Investment Funds 2018 Update

Welcome to our annual Investment Funds Update, our briefing highlighting the key 2017 legal developments which impact the investment funds' industry and previewing what can be expected in 2018. This Briefing will be relevant for managers and investors in a wide range of private and listed investment funds and includes links to our more detailed briefings on certain key topics. If you require any further details or would like to discuss further, please feel free to contact us.

GENERAL

Government's Investment Management Strategy II

In December 2017, the UK Government published an updated version of its strategy paper on the UK investment management industry. This paper, "Investment Management Strategy II", is an important signpost to the UK's post-Brexit approach to financial services. It also has wider, international implications because the UK asset management industry is the largest in Europe with £8.1 trillion of assets under management.

The strategy is described as a comprehensive long-term approach, to create "an environment in which firms can deliver the best possible outcomes for investors" and strengthen "the UK's brand for asset management, enabling firms to respond effectively to the UK's withdrawal from the European Union and capitalise upon future trading opportunities".

The Investment Management Strategy II targets a broad range of policy areas. It sets out the policy initiatives that the Government, in collaboration with the industry and the FCA, will take forward to:

- enhance the Government, regulator and industry dialogue through a newly established Asset Management Taskforce. The Government will use the Asset Management Taskforce to identify opportunities to enhance the UK's competitiveness as a global centre for asset management and oversee the delivery of this strategy;
- maintain stable tax and regulatory environments and promote the competiveness of the UK regime in the area;
- strengthen the domestic asset management skills pipeline;
- advance the development of asset management FinTech solutions to capitalise on the UK's world-leading status in FinTech;
- support UK asset managers to be global leaders in developing innovative investment strategies. In particular, the paper highlights patient capital, social and impact investments, the financing of other technologies and the provisions of Sharia compliant products; and
- continue a coordinated programme of international engagement to attract overseas firms to locate in the UK and promote UK firms overseas. The Government will seek to ensure that the UK's trade policy complements international regulatory cooperation and reflects the priorities of the UK asset management industry.

The ambitions set out in the paper are welcome but, as may be expected, the paper is light on details of what the Government will actually do. There will also be challenges ahead to reconcile the strategy with the agreed position set out in the Phase 1 Brexit negotiations that the UK will maintain full alignment with the rules of the Single Market as between Northern Ireland and the Republic of Ireland, but will also ensure no new regulatory barriers develop between Northern Ireland and the rest of the UK.

PRIVATE FUNDS

Limited Partnerships Act reforms come into force

In April 2017, the Legislative Reform (Private Fund Limited Partnerships) Order (the "**Order**"), to modernise the UK limited partnerships regime for private funds by way of amendments to the Limited Partnerships Act 1907 (the "**1907 Act**"), came into effect. The reforms have been introduced with a view to simplifying the pre-existing law, reducing uncertainty and administrative costs and burdens, and ensuring that the UK remains an attractive and competitive location for private investment funds in comparison to other jurisdictions.

The reforms apply only to a limited partnership that is "designated" as a "Private Fund Limited Partnership" ("**PFLP**"). The pre-existing law continues to apply to all other English and Scottish limited partnerships.

A PFLP is a limited partnership that satisfies the following two conditions:

- it is constituted by an agreement in writing; and

- it is a "collective investment scheme" within the meaning of section 235 of the UK Financial Services Markets Act 2000 ("**FSMA**") but ignoring any exemptions pursuant to section 235 (5) of the FSMA (for example, the "group" exemption).

Most private investment funds (such as private equity and venture capital funds and their related vehicles such co-investment vehicles, and feeder funds) will fulfil these conditions.

The new regime is not mandatory: it is open to a limited partnership that satisfies the conditions to be a PFLP to choose not to apply to be designated as a PFLP, in which case the pre-existing limited partnership law will continue to apply to it.

The reforms make significant changes to the existing regime and largely relate to (i) introducing a list of matters (the 'white list activities') that limited partners can participate in without jeopardising their limited liability status; (ii) no longer requiring a limited partner to contribute capital to a UK limited partnership; and (iii) other miscellaneous changes relating to winding-up, filing/advertising requirements etc.

Further details on the reforms are contained in our client briefing.

Review of limited partnership law

Separately, in January 2017, the Business, Energy and Industrial Strategy Department ("**BEIS**") published a call for evidence on limited partnership law. BEIS conducted the review in light of concerns voiced in the media that some limited partnerships registered in Scotland are being used for criminal activity. The consultation also dealt with some more general points about limited partnership law. Depending upon the outcome of that consultation, further amendments to the 1907 Act may come into effect in 2018.

PSC Register extended to include Scottish limited partnerships

In June 2017, regulations making changes to the PSC regime came into force. The Information about People with Significant Control (Amendment) Regulations 2017 (the "**Regulations**") conform the UK PSC regime to the requirements of the EU Fourth Money Laundering Directive ("**MLD4**"). The Scottish Partnerships (Register of People with Significant Control) Regulations 2017 also came into force yesterday, and extend the PSC regime to Scottish limited partnerships and Scottish general partnerships in which the partners are all corporate bodies ("eligible Scottish partnerships").

Eligible Scottish partnerships are now required to identify their PSCs and register their PSC information at Companies House. They are not required to maintain their own PSC register. New statutory guidance on the meaning of "significant influence or control" over eligible Scottish partnerships has been published by Companies House. Links to the relevant Companies House PSC forms for eligible Scottish partnerships can be found here.

LGPS opt-ups

As noted in the Regulatory section of this briefing note under the heading of 'MiFID II', there is now a new retail client categorisation and opt-up criteria in respect of local government pension schemes ("**LGPS**"). This is relevant not only for the purposes of fund managers being able to market to LGPS, but also determining whether the PRIIPs Regulations will apply (and, therefore, whether a key information document is needed to market to the LGPS). The Local Government Pension Scheme Advisory Board has produced some useful guidance on how a LGPS can assess if the new opt-up process is available and also the documentation that a LGPS should provide to fund managers to request elective professional client status (see - http://lgpsboard.org/index.php/opting-up-process). For funds with LGPS as investors or which are being marketed to LGPS, the manager should expect to receive such applications for such existing and new funds.

Patient Capital Review and the British Business Bank

In his Autumn Budget, the Chancellor announced £2.5bn of new resources for the British Business Bank ("**BBB**") in response to the HM Treasury's Patient Capital Review and its consultation on Financing Growth in Innovative Firms. This, together with existing resources, will unlock up to £13bn of finance to support UK smaller businesses looking to scale-up and realise their growth potential and has received support from the British Private Equity & Venture Capital Association

("**BVCA**"). British Business Investments – the Bank's existing commercial arm – will cornerstone a small number of large scale, private sector managed funds of funds, which will in turn catalyse patient investment into high potential businesses. A 'Request for Proposals' to manage the first phase of these funds (up to £500million) will be issued early 2018, and two subsequent phases are possible subject to the market response.

The Government also intends to set up a working group of fund managers and institutional investors to unlock further supply of patient capital, including tackling barriers holding back DC pension investment in illiquid assets.

EuVECA Regulation

Although the European Venture Capital Funds ("**EuVECA**") Regulation was not due for general review until July 2017, the European Commission brought the review forward as part of the Capital Markets Union Action Plan so as to encourage an increase take-up which has been modest.

