



Friday, 19 October 2018

# HM Treasury and FCA Brexit proposals for investment funds

HM Treasury and the FCA have published draft regulations and rules which contain their respective Brexit proposals for investment funds. These are designed to facilitate the "onshoring" of EU legislation relating to investment funds, including AIFs and UCITS funds, and to establish a temporary permissions regime following the UK's withdrawal from the European Union.

In this briefing, we discuss the key elements of each of these proposals as they relate to AIFs and UCITS and identify some of the resulting practical implications.

## SUMMARY OF KEY POINTS

### NON-EEA FUNDS MARKETED IN THE EEA

- Funds that have been notified for marketing under the UK national private placement regime (NPPR) will be largely unaffected by Brexit.
- Some minor helpful changes are being made – e.g. to confine the portfolio company and anti-asset stripping regimes to UK targets. In practice, this is only likely to help funds which are not marketed in other EEA jurisdictions because the wider portfolio company provisions will continue to apply to marketing in the EEA.

### FUNDS MARKETED BY EEA AIFMS

- This applies only to existing funds and sub-funds which have been validly notified or registered for marketing in the UK by an EEA AIFM prior to exit day – i.e. 29 March 2019 if there is a "no deal" Brexit, or, if there is a transitional period as part of a deal, such later date as is specified under that deal (currently expected to be 31 December 2020).
- A temporary permissions regime will permit the EEA AIFM to continue to market the fund for up to 3 years. The EEA AIFM must notify the FCA in Q1 2019 that it wishes to rely on the temporary permissions regime. Subsequently, it will be given a fixed time window during which it must apply for the fund to be registered for marketing in the UK. Once registered, the fund will be treated as a NPPR fund.
- If the AIFM fails to register for the temporary permissions regime, or fails to apply for registration under the UK NPPR during its subsequent window, it will lose the right to market the fund until it makes a new application under the NPPR. New funds or sub-funds established after exit day will also need to be registered under the NPPR and cannot benefit from the temporary permissions regime.

- Following exit day, the AIFM will need to provide relevant notifications to the FCA, as well as to its home regulator.

## EEA AIFM MANAGEMENT PASSPORTS

---

- A temporary permissions regime will apply in a similar way to the AIFM management activities of UK branches of EEA AIFMs.

## UK AIFM PASSPORTS

---

- In the absence of a deal, no similar arrangements are expected to be in place for UK AIFMs in relation to their marketing and/or management activities in the EEA.

## UCITS

---

- The temporary arrangements for UCITS will be very similar to those for AIFs, but with some nuances reflecting the different regimes.
- After exit day, UK UCITS will have a stand-alone UK regulatory regime and are not expected to retain EEA passporting rights.
- From a UK perspective, non-UK UCITS will be treated in the same way as AIFs.

## BACKGROUND

Under the European Union (Withdrawal) Act 2018 (EUWA) as currently enacted, all EU law will, through a process of automatic domestication or "onshoring", be preserved and retained as of "**exit day**" – 29 March 2019. All EU regulations which are currently directly applicable will be incorporated into UK domestic law. The practical impact of this is that AIFMD and the UCITS regime will continue to apply in the UK. However, EUWA also gives HM Treasury the power to correct "deficiencies" in the "onshored" legislation in order to ensure that it works and makes sense once the UK is no longer a member of the EU.

The recent publications are:

- the draft [Alternative Investment Fund Management \(Amendment\) \(EU Exit\) Regulations 2018 \(AIFM Exit SI\)](#) and an [accompanying explanatory policy note](#);
- the draft [Collective Investment Schemes \(Amendment etc.\) \(EU Exit\) Regulations 2018 \(CIS Exit SI\)](#) and an [accompanying explanatory policy note](#);
- the draft [EEA Passport Rights \(Amendments etc. and Transitional Provisions\) \(EU Exit\) Regulations 2018 \(Passporting SI\)](#) relating to passporting rights under a range of EU Single Market legislation, including AIFMD and the UCITS Directive, and an [accompanying explanatory policy note](#); and
- the Financial Conduct Authority's (FCA) [consultation paper](#) setting out its proposals in relation to the temporary permissions regime.

