using the passporting processes under these regimes¹. Once the Brexit transition period ends, the ability to rely on these passporting processes in order to market investment funds authorised under either of these regimes in the UK will cease.

Temporary Marketing Permissions Regime – Register Now to Guarantee Access

In order to allow eligible investment funds to be marketed in the UK, before transitioning to the OFR, a temporary marketing permissions regime (“TMPR”) has been established which will operate for a limited time from the end of the transition period. The TMPR is available to UCITS and AIFs which are already registered to market in the UK and which additionally make a notification under the TMPR.

The notification window has re-opened for a final limited period until 30 December 2020 (the “TMPR Deadline”), allowing UCITS and any notified sub-funds of UCITS and EEA-domiciled Alternative Investment Funds registered under the TMPR to continue to be marketed into the UK for up to three years after the end of the transition period. The Bill additionally enables the UK Treasury to further extend the TMPR exemption in place for UCITS to continue marketing to retail investors for a further two years (until the end of 2025), thereby allowing UCITS more time to transition to the OFR and for the UK government to conclude equivalence assessments of other countries’ financial regulatory regimes.

Many managers have already made initial notifications during previous notification windows and these remain valid. Notifications are made via the Financial Conduct Authority (“FCA”) online system (FCA Connect) including any updates which should be made to existing notifications. However if new sub-funds have been added to marketing passports since an earlier notification was submitted, the new sub-funds will not be included in the TMPR unless managers submit a request to update their notification prior to the TMPR Deadline and include them in that updated notification.



Accordingly for managers that intend to update their previously submitted notification (for example, for sub-funds which were established after the original TMPR notification) it is necessary to notify the FCA by email of this intention by the end of 9 December 2020. Investment fund managers should then expect to be able to submit their updated notification from 14 December 2020 up to the TMPR Deadline via FCA Connect. For managers who expect to add sub-funds to their notification before the window closes, the FCA has advised that they should wait until they have a full list of sub-funds before submitting their notification.

As the UCITS and AIFMD marketing passports will cease at the end of the transition period those investment funds authorised and availing of the marketing passport prior to the TMPR Deadline, but which do not apply to use the TMPR, will generally no longer be permitted to market in the UK after the end of the transition period. However, if a new sub-fund of a UCITS umbrella is established after the TMPR Deadline, but forms part of an umbrella that was registered under the TMPR, the FCA will permit the notification of a new sub-fund to be added into the TMPR to market to UK retail investors. It should be borne in mind by managers that investment funds may also be marketed without relying on the passporting process, instead using the national private placement regime in order to gain access to professional investors in the UK (or for marketing to retail investors via the section 272 of the Financial Services and Markets Act (“FSMA”) registration process).

Accordingly it is important that managers wishing to continue to market existing sub-funds in the UK on the basis of their UCITS and AIFMD passporting permissions after the end of the transition period:

- (a) review any previous TMPR applications made to ensure that they include all registered UCITS sub-funds and AIFs which are to continue to be marketed in the UK and, if necessary, update the application prior to the TMPR Deadline; or
- (b) if one has not previously been submitted, prepare to make such notification prior to the TMPR Deadline.

For AIFs established but not notified to the TMPR, in the event of a no-deal Brexit they will be able to market under the temporary transitional powers granted to the FCA to minimise disruption to financial services and ease businesses into the post-Brexit world. The FCA has stated that an EEA AIFM marketing an AIF in the UK can continue to market that AIF in accordance with the current UK AIFM Regulations for a transitional period following the end of the transition period for a temporary period of 15 months, from the end of the Brexit transition period until 31 March 2022.

Overseas Funds Regime (the “OFR”)

The Bill contains details of the UK government’s proposal to legislate for a streamlined mechanism for the recognition of certain overseas retail investment funds to be sold to UK investors from 2021 as envisaged in the Consultation. The current OFR proposal incorporates two new sets of rules, one for retail investment funds and one for MMFs. The rules will be based on a broad principle of regulatory equivalence, as well as adequate reciprocal supervisory cooperation between the FCA and the national competent authority in the jurisdiction seeking equivalence.