Accordingly, in November 2017 the text of the revised EuVECA Regulation entered into force and will apply from 1 March 2018.

The EuVECA Regulation applies to managers of alternative investment funds ("**AIFs**") that meet all of the following conditions:

- their assets under management in total do not exceed the threshold in Article 3(2)(b) of the AIFMD (that is EUR500 million);
- they are established in the EU;
- they are subject to registration in their home member state in accordance with the AIFMD; and
- they manage portfolios of qualifying venture capital funds (as that term is defined in the EuVECA Regulation).

Among other things, the revised text enables EuSEF and EuVECA registered managers to market their funds across the EU. Further, it also widens the range of managers eligible to set up and manage EuVECA and EuSEF funds to include those with assets under management of more than EUR500 million and widens the range of firms that EuVECA funds can invest in (to include unlisted companies with up to 499 employees).

ESMA has also been given an oversight role to ensure that funds are consistently registered and supervised.

ILPA's second phase of Reporting Template

In March 2017, the Institutional Limited Partners Association ("**ILPA**") launched Phase II of its Reporting Template. In 2016, ILPA released the ILPA Reporting Template for fees, expenses, and carried interest. The aim of the template is to encourage uniformity in these disclosures, both to provide limited partners with an improved baseline of information to streamline analysis and drive decision making, and to reduce the compliance burden on general partners being asked to report against a range of disparate formats from limited partners. Since its release, more than 140 organisations have endorsed the template, including more than 20 general partners. Additionally, it has been reported by limited partners mandating template usage that, as of Q3 2017, more than 200 general partners are completing the template when asked.

The ILPA Phase II Plan comprises a number of implementation initiatives to support and expand adoption of the reporting template. Specifically, the ILPA will:

- leverage existing template users' experiences to identify best practices for implementation, including raising awareness of the range of solutions from technology providers, fund administrators and other advisers;
- create "communities of practice" to exchange perspectives among reporting professionals using the template and provide recommendations for further development and support; and
- provide new guidance on oversight of data provided in the template, including recommendations on the role of auditors and third party service providers in ensuring compliance with limited partnership agreements.

ILPA guidance on use of credit facilities

In June 2017, ILPA published guidance regarding the risks and potential impact on limited partners resulting from using short-term financing to

bridge the time between a deal closing and the eventual calling of capital. The guidance also includes recommendations for greater disclosures and clarity in limited partnership agreements around parameters for their use. Specific recommendations include:

- within limited partnership agreements, waterfall provisions should specify that the date used to calculate the general partner's preferred return hurdle aligns to when the credit facility is drawn, rather than when capital is ultimately called from the LPs;
- managers using credit lines should disclose to their limited partners certain, specified information as part of quarterly reports;
- managers are advised against using these facilities to cover fund distributions in anticipation of, but prior to, a portfolio company exit; and
- limited partners sitting on advisory committees should consider adding a discussion item on the use of credit lines to LPAC meeting agendas, potentially to include an assessment of whether the terms of facilities in use are considered "market".

Industry response to the guidance has included a feeling that ILPA is overstepping as limited partners are sophisticated enough to engage with general partners on this issue and to make investment decisions. In its response, the Fund Finance Association ("**FFA**") stated that "*the FFA welcomes discussion with ILPA to ensure that ILPA's suggestions and best practices for facilities will be fully informed.*"

The guidance, reflecting any revisions subsequent to its initial release, will be incorporated into the forthcoming revised ILPA Principles, to be released by early 2018.

ILPA model Subscription Agreement

In December 2017, ILPA also published a model subscription agreement for private equity funds in an effort to streamline fundraising, increase clarity and improve the efficiency of capital formation. ILPA states that the modular, multi-jurisdictional document provides a balanced, off-the-shelf solution which can be easily customised to meet the needs of fund managers and their investors and has been developed by legal counsels representing the private equity industry.

ILPA model form subscription agreement is available on the ILPA website.

10th Annual PERG Report

In December 2017, the 10th edition of the annual report by PERG, the Private Equity Reporting Group, the body set-up in 2008 to monitor openness and transparency in the private equity industry and measure compliance with the Walker Guidelines, was published. Each year, a sample of approximately a third of portfolio companies that fall within the scope of the Guidelines are reviewed for compliance with the disclosure requirements. In 2017, compliance fell to 79%, against 86% the previous year. In its accompanying press release, PERG states non-compliance is driven by non-BVCA members. The fall is attributed to the failure of some private equity firms and their portfolio companies to embed the 2014 revisions of the Guidelines, and the continued rise in reporting standards by FTSE 350 companies, the benchmark PERG uses for judging compliance.

LISTED FUNDS

LPDT and AIM Rules

Listing Rule changes for 2018 IPOs

In October 2017, the FCA announced a package of rule changes which will affect fund IPOs scheduled for 2018.

From January 2018, a new version of the premium listing eligibility requirements will come into force. Notably, a new concessionary route for property companies will be introduced. In order to benefit from this route, the property company must either:

- demonstrate that it has three years of development of its real estate assets represented by increases of the gross asset value of its real estate assets, evidenced by financial statements and supported by a property valuation report; or
- demonstrate that 75% of the gross asset value of its real estate assets, as supported by a published property value report, are revenue generating at the point in time when the application for admission to a premium listing is made.

It is expected that this development will eliminate the current practice of property fund IPOs being followed by a conversion to Chapter 6 at a later date.

Chapter 6 has been redrafted for clarity and several new Technical Notes will be introduced.

To view our full briefing please click here.

UKLA Knowledge Base

The FCA launched several consultations in 2017. The only one pertinent to the listed funds market is Primary Market Bulletin No. 18 which consults on changes to the UKLA Knowledge Base, including proposed new technical guidance for sponsors on their obligations to ensure directors understand their responsibilities and obligations under the LPDT Rules.

LEI Requirement for Official List and AIM Companies

Since 1 October 2017, all Official List companies have been required to have a legal entity identifier or "LEI": a unique 20 digit alpha-numeric code which identifies companies participating in financial transactions. The DTRs require Official List companies to submit their LEI to the FCA whenever they make an announcement of regulated information, i.e. one including inside information.

As a result of MiFID II, all AIM companies now also need to have an LEI and should have obtained one by 30 November 2017. Under MiFID II, where an AIM company is a direct client of a MiFID investment firm and the MiFID firm has a transaction reporting obligation in relation to that client, it will need to identify the AIM company as buyer or seller in relation to the relevant transaction using an LEI code. If the AIM company does not have an LEI code, the MiFID firm will be unable to carry out any MiFID service for that company which would result in a transaction report needing to be filed.

Although ESMA has provided a last minute six month reprieve to deal with a backlog of applications, all companies should obtain an LEI without delay.

For further details, please see our client notes on these new requirements - Regulated information: new rules for announcements and LEI requirement for AIM companies.

Prospectus Regulation: publication in the Official Journal

In July 2017, the new Prospectus Regulation, which repeals and replaces the existing Prospectus Directive, entered into force. Whilst it will have effect from 21 July 2019, a limited number of provisions relating to the exemptions to the requirement to publish a prospectus came into force on 20 July 2017:

- the 10 per cent. "tap issue" exemption (where the shares being admitted to trading represent, over a 12 month period, less than 10 per cent. of the number of shares of the same class already admitted to trading on the same regulated market) has been increased to 20 per cent.