The AIFM Exit SI and the CIS Exit SI serve to correct any deficiencies as regards Level 1 and Level 2 legislation that is relevant to investment funds, including by implementing a temporary marketing permissions regime for fund marketing. The Passporting SI seeks to introduce a more general temporary permissions regime relating to activities that may be undertaken in the UK on a passported basis under EU Single Market legislation.

In addition, HM Treasury has delegated its deficiency-correcting power to the UK regulators as regards all binding technical standards made under EU legislation and we are expecting drafts of their correcting instruments in due course.

Note that EUWA, and each of the SIs, are currently predicated on there being a "hard Brexit" – i.e. the UK will leave the EU on 29 March 2019 without any transitional deal. If there is a deal, amendments will be required to postpone the process of onshoring EU legislation until the expiry of the transitional period – currently defined as 31 December 2020 in the draft EU Withdrawal Agreement.

## KEY PROPOSALS RELEVANT TO AIFMS

From the perspective of AIFMs, the key points contained in the AIFM Exit SI, the Passporting SI and in the FCA's consultation paper are as follows:

### TEMPORARY PERMISSIONS REGIME FOR EEA AIFMS – MARKETING IN THE UK

---

The AIFMD marketing passport will cease to be available from exit day. Broadly speaking, incoming EEA AIFMs will be permitted to continue to market their EEA and third country AIFs in the UK on the existing basis (i.e. on the same terms and subject to the same conditions as under the current marketing regime) for up to three years provided that, prior to exit day, such AIFs were validly registered for marketing under the existing regime and the AIFM has notified the FCA that it wants to take advantage of the temporary marketing permission. The window for making such notifications to the FCA is expected to open in early 2019 and will close before exit day. The FCA is expected to publish the exact dates for the notification window in due course.

Note that the temporary marketing permission is **fund-specific**, and will not apply in relation to any AIFs that have not been previously marketed or notified: these will have to be marketed under the UK national private placement regime (**NPPR**). The FCA has confirmed in CP 18/29 that this means, for example, that an AIFM cannot add new established AIFs or sub-funds of umbrella AIFs to its temporary marketing permission after exit day – these will instead have to be marketed under the UK NPPR. It is unlikely that the EU will be granting any reciprocal rights to UK AIFMs in terms of their outward marketing activities.

During the temporary permission period, the fund manager will be allocated a "landing slot" during which it must submit an application to the FCA to register the relevant AIF under the UK NPPR. The FCA is proposing that this application must be submitted through its Connect system. If the fund manager fails to submit the required notification during the landing slot, **it will no longer benefit from the temporary marketing permission and therefore will need to cease marketing in the UK** (at least until it is able to re-register appropriately under the NPPR). The FCA also states that it is unlikely to allow a fund manager to request a different landing slot, save for exceptional cases.

Following exit day, the FCA will no longer have the right to receive relevant information about incoming EEA AIFMs from their Home State supervisors. As a result, where an EEA AIFM is relying on the temporary marketing regime, if it is required to provide any information to its Home State regulator under AIFMD, it will need to provide the same information directly to the FCA. The FCA has yet to specify how such information should be provided, but has stated that it will provide further information on its website in due course.

### TEMPORARY PERMISSIONS REGIME FOR EEA AIFMS – UK MANAGEMENT ACTIVITIES

---

Although it is less likely in practice, the temporary permissions regime in the Passporting SI will also cover EEA AIFMs who were carrying on AIF management activities from the UK in reliance on the AIFMD management passport prior to exit day (for example, through a UK branch). In that case, such AIFMs will be deemed to have equivalent UK domestic Part 4A permissions covering all activities permitted under the passport, provided that they notify the FCA that they intend to rely on the temporary permissions regime during the notification window. The AIFM will then be allocated a "landing slot" during which it must submit an application to obtain formal Part 4A permission for the relevant activities, following which it will be treated as a third country branch.