The equivalence test would be slightly different for each investment fund type. The other country’s regulatory regime for retail funds must achieve at least equivalent investor protection to comparable UK authorised investment funds. The other country’s regulatory regime for MMFs must be at least equivalent to the regulations that apply to UK MMFs. The UK Treasury would also be permitted to impose additional requirements to retail funds from such equivalent countries, something that is not possible currently. The government has stated “(t)here may be circumstances where the regulation of a category of investment funds in a country meets the standard of equivalent investor protection, but it is still desirable to specify additional requirements as a condition of marketing those funds in the UK. This may be to give consistency for retail investors investing in these funds and to ensure a level playing field with UK funds”. In its conclusions the Treasury outlined that it did not find any reason to depart from its proposed approach, which remains similar to that outlined in the Consultation. Irish Funds has made a strong case for why such additional requirements should not be necessary for Irish authorised UCITS.

Following an equivalence determination retail funds and MMFs marketing to retail clients will have to seek individual recognition with the FCA. Under the Consultation investment funds that wish to be recognised for marketing in the UK would need to ensure disclosure regarding access to the Financial Ombudsman and the role of alternative dispute resolution; regular reporting to the FCA on changes to fund governance arrangements; the maintenance of investor facilities in the UK and the use of authorised persons in the UK to make or approve financial promotions. In addition the FCA will be enabled to make rules to set registration and periodic fees which would be imposed on overseas investment funds for the purposes of maintaining recognition under the OFR.

The Treasury response notes that the UK would be able to withdraw equivalence decisions at a future date “if the UK judges that the overseas jurisdiction no longer delivers equivalent outcomes (or an equivalence decision is no longer compatible with the UK’s policy priorities including



the rule of law, international sanctions, human rights and efforts to combat money laundering)". The Treasury noted that "in the event that equivalence is withdrawn, the government's policy is that investors should not be forced to divest their investments in the fund, and the fund should continue to service them". Overseas investment funds from a country that is no longer recognised as equivalent would instead need to apply to continue distributing in the UK under the default section 272 procedure.

Funds Falling Outside of the OFR

The OFR is intended to address the fact that: (i) very few MMFs are domiciled in the UK; and (ii) the existing individual recognition process for non-UCITS retail investment funds under section 272 of the FSMA would not be suitable for the large number of investment funds expected to seek to avail of the "on-shoring" process following the end of the TMPR.

The existing regime under section 272 FSMA will not be repealed under the Bill, but will continue to be available for individual funds that are not eligible to be recognised through the OFR because they are not covered by an equivalence determination for retail investment funds. However, the Bill proposes some minor amendments to this regime to streamline the process.

OFR - Next Steps

Following its introduction to Parliament, the Bill is subject to the usual processes of legislative scrutiny in both the House of Commons and the House of Lords and the timing of the Bill's progression through Parliament will be subject to parliamentary scheduling. In addition to the now published Consultation response the Treasury will publish further detail on the Bill's measures in due course, through policy statements to provide further clarity where appropriate on the implementing measures during the Bill's passage through Parliament.

While the TMPR provides managers with welcome continuity for marketing to investors in the UK following the end of the transition period there remains less certainty on the TMPR exit process. Further clarity will be required on the 3 month "landing slots" for investment funds to leave the TMPR within which they would be required to submit an application for permanent recognition under the OFR. Additionally, as Brexit talks once more intensify the attention of the Treasury will turn to the European Commission and whether it will reciprocate with a streamlined mechanism of its own for recognising the distribution of UK investment funds in the interest of investors across Europe.

Contacts

If you have any queries on the content of this advisory please speak to your usual contact in Walkers or connect with:



Nicholas Blake-Knox
Partner, Investment Funds
T: +353 1 470 6669
E: nicholas.blake-knox@walkersglobal.com



Jennifer Fox
Partner, Investment Funds
T: +353 1 863 8531
E: jennifer.fox@walkersglobal.com



Eimear Keane
Partner, Investment Funds
T: +353 1 470 6622
E: eimear.keane@walkersglobal.com



Sarah Maguire
Partner, Investment Funds
T: +353 1 470 6691
E: sarah.maguire@walkersglobal.com



Joseph Mitchell
Senior Associate, Investment Funds
T: +353 1 470 6649
E: joseph.mitchell@walkersglobal.com



Jill Shaw
Professional Support Lawyer
Investment Funds
T: +353 1 863 8546
E: jill.shaw@walkersglobal.com

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