  In July 2017, the Pre-Emption Group published a statement confirming that it does not intend to change the pre-emption thresholds set out in its 2015 Statement of Principles following these changes, so institutional investors who might otherwise follow their guidance will need to be persuaded on a case by case basis to vote for a 20 per cent. disapplication of pre-emption rights. (See page 9 for more information on recent votes against such resolutions proposed by funds).

- the exemption where shares are converted or exchanged (where the shares result from the conversion or exchange of other transferable securities or from the exercise of rights conferred by other transferable securities, provided that the shares are of the same class as shares already admitted to trading on the same regulated market) has been limited, with some exceptions, so that it only applies when the resulting shares represent, over a period of 12 months, less than 20 per cent. of the number of shares of the same class already admitted to trading on the same regulated market. It is worth noting that the drafting of the new rule poses certain issues for several listed investment funds which have multiple currency classes. We are lobbying for guidance to clarify this.

From 21 July 2018, the consideration exemption threshold for offers to the public (where the offer has a total consideration of less than €5 million) is

being increased to €8 million, although member states can elect to set a smaller threshold of between €1 million and €8 million.

The de minimis threshold (where a prospectus is not required regardless of the type of offer) is being increased from €100,000 to €1 million.

ESMA Prospectuses Q&A

In October 2017, ESMA updated its Q&As on prospectuses. The amendments are mainly to reflect the implementation of the parts of the Prospectus Regulation relating to the exemptions from the requirement to publish a prospectus which came into effect in July 2017

AIM's designation as an SME Growth Market

In order to comply with the rules for SME Growth Markets, the AIM Rules now require that any prospectuses, annual or half yearly reports or notifications of inside information for the purposes of MAR, which are published from 3 January 2018 will be required to remain on an issuer's website for 5 years.

The provisions of Rule 18 (Insider Lists) will apply which provide a very limited exemption from the insider list requirement. This exemption is subject to the following conditions:

- the issuer taking all reasonable steps to ensure that any person with access to inside information acknowledges the legal and regulatory duties entailed and is aware of the sanctions applicable to insider dealing and unlawful disclosure of inside information; and
- the issuer being able to provide the competent authority, upon request, with an insider list.

Given the very limited nature of this exemption, and the fact that issuers will still be under an obligation to provide an insider list on request, AIM investment companies should not be changing their practices.

Consultation on proposed amendments to the AIM Rules

In December 2017, the London Stock Exchange published AIM Notice 49 which detailed feedback received to a discussion paper (AIM Notice 46) on changes to its rules and a consultation on the resultant proposed changes, which include:

- formalising an early notification process for nominated advisers to notify a proposed IPO to the London Stock Exchange (although, making it clear that early notification does not diminish a nominated adviser's obligation to assess the appropriateness of an applicant for admission);
- providing guidance to nominated advisers on appropriateness considerations; and
- requiring AIM companies to comply or explain against a recognised corporate governance code. There is no definition of a "recognised corporate governance code"; the AIC, in its consultation response, has suggested that codes that have been endorsed by a regulatory body, such as the AIC Code of Corporate Governance, be included in the definition.

Responses to the consultation are due by 28 January 2018; the changes to introduce the comply or explain statement are expected to take effect from 30 June 2018, to allow AIM companies adequate time to prepare for the change.

Market Abuse Regulation

ESMA MAR Q&A

ESMA published updated versions of its Q&A on MAR in July, September and November 2017, which covered the following:

- updated guidance on when a company ("B") would become a person closely associated with a PDMR of another company ("A") where the same individual was a PDMR of both (see CLLS below);
- a new question addressing how an issuer should deal with the situation where it has delayed a disclosure of inside information but subsequently the information loses the element of price-sensitivity and accordingly its inside nature; and
- two new questions on trading during closed periods and prohibition of insider dealing.

CLLS and Law Society MAR Q&A

In October 2017, the CLLS and the Law Society published a revised Q&A on MAR in line with

ESMA's view, which covers the position where a company (A) has invested in a listed company (B), and they have a common PDMR.

The CLLS Q&A now states that "B will not be a "person closely associated" to the director unless and until B carries out a transaction in A's financial instruments. If B does carry out a transaction in the financial instrument of A, B will only be treated as a "person closely associated" if the director took part in or influenced the decision of B to carry out that transaction. To avoid making B a "person closely associated" ... the director should not vote on, participate in any discussion in relation to or otherwise influence any decision of B to carry out a transaction in financial instruments of A. It will be sufficient for these purposes for the director to recuse him/herself from any board meeting discussing or relating to A, unless on the specific facts of the case the director otherwise exerted an influence on B's decision. A should not include B on its list of "persons closely associated", and the director should not notify B in writing of its obligations as a "person closely associated" to a "person discharging managerial responsibilities" in A under Art 19(5) unless and until B carries out a transaction in the financial instruments of A and the director participated in or influenced B's decision to do so."

Corporate Governance

Consultation for revisions to the UK Corporate Governance Code

In December 2017, the FRC published its awaited proposals for a revised UK Corporate Governance Code: a "comprehensive review to ensure that the Code remains fit for purpose". This is the biggest shake-up of the Code in recent years, and the changes will affect all companies on the premium segment of the Official List and others who have voluntarily agreed to comply with the Code. The consultation will close on 28 February 2018. The FRC aims to publish a final version of the Code by early summer 2018 and the new Code will apply to accounting periods beginning on or after 1 January 2019.

The proposals include revised guidance on the independence and tenure of non-executive directors. Currently, the Code provides that the board may determine a director to be independent notwithstanding the existence of certain relationships or circumstances, including where the director has served on the board for more than nine years. This presumption of independence will be removed and the revised Code will state that non-executive directors, including the chair, should not be considered independent for the purposes of board and committee composition, if any of the specified factors (including the nine year rule) are relevant. The FRC notes that, although the Code does not refer to tenure, many companies and investors use the nine year criterion for independence as a "de facto" tenure period. It confirms that this is the right approach and, in normal circumstances, it would not expect either an independent director or chair to be on a board for more than nine years in total, including where a non-executive goes on to become the chair. This will be particularly controversial for those chairmen who have not yet served nine years in their current role but previously held non-executive positions which would bring them within the nine year rule. We expect that some companies may therefore choose to explain their non-compliance in relation to this.

Please see our client note on the key changes and their implications.

Investment Association updates its principles of remuneration.

In November 2017, the IA wrote to the chairmen of remuneration committees of FTSE 350 companies to outline the key changes to The Investment Association Principles of Remuneration for 2018, and to highlight the items of focus for the 2018 AGM season. Following extensive changes to the Principles for 2017, the changes for 2018 are mostly incremental and only relevant to internally managed funds. The main rule change is a requirement for long term incentives and bonuses paid as shares to have a minimum 5 year vesting and post-vesting hold period (in total).

European Commission's consultation on institutional investors and asset managers' duties regarding sustainability.