The application of the FCA rules to such AIFMs during the temporary permission period is complex – essentially, the FCA is proposing that they should be subject to all FCA rules that applied to them when exercising the management passport, as well as any FCA rules that implement requirements reserved to a

# TRIVERS SMITH

---

Home State regulator under AIFMD. However, in the case of Home State rules, the AIFM will be able to rely on "substituted compliance" if it can show that it complies with the equivalent requirements under the Home State provisions and these cover its UK activities. Certain additional FCA rules designed to ensure appropriate consumer protection will also apply.

Due to the relative complexity of the FCA's proposals in this area and the fact that such arrangements are uncommon in practice, we have not provided further details in this briefing. We can, however, provide further advice to clients on request.

## MARKETING OF NEW EEA AIFS

---

All new EEA AIFs will be treated like other third country AIFs and will require marketing under the NPPR under Regulation 59 (Article 42 AIFMD) in order to be marketed to professional investors.

## TECHNICAL DEFINITION OF AN AIF

---

The existing definition of AIF will change so that only UK UCITS will be carved out. This means that, in future, EEA UCITS will be viewed in the UK as AIFs, although UCITS which obtain individual recognition under section 272 FSMA will be relieved from the NPPR requirements regarding information and reporting.

Note that the CIS Exit SI (see below) contains a temporary marketing regime which will allow EEA UCITS which have been marketed under a passport prior to Brexit to continue to be marketed for up to three years, subject to notifying the FCA.

## ACQUISITION OF CONTROL OF COMPANIES AND ASSET-STRIPPING

---

The company transparency and asset stripping regime under AIFMD will only apply in the UK in relation to acquisitions of control in companies which have their registered office in the UK and, in the case of issuers, which are admitted to trading on a UK regulated market.

The UK regime will apply to UK AIFMs and third country AIFMs marketing their AIFs under the UK NPPR (following Brexit, EEA AIFMs will be third country AIFMs for these purposes).

While helpful, in practice these changes will only assist funds which are not marketed in other EEA jurisdictions because the wider portfolio company provisions will continue to apply to marketing in the EEA.

## COOPERATION ARRANGEMENTS

---

A number of provisions are dependent on the existence of appropriate cooperation arrangements between the FCA and the relevant supervisory authorities of a third country – for instance the rules governing: a full-scope UK AIFM wanting to manage a third country AIF that it is not marketing in the UK or Gibraltar; a full-scope UK AIFM wanting to market a third country AIF in the UK under the NPPR; and a third country AIFM wanting to market in the UK under the NPPR.

We understand that there is optimism on the part of the various supervisors that such cooperation arrangements will be in place by exit day, if required. If they are not, this may obviously have a significant impact on certain AIFMs' ability to manage or market AIFs on a cross-border basis.

## ANNEX IV REPORTING

---

The frequency of reporting will continue to be determined by reference to the AUM thresholds for each of the UK and EU AIFs that an AIFM manages or for each AIF that it markets in the UK or the EU – i.e. this will not be determined solely on the basis of funds established in or marketed in the UK.

---

## REFERENCES TO FCA RULES IN EXIT SI

---

As part of the deficiency-correcting exercise, many references to EU legislative provisions have been replaced by references to the UK AIFM Regulations or specific rules in the FCA Investment Funds sourcebook (FUND) as it has effect on exit day. On the face of it, no future amendments to those "static" rules will be possible except by way of further statutory instrument.