In November 2017, the European Commission published a consultation on the duties of institutional investors and asset managers regarding sustainability. The consultation covers how asset managers and institutional investors could include environmental, social and governance factors when taking decisions. It closes on 22 January 2018.

FRC advice to audit committee chairs and finance directors for preparing 2017/18 annual reports.

In October 2017, the FRC published its advice to audit committee chairs and finance directors of companies for preparing 2017/18 annual reports. The letter of advice highlights changes to reporting requirements and key areas where the FRC considers that improvements can be made to annual reports in the 2017/18 reporting season.

New public Register of Shareholder Votes

As a result of the proposals in the Government's response to the Green Paper on corporate governance reform, the Investment Association has created a new Public Register of shareholder votes. The Public Register comprises FTSE All-Share companies who received votes of 20% or more against any resolution or who withdrew any resolution in 2017 and, going forward, will be updated on an ongoing basis. The IA will give companies to be included on the register the opportunity to provide an explanation of how they have addressed shareholder concerns since the shareholder vote. A link to any company's response will be included alongside its voting data in the Public Register.

The Register so far shows four attempts by funds to pass a 20 per cent. disapplication of pre-emption rights which have failed (Bluefield Solar, Diverse Income Trust, Custodian REIT and 24 Select Income). Unfortunately, it does not also record those companies which have passed a similar resolution, but we are aware of examples which have passed with nearly 100 per cent. of votes in favour.

PRIIPs and KIDs

A brief summary of the regulation is set out in the Regulatory section of this briefing note. All listed funds should have published their first Key Information Document on 1 January 2018 save for a few extremely rare exceptions where the fund was "not designed for retail investors".

We are aware of a handful of funds which have still to comply.

We will shortly be publishing a lawyer's survey of the KIDs produced to date which will complement the research produced by certain listed investment company brokers. Our analysis to date confirms many differing styles have been adopted and comparisons between competitor funds are not as obvious as one would hope. We suspect many funds will update their KIDs over the coming weeks which may lead to greater convergence.

Miscellaneous Listed Funds developments

Draft Omnibus 3 Regulation – Reforms to European financial supervision regime including centralisation of approval of certain prospectuses

In September 2017, the European Commission published a draft of the "Omnibus 3 Regulation" containing proposals to reform the EU's supervisory structure. Most relevant to the listed funds' industry are the proposals to extend ESMA's role and powers in respect of prospectuses and market abuse. This represents the first concrete step towards the creation of a single European capital markets supervisor.

It is proposed that, from 2019, the responsibility for approving certain types of prospectus will shift from the national competent authority to ESMA. These would include prospectuses drawn up by non-EU country issuers.

The proposals also include a greater role for ESMA in coordinating market abuse investigations. This could extend to recommending that competent authorities initiate investigations and to facilitating the exchange of information relevant for those investigations, where ESMA has reasonable grounds to suspect that activity with significant cross-border effects is taking place that threatens the orderly functioning and integrity of financial markets or financial stability in the EU. ESMA would maintain a data storage facility to collect from, and disseminate between, competent authorities, all relevant information

It is intended that these proposals would enter into force in 2019.

Investment and corporate banking: prohibition on restrictive contractual clauses

The FCA published new rules, which came into effect on 3 January 2018, banning provisions in authorised firms' engagement letters that restrict a client's choice of future providers of ECM, DCM

and M&A services, where those services are unspecified and uncertain.

The types of restrictive clauses that will be caught by the prohibition are:

- right to act clauses - these give the bank/broker the right to provide corporate finance services to the client (regardless of whether there are other banks/brokers willing to offer these services); and

- right of first refusal clauses - these prevent a company from accepting a third party offer to provide future corporate finance services unless the company has first offered the mandate to the bank/broker on the same terms as proposed by the third party bank/broker.

Please see our client note on this topic for further information.

Changes to PSC regime: application to AIM companies

In June 2017, important changes to the PSC regime resulting from the UK's implementation of the Fourth Anti-Money Laundering Directive came into force via The Information about People with Significant Control (Amendment) Regulations 2017.

While Main Market companies are still exempt from PSC requirements by virtue of being DTR 5 issuers, AIM companies are now subject to the PSC regime, as the exemption which applied to such companies has been removed.

Please see our updated client note outlining the requirements of the new regime.

TAX

Base erosion & profit shifting ("BEPS"): UK perspective

The UK government has expressed keen support for the BEPS project. The UK government is in the process of implementing (or has implemented) the OECD's recommendations on Action 2 (Hybrids), Action 4 (Interest deductibility), Action 5 (Harmful tax practices, including patent box) and Action 13 (Country-by-Country reporting). In other areas, the UK already considers that its domestic legislation satisfies the minimum standard or best practice (for example, existing UK Controlled Foreign Companies rules in relation to Action 3).

Hybrid rules

The UK anti-hybrids rules enacted as part of the wider OECD BEPS project came into force on 1 January 2017. Other EU countries will be required to implement similar anti-hybrid rules in the next couple of years under the EU's Anti-Tax Avoidance Directive (as amended in May 2017), but for now the UK is the only EU country to have enacted any such rules.

Finance Bill 2018, the first draft of which was published on 1 December 2017, proposes a series of changes to the UK anti-hybrid rules, some of which are to apply from 1 January 2017 (i.e. have retrospective effect) and some of which are to apply from 1 January 2018. Broadly speaking, the proposed changes are intended to clarify various uncertainties within the rules which had been identified by HMRC.

Finance Bill 2018 is only in draft form and may be subject to change, but the following proposed changes are of particular note:

- An amendment to the hybrid payee deduction/non-inclusion mismatch rule (Chapter 7), so that where the hybrid entity payee is a partnership which is treated as transparent in both the partnership and partner jurisdictions, it is assumed that no ordinary income arises as a result of the payment – and therefore there is no mismatch to counteract.

- An amendment to the imported mismatch rules (Chapter 11) to ensure that the amount of the counteraction under Chapter 11 is not greater than it would have been had the mismatch been counteracted by the direct chapters (Chapters 3 to 10).

- An amendment to the hybrid entity double deduction mismatch rules (Chapter 9), so that the rules take into account certain transactions which do not generate a tax deduction for the payer, but give rise to a taxable receipt for the payee. However, it is currently uncertain whether the amendment (as currently drafted) adequately solves the difficulties for structures with US fund managers and UK sub-advisers.

Corporate interest restriction

The UK Government has implemented the OECD's BEPS recommendations on interest deductibility with new rules which came into effect on 1 April 2017. Groups with net interest cost of £2 million or less will suffer no restriction on deductibility for a period. Otherwise, under the 'fixed ratio method', a group's deductible net interest cost is set at 30% of its UK group's taxable EBITDA, subject to a debt cap. There is an alternative 'group ratio method' worked out by reference to the group's worldwide ratio of net interest expense to EBITDA, again subject to a debt cap. There are specific rules for public infrastructure companies. Disallowed interest cost can be carried forward indefinitely and potentially reactivated in a later period. Unused interest allowance can be carried forward for up to five years.

Under the draft Finance Bill 2018, the definition of 'group' is to be amended so that asset management arrangements do not cause groups to be consolidated – this is likely to exclude such entities as LLPs and collective investment schemes from being the ultimate parent of a group (thereby preventing otherwise unrelated portfolio groups from being grouped together).

The Multilateral Instrument

The UK, together with over 70 other jurisdictions, has signed up to the OECD's Multilateral Instrument ("**MLI**") (Action 15 of the BEPS project), although it has yet to be ratified by the UK Parliament. The UK MLI Position Paper indicates that the UK intends to adopt the MLI treaty abuse principal purpose test ("**PPT**") provisions in its double tax treaties. The UK will not adopt the MLI permanent establishment changes to the 'dependent agent'/'independent agent' test or the specific activity exemptions, but it will adopt the anti-fragmentation rule. The UK has signed up to much of the dispute resolution actions implemented by the MLI, and is one of the few countries committed to binding arbitration.

We published an overview of the MLI as part of our "Asset Management Tax: Summer reading" note (click here), which focused on the treaty changes most relevant to funds and asset managers (treaty abuse and PE status) to give an overview of the options chosen by key jurisdictions.

Loss relief restrictions

New rules came into effect on 1 April 2017 which impose a further limit on carried forward losses, while also giving greater flexibility in using prior year losses and moving those losses forward around a group. These rules relate to trading and other revenue losses, not capital losses. Under the rules, carried forward losses incurred from 1 April 2017 can be set against taxable profits from different activities and profits of other group members. However – subject to an annual group wide £5 million de minimis allowance - the amount of profit that can be relieved by carried forward losses (whenever incurred) is restricted to 50% from 1 April 2017.

The implications of these new rules will likely be significant for many of our clients who manage limited partnership funds with UK general partners, and may have a direct economic impact on fund managers. In August 2017 we produced a note which considered the impact of these new rules on UK general partners. For further detail, please click here.

Substantial shareholding exemption

New rules came into effect on 1 April 2017 which relax the substantial shareholding exemption ("**SSE**") (the UK's participation exemption). Previously, gains on the disposal of shares were tax exempt where the investing company held a 10% shareholding for a 12 month period in the two years prior to the disposal. Requirements as to the investing company and the investee company's trading status also had to be satisfied. The trading condition for investing companies has been entirely abolished and the requirement for investee companies to satisfy the trading condition immediately after the share disposal has also been relaxed. The qualifying period has been extended from two to six years.

In addition, a new exemption for share disposals by 'qualifying institutional investors' (such as pension schemes, sovereign wealth funds, investments trusts and AIFs) has been introduced from 1 April 2017. Where certain conditions are met, disposals by qualifying institutional investors which would fall outside the main exemption – disposals of shares in non-trading companies or shares where the investor did not hold a 10% shareholding – will be tax exempt.

Partnership tax rules

The partnership taxation rules previously published in draft in September 2017 (dealing with, for example, partnerships which are partners in other partnerships) will be enacted in 2018 as part of Finance Bill 2018. However, the controversial profit and loss allocation provisions have been deleted in the latest draft of the bill, which was published in December 2017.

The new rules propose various changes to the reporting requirements for partnership tax returns, particularly in relation to partnerships which are partners in other partnerships and the treatment of partners holding via nominee/bare trust. One welcome change proposed by the new rules is that where an investment partnership makes CRS / FATCA returns, the investment partnership is no longer required to include a unique tax reference number (UTR) for each overseas partner in the partnership.

VAT grouping

In December 2017 HMRC published its response to a consultation document entitled "Scope of VAT Grouping", which sought views on the future structure of UK VAT grouping following the decisions of the Court of Justice of the European Union in *Larentia + Minerva and Marenave* (C-108/14 and C-109/14) and *Skandia America Corporation* (C-7/13).

The response document noted that HMRC recognised the importance of VAT grouping to businesses, and that HMRC will continue to look at the scope of VAT grouping and the issues raised by respondents. HMRC intend to discuss their interim views with the Joint VAT Consultative Committee and other invited representative bodies. The response document also noted that HMRC's review would take place alongside a consideration of the outcomes of the UK's EU exit negotiations.

In the meantime HMRC intends to clarify its current approach to certain types of partnerships through a policy paper and clearer guidance for business – but it is currently unclear when this policy paper and guidance will be published.

Corporate criminal offence of failure to prevent the facilitation of tax evasion

Two new corporate criminal offences for failing to prevent the facilitation of tax evasion (whether in the UK or overseas) were enacted under the UK's Criminal Finances Act 2017 and came into force on 30 September 2017. Under the new rules, a company, partnership, LLP or similar foreign entity can be criminally liable where it has failed to prevent the criminal facilitation of tax evasion by a 'person associated' with it – this is someone who provides services for it, or on its behalf (e.g. an employee, agent, contractor, joint venture partner or other third party service provider). A business can only claim a defence to the offence if it has 'reasonable prevention procedures' in place to prevent those acting on its behalf from facilitating tax evasion.

This is not an asset manager specific issue, although HMRC has identified the financial services sector as high risk. These offences require all businesses, irrespective of size or sector, to review their business and supply chains for potential tax evasion risk – of UK and foreign taxes – and to update their compliance policies and procedures to ensure that the business satisfies the defence. Foreign businesses are also potentially caught by the scope of both offences and so should undertake the same review. If found guilty of an offence, businesses could be liable for unlimited financial penalties and other sanctions, which could be significant for regulated entities.

In February 2017 we produced a note which considered the impact of these new rules for asset managers and advisers. For further detail, please click here.

Disposals of UK land by non-residents to become subject to UK tax

On 22 November 2017 the UK Government announced that from April 2019 UK tax (corporation tax for corporate bodies, otherwise capital gains tax) will be charged on gains made by non-residents on disposals of all types of UK immovable property. The details and scope of the new rules have not yet been finalised, and are subject to an ongoing consultation process. The consultation paper proposes that non-residents will also be subject to UK tax on the disposal of an interest in an entity which derives its value from UK residential or commercial property if the non-

resident has a 25% or more stake and the entity is 'property rich'. The proposal is that an entity will be 'property rich' if 75% or more of its value derives directly or indirectly from UK land at the time of disposal based on gross values (i.e. ignoring loan financing).

HMRC / HM Treasury acknowledge that there is significant investment in UK commercial property through investment funds and that the impact on them needs to be carefully considered. Having made these promising noises, the consultation paper nonetheless states that 'in general' HMRC/HM Treasury do want the new rules to result in a non-UK fund (or presumably, its non-resident investors where the fund is transparent) being subject to UK tax when it sells UK-property or where it sells UK property rich entities.

The consultation paper acknowledges that the recent extension to the SSE (substantial shareholding exemption) (see above) may apply to the sale of a 'property rich' entity by a holding company where the relevant conditions are satisfied. Where this new SSE limb applies, a percentage of the gain (up to 100%) is treated as exempt from corporation tax. The conditions for this limb include that the company is not trading, and that at least 25% of the holding company is owned by 'qualifying institutional investors' such as pension schemes, sovereign wealth funds, investments trusts and AIFs.

REGULATORY

MiFID II

The recast EU Markets in Financial Instruments Directive ("**MiFID II**") and Markets in Financial Instruments Regulation ("**MiFIR**") took effect on **3 January 2018**. During 2017, the FCA published two policy statements (PS 17/5 and PS 17/14) which set out its final rules for implementing MiFID II in the UK.

Although managers of collective investment undertakings (such as AIFMs, UCITS managers and operators of residual collective investment schemes ("**CISs**")) are not directly within scope of the MiFID regime when acting in that capacity, the new rules will nonetheless still have an impact on them because:

- AIFMs or UCITS managers also undertake certain permitted MiFID "top-up" activities and therefore are directly subject to certain MiFID-based rules when doing so;
- counterparties with whom fund managers are dealing (e.g. brokers, trading venue operators or third party distributors of fund interests) are themselves subject to MiFID rules and in order to comply with those requirements, they require (whether by contract or as a matter of practice) the fund managers to adhere to certain new standards; and/or
- the FCA has chosen to "gold plate" the application of certain MiFID requirements by extending these to fund managers in its domestic rules.

In terms of "gold-plating", PS 17/14 confirmed that the FCA:

- will not extend the application of transaction reporting requirements to fund managers (even when they are undertaking MiFID "top-up" activities);
- will apply the best execution requirements (including data publication reports) to UCITS managers, but will not apply them to AIFMs or residual CIS operators;
- will not apply the requirements relating to telephone taping and recording of electronic communications to fund managers, provided that the relevant transactions do not relate to instruments which are admitted to trading, traded or subject to a request for admission to trading on a trading venue (or related instruments whose price or value depends on, or has an effect on, the value of such instruments);
- will apply, with appropriate modifications, the ban on receiving inducements and the associated research rules on investment research to fund managers when executing orders or placing them for execution, subject to an exemption in relation to AIFs or CISs whose core investment policy:
  - does not generally involve investing in financial instruments that can be registered in a financial instruments account opened in the books of a depositary or physically delivered to a depositary; or

- generally involves investing in issuers or non-listed companies in order to acquire control.

In practice, this means that the ban and research rules will not apply to private equity fund managers;

- will apply the product governance requirements as guidance, but not binding rules, to fund managers (but note that fund managers may be required to comply with certain product governance requirements as a matter of practice if they are deemed to be co-manufacturing with an in-scope firm and/or interests in their funds are distributed by MiFID firms); and

- will apply the new retail client categorisation and opt-up criteria in respect of local authorities to both MiFID and non-MiFID business.

By now, fund managers should have identified those elements of MiFID II which will impact them (either directly or indirectly) and have well-advanced implementation plans for any elements that they have not managed to implement in full by 3 January 2018. It is also likely that MiFID counterparties with whom fund managers regularly interact will (if they have not already) be making contact to discuss the new requirements, including any changes in the terms of agreements or additional required data from 2018 onwards.

PRIIPs Regulation

The Regulation on Packaged Retail and Insurance-Based Investment Products ("**PRIIPs**") took effect on **1 January 2018**. A PRIIP includes investments in relation to which the amount repayable to the investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the investor. In practice, this will therefore include shares or units in all types of funds, including AIFs, non-AIF CISs and UCITS funds, although UCITS funds benefit from transitional relief until 31 December 2019.

As "manufacturers" under the PRIIPs Regulation, fund managers (or, in the case of listed investment companies, potentially the fund itself) will be required to prepare the PRIIPs key information document ("**KID**") if interests in the relevant fund are made available to retail investors (as defined under MiFID II) on or after 1 January 2018. This includes where a fund was established prior to 1 January 2018, but continues to be made available to retail investors on or after that date. The KID must comply with the detailed technical standards set out in Commission Delegated Regulation 2017/653 ("**PRIIPs RTS**"). The PRIIPs manufacturer will be liable if a retail investor can demonstrate loss as a result of relying on a misleading or inaccurate KID.

Firms that advise on or sell PRIIPs to retail investors are required to provide the relevant KID to such investors in good time before they are bound to enter into the transaction. This will include firms (such as adviser-arrangers) that may be involved in distributing fund interests to retail investors, but may also catch fund managers themselves to the extent that they are directly involved in distribution.

Firms that do not make PRIIPs available to retail investors (for example, because they do not sell products to retail investors and include appropriate restrictions on the subsequent distribution of products that they do sell) will fall outside the scope of the PRIIPs Regulation. However, MiFID firms should be aware of ESMA's view that under the MiFID II costs and charges disclosure regime, where the relevant product is a PRIIP, the detailed methodology applicable for calculating the costs of that product should be as set out in the PRIIPs RTS, even if that product is not being distributed to retail investors and a PRIIPs KID is not required. This means that MiFID firms that deal in PRIIPs on behalf of their professional clients (for example, by buying and selling interests in investment funds) will need to gather the relevant data and apply the PRIIPs methodology in order to make costs disclosures to those clients. In turn, this may mean that PRIIPs manufacturers, such as fund managers, may be asked to provide additional granular information to facilitate the application of the PRIIPs cost methodology, even though their funds are not made available to retail investors and they do not have to prepare a PRIIPs KID.

UK Senior Managers and Certification Regime

In July 2017, the FCA published a consultation paper (CP 17/25) which set out its initial proposals for extending the Senior Managers and Certification Regime ("**SMCR**") to all firms

authorised under the Financial Services and Markets Act 2000. Currently, the SMCR only applies to (broadly) UK banks and insurers, but the FCA anticipates that HM Treasury will publish legislation that will require it to be extended to other FCA-regulated firms from a date in (or a series of dates starting in) 2018 that is yet to be specified.

The extended SMCR will replace the existing approved persons regime. In many cases, it is likely to reduce the number of individuals within a firm that require FCA pre-approval to perform their roles, but it will also require firms to take responsibility for certifying certain other staff as being fit and proper to perform their functions. In addition, all employees within the firm (except those performing specified ancillary roles which are set out in an exhaustive list) will become subject to new conduct rules and will need to be trained on them.

In December 2017, the FCA published three supplementary consultation papers, which address technical issues such as the forms that will be required under the new SMCR and the mechanics for transitioning to the new regime. Of these, CP 17/40 addresses the arrangements for non-insurer firms transitioning to the SMCR, while CP 17/41 discusses the same issues for insurers. CP 17/42 discusses the FCA's proposed approach to applying the duty of responsibility under the SMCR for both insurers and non-insurer FCA solo-regulated firms. A policy statement setting out final substantive rules arising from all of the consultations is expected in summer 2018. The latest CPs do not confirm the date on which the extension of the SMCR will take effect and note that this still needs to be determined by HM Treasury. However, for the purposes of its draft rules in the latest CPs, the FCA has assumed that the rules will apply to insurers in late 2018 and to FCA solo-regulated firms in mid-to-late 2019. Firms should continue to monitor for further announcements which may confirm the final timetable.

We published a briefing in July 2017 summarising the FCA's proposals on the extension of the SMCR and their main practical implications, which is available here, and a supplementary briefing in December 2017 noting the publication of the supplementary CPs, which is available here.

EBA opinion on new prudential regime for investment firms

On 29 September 2017, the European Banking Authority ("**EBA**") published an opinion addressed to the European Commission containing the EBA's proposals for a new prudential regime for MiFID investment firms. If these proposals are introduced as law, they would result in significant changes to the regulatory capital rules applicable to MiFID firms, as well as impacting other areas such as pay regulation and disclosure requirements for such firms. Fund management groups with MiFID firms within their structures would therefore be affected by the new rules. We published a briefing which summarised the EBA's proposals in October 2017, which is available here.

On 20 December 2017, the European Commission published a legislative proposal setting out a proposed new directive and regulation based on the EBA's opinion. These proposals will still need to be negotiated and agreed by the European Parliament and Council in order to become effective. The timetable for the entry into force of any new legislation is unclear and may be affected by a number of factors, but it is possible that the new regime could take effect by 2020 if the legislative process is not unduly delayed. We published a briefing on the Commission's proposals in December 2017 highlighting the most significant elements and identifying key areas which had gone beyond the EBA's advice, which is available here.

The EBA's proposals are separate from the proposed regulation amending the EU Capital Requirements Regulation ("**CRR II**") and proposed directive amending the existing CRD IV Directive ("**CRD V**"). Those texts are still subject to negotiation between the European institutions and are not expected to be finalised until mid-2018 at the earliest. However, the final revised prudential regime that results from the EBA's proposals may affect whether the CRR II and CRD V rules are relevant to individual firms, depending on the extent to which the new regime excludes firms from the current CRR and CRD IV regime.

AIFMD

On 5 October 2017, ESMA published an updated set of Q&As in relation to the application of the AIFMD (ESMA34-32-352).

One new response confirmed that the remuneration disclosure requirements in relation to AIF annual reports also apply to the staff of a delegate to whom an AIFM has delegated portfolio or risk management. The AIFM may obtain the relevant information in one of two ways:

- if the delegate is subject to regulatory rules which require remuneration disclosures in relation to its staff undertaking portfolio and/or risk management that are equally as effective as the AIFMD disclosure requirements, the AIFM may use the information disclosed by the delegate for those purposes. ESMA has not expressly defined the concept of "equal effectiveness" in this context, although the language used in the response appears to envisage that the delegate will be subject to the specific AIFMD rules; or

- through appropriate contractual arrangements with the delegate which allow the AIFM to receive and disclose in its annual report the necessary information about remuneration of identified staff within the delegate in connection with the delegated portfolio.

ESMA has also confirmed that information on remuneration disclosures in the AIF annual report should be included in the report itself, rather than by way of a link or cross-reference to external material.

The revised Q&As also give further guidance on how AIFMs should report their use of securities financing transactions ("**SFTs**") on behalf of the AIF. In particular, ESMA has confirmed that generally, the information should be reported as a snapshot as at the reporting date, except in relation to data on the reuse of collateral and data on the return and cost for each type of SFT.

EMIR

In May 2017, the European Commission published a proposal for a regulation to amend the existing European Market Infrastructure Regulation ("**EMIR**"). A number of the proposed amendments are likely to be welcomed by firms, including increased proportionality in relation to the EMIR clearing requirements.

However, certain amendments may be less well received, including the proposal to broaden the definition of a "financial counterparty" in a manner which is likely to capture non-EU AIFs managed by non-EU AIFMs. In turn, this could mean that many such AIFs, when trading with in-scope EU counterparties, would be required to comply with the expensive EMIR clearing and margining requirements for the first time, whereas as non-financial counterparties, are currently exempt from doing so unless they exceed one of the specified clearing thresholds.

It remains to be seen how the proposals change during negotiations throughout the legislative process. In any event, it is unlikely that any agreed amendments would enter into force prior to late 2018 at the earliest, but firms should continue to monitor developments in this area.

We published a briefing in July 2017 summarising the Commission's proposals and discussing their implications for firms, which is available here.

EU Securitisation Regulation

On 28 December 2017, the official text of the Securitisation Regulation (Regulation (EU) 2017/2402) was published in the EU Official Journal. Broadly, the Securitisation Regulation aims to:

- harmonise due diligence, risk retention and transparency requirements for parties involved in securitisations, including originators, sponsors, original lenders and investors; and

- establish the regulatory framework for so-called "simple, transparent and standardised" ("**STS**") securitisations.

In particular, it will:

- impose a direct risk retention requirement of at least 5% on the originator, sponsor or original lender (rather than the existing indirect approach, whereby regulated investors suffer a penal capital charge if they invest in securitisations where the risk retention requirements have not been met, which creates market pressure for the originator, sponsor or original lender to comply);

- introduce new due diligence requirements for regulated investors;

- make originators, sponsors and securitisation special purpose entities ("**SSPEs**") subject to new transparency rules requiring them to make additional information available about the

securitisation structure and the underlying exposures;

- introduce a new regime for "securitisation repositories" to hold data on securitisations;
- introduce new restrictions on the sale of securitisation positions to retail clients;
- ban re-securitisations, except in relation to those which are used for "legitimate purposes" which have been approved by regulators; and
- introduce a new regime for STS securitisations, which will qualify for more favourable regulatory treatment.

In parallel, the text of a regulation amending the existing CRR to introduce revised regulatory capital rules applicable to positions in securitisations (Regulation (EU) 2017/2401) was also published in the Official Journal on 28 December 2017. This will introduce new rules relating to securitisation exposures which are designed to be more risk sensitive and which will introduce more favourable regulatory capital treatment for STS securitisations.

Both the Securitisation Regulation and the regulation amending the CRR will apply from **1 January 2019**, although certain grandfathering and transitional arrangements apply. Fund managers that are involved in establishing and/or structuring securitisations will need to assess the implications of the new legislation carefully in order to ensure that future securitisations have an efficient regulatory capital structure and comply with the increased disclosure requirements. Where a fund manager invests in securitisations on behalf of the funds it manages, it will need to take into account the new due diligence requirements and the potentially increased information available to it.

MLD 4

The Fourth Anti-Money Laundering Directive ("**MLD 4**") was required to be transposed into national law by EU Member States by 26 June 2017. In the UK, the relevant requirements were given effect from that date through the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 ("**MLRs 2017**").

In addition to the formal legislation itself, additional guidance on the applicable requirements has been published in the Risk Factor Guidelines published by the joint European Supervisory Authorities in June 2017 and in the guidance published by the UK Joint Money Laundering Steering Group ("**JMLSG**") in December 2017 (building on consultations published in June and November 2017). The FCA also published finalised guidance in July 2017 (FG 17/6) on how firms should treat customers who are politically-exposed persons ("**PEPs**") when complying with the new anti-money laundering obligations.

By now, firms should have reviewed their anti-money laundering and customer due diligence ("**CDD**") procedures to ensure that these are compliant with the new requirements in the MLRs 2017 and take into account the Risk Factor Guidelines, the JMLSG guidance and the FCA guidance on PEPs. This will involve, amongst other steps, revisions to the firm's CDD documentation and internal policies, as well as additional staff training.

MISCELLENOUS

BREXIT

The Brexit negotiations continued to dominate headlines in 2017 and the ongoing uncertainty looks set to preoccupy funds, their managers and advisers in 2018.

In the UK, the European Union Withdrawal Bill (the "**EU Withdrawal Bill**"), formerly referred to as the Great Repeal Bill and subsequently the Repeal Bill, was published and given its first reading in Parliament in July 2017, together with the Government's *EU Withdrawal Bill: explanatory notes*. The EU Withdrawal Bill will repeal the European Communities Act 1972, which provides that EU law has effect in the UK and must be followed by the courts, and gives wide powers to ministers to amend UK law to make it consistent with the requirements of EU law. It passed its second reading in Parliament and, at the time of writing, is currently in Committee Stage for debate on a clause by clause basis before the whole House of Commons.

Some key Brexit related developments in 2017 include:

- In July 2017, ESMA published various opinions containing sector-specific principles, building on the general opinion published by ESMA in May 2017. These included (i) an *Opinion on investment firms* which addresses regulatory and supervisory arbitrage risks related to the relocation of investment firms' activities. It is based on the framework under the *Markets in Financial Instruments Directive* (*2004/39/EC*) ("**MiFID**") and the *MiFID II Directive* (*2014/65/EU*); and (ii) an *Opinion on investment management* which addresses regulatory and supervisory arbitrage risks related to the relocation activities of UCITS management companies, self-managed investment companies and authorised alternative investment fund managers ("**AIFMs**"). It is based on the framework under the *Alternative Investment Fund Managers Directive* (*2011/61/EU*) ("**AIFMD**") and the *UCITS IV Directive* (*2009/65/EC*)

- in August 2017, the Financial Markets Law Committee published a letter addressed to the Ministry of Justice that highlights issues of legal uncertainty arising out of clause 3 of the EU (Withdrawal) Bill in relation to direct EU legislation forming part of domestic law on and after exit day provided that it is 'operative immediately before exit day';

- in September 2017, the Law Society published a briefing that outlines its views on the EU Withdrawal Bill and its wider priorities for Brexit. The Law Society is calling for the Government to provide clarity around the use of delegated powers, to place greater emphasis on the devolved administrations and to seek transitional arrangements;

- also in September 2017, the House of Lords Constitution Committee launched an inquiry into the EU Withdrawal Bill which will examine the constitutional implications of the EU Withdrawal Bill across the following three broad themes: (i) the relationship between Parliament and the executive; (ii) the rule of law and legal certainty; and (iii) the consequences for the UK's territorial constitution;

- also in September 2017, the Association for Financial Markets in Europe ("**AFME**") and UK Finance published a *joint paper* on the impact of Brexit on cross-border financial services contracts;

- in November 2017, the European Commission published a Notice to Stakeholders warning that EU company law will no longer apply in the UK following Brexit; and

- also in November 2017, Michel Barnier (chief negotiator for the European Commission on the Brexit negotiations) gave a speech that considered the impact of Brexit on financial services. Mr Barnier stated that the legal consequence of Brexit would be that UK financial services providers will lose their EU passport. However, he also stated that the EU would "have the possibility to judge some UK rules as equivalent", based on a proportional and risk-based approach, and in those areas where EU legislation foresees equivalence.

Following the Brexit vote in 2016, many considered that UK based managers would be moving their operations offshore but this has not materialised to date. Instead, there are signs within the investment funds industry that it will be fund vehicles, rather than UK based managers, which will migrate. From a legal perspective, a potential migration could be considered and agreed now and included in key documentation as an option within the manager's control (for private funds, such an option could be included in a limited partnership agreement; for listed funds, this could be included in in the investment management agreement).

Given the lack of clarity thus far on what arrangements will eventually replace the UK's membership of the EU, funds, investors and their advisers need to plan ahead for the post-Brexit world as best they can. The key priorities for the investment funds industry remain the need (i) for a sensible transitional arrangement between the UK and the EU to be put in place and agreed early on in the negotiation process; and (ii) post-Brexit, UK firms to still have access to EU investors and vice versa as a loss of access to the European market would substantially impact the ability of the UK industry to raise funds and could reduce the amount of investment available to businesses in both the UK and Europe.

Property funds, open-ended investment funds and liquidity risks

During 2017, open-ended funds and liquidity risks were in the spotlight. The FCA published its findings on its review of fund suspensions and

pricing adjustments by property funds following the Brexit vote in June 2016. Linked to this, the FCA decided to issue a discussion paper (DP17/1) as part of a broader review of the regulatory approach to open-ended funds investing in illiquid assets. Whilst both of these publications are focused on authorised funds and linked life assurance contracts because they provide greater access to retail investors, the papers provide a useful summary of liquidity management tools and demonstrate the direction of travel for open-ended funds of all asset classes.

Regarding property funds specifically, the FCA noted that the use of liquidity management tools such as deferring and suspending redemptions were effective in preventing the escalation of market uncertainty following the Brexit referendum. However, concerns were raised on the need to ensure investors properly understand the implications of these tools on their ability to redeem, especially under stressed market conditions. Questions were also raised about the 'fair value pricing' adjustments that were applied and whether it is appropriate for funds to invest in illiquid assets when they offer frequent redemption opportunities.

These themes were expanded in the discussion paper on illiquid assets and open-ended funds. The paper highlights the different types of liquidity management available: portfolio construction and keeping a liquidity buffer; applying redemption charges, including using a sliding scale depending on the length of time the investment has been held; applying fair value pricing when the manager considers that asset valuations have become unreliable; deferring redemptions (or 'gating'); suspending redemptions; and redemptions in specie. Further, the paper sought feedback on whether the regulator should develop its rules. Suggestions included different treatment for professional and retail investors within the same fund, developing rules and/or guidance to require funds to use specific tools to manage liquidity risks and requirements for enhanced disclosure.

The FCA indicated it would provide feedback on its discussion paper during 2017, although this is still awaited. If the FCA decides to propose new or amended rules, it will then issue a consultation paper.

General Data Protection Regulation

The General Data Protection Regulation (2016/679) ("**GDPR**") will take direct effect on 25 May 2018 repealing the Data Protection Directive (95/46/EC), which was implemented in the UK by the Data Protection Act 1998. In the UK, the Data Protection Bill 2017 ("**DP Bill**") had its first reading in the House of Lords. The DP Bill will replace the Data Protection Act 1998. Although the GDPR will have direct effect when it comes into force, the GDPR and the DP Bill should be read side by side when enacted, as the bill effectively serves to "fill in the gaps" not covered by the GDPR, and makes certain provisions as to how the GDPR will be implemented in the UK. Crucially, article 23 of the GDPR permits Member States to introduce derogations to the GDPR in certain situations.

For various reasons, the GDPR (or something like it) is likely to remain a part of English law regardless of Brexit. Further, the GDPR will significantly extend the application of the EU data protection regime, catching GPs and fund managers outside the EEA. The GDPR, like the current directive, will apply to data controllers (the person who determines the purposes and manner in which personal data is processed) established in the EU, but it will also apply to data processors (a person who processes personal data on behalf of the data controller).

Day one compliance is required. Funds and their administrators should now consider the issues and changes they will need to make and use the next few months to put them into effect, e.g. in terms of their procedures, systems and technology, in order to be ready. In many cases, funds will need data subject consent to its use of their data. The requirements surrounding obtaining and being able to demonstrate consent to a fund's use will be much tighter (particularly in direct marketing), use of online behavioural advertising etc. – for instance "opt out" boxes will no longer be acceptable.

For further information about the issues discussed in this briefing, please contact one of the partners in our Investment Funds group, or your usual contact at Travers Smith.

Travers Smith

January 2018

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