## KEY PROPOSALS FOR UCITS MANAGERS AND OTHER MANAGERS OF AUTHORISED FUNDS

As regards UCITS managers, the key points in the CIS Exit SI, the Passporting SI and in the FCA's consultation paper are as follows:

### SCOPE AND RELABELLING – THE NEW UK UCITS REGIME

---

From exit day onwards, there will be a "standalone" regime for UCITS-like funds established and authorised in the UK, to be labelled "UK UCITS". Such funds will no longer qualify as UCITS under the UCITS Directive because they will no longer be established and authorised in the EEA. As a result, they will not have passporting rights into the EEA. However, the existing rules as regards eligible assets will be maintained for UK UCITS and it will still be possible for the cash of the UK UCITS to be booked in an account with any EEA credit institution.

### TEMPORARY PERMISSIONS REGIME FOR EEA UCITS – MARKETING AND/OR MANAGING IN THE UK

---

The FCA is introducing a temporary permissions regime for EEA UCITS and EEA UCITS managers which operates in a very similar way to that for AIFMs, adapted to reflect the technical differences between the two regimes. This should ensure that EEA UCITS and EEA UCITS managers can continue to market and/or manage their funds in the UK seamlessly for a period of up to 3 years.

We can provide further advice on the technical differences between the two regimes to clients on request.

### MARKETING OF EEA UCITS AFTER EXIT DAY

---

All EEA UCITS not covered by the temporary permissions regime (e.g. UCITS or sub-funds that are established after exit day, or UCITS in respect of which the manager failed to make a notification under the temporary permissions regime) will require recognition under section 272 FSMA if they are to be marketed to retail investors. Any marketing to professional investors will require notification under the UK's NPPR under Regulation 59 (Article 42 AIFMD) as a third country AIF.

### UK UCITS AND OTHER UK AUTHORISED FUNDS

---

Broadly speaking, the various entities involved in the managing and marketing of UK authorised funds will all have to be located in the UK. More specifically:

- in an authorised unit trust under section 243 FSMA, the manager and the trustee must each be a body corporate incorporated in the UK and have their place of business here;
- in an open-ended investment company, the sole director and the depositary must both be bodies corporate incorporated in the UK, and the depositary must also have a place of business here;
- in an authorised contractual scheme, the operator and the depositary must each be a UK body corporate and have a place of business in the UK, and their affairs must be conducted in the UK.

Under the temporary permissions regime created under the Passporting SI, EEA firms with UK branches will be able to obtain temporary permission to continue carrying on regulated activities in the UK. To complement that, the above UK location requirements will be switched off for as long as the UK branch of an EEA firm has

# TRIVERS SMITH

---

such temporary permission, so that any depositaries, trustees, operators and/or managers operating through such a branch can continue carrying on their activities for a limited period.

## UK REGULATED ACTIVITY OF MANAGING A UCITS

---

HM Treasury's policy note, together with a proposed amendment to the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001, suggest that the UK Regulated Activities Order will be amended to redefine the section 51ZA activity as managing a UK UCITS.

Curiously, the CIS Exit Order does not actually make any amendments to the Regulated Activities Order – this looks like it might be an oversight, unless appropriate amendments are effected in another Exit Order.

## CROSS-BORDER UCITS MERGERS

---

Following the bifurcation of the UK UCITS regime and the EU UCITS Directive regime, it will no longer be possible to effect a merger between a UK UCITS and an EEA UCITS (although mergers between two UK UCITS will still be possible).

## REFERENCES TO FCA RULES IN EXIT SI

---

As with the AIFM Exit SI above, as part of the deficiency-correcting exercise, the CIS Exit SI replaces many references to EU legislative provisions with references to the FCA Collective Investment Schemes sourcebook (COLL) as it has effect on exit day. On the face of it, no future amendments to those "static" rules will be possible except by way of further statutory instrument.

If you would like to know more about how these issues may affect you and your firm, please contact any of the partners named below.

## FOR FURTHER INFORMATION, PLEASE CONTACT

---

10 Snow Hill  
London EC1A 2AL  
T: +44 (0)20 7295 3000  
F: +44 (0)20 7295 3500  
[www.traverssmith.com](http://www.traverssmith.com)



### Tim Lewis

Head of Financial Services and Markets

E: [tim.lewis@traverssmith.com](mailto:tim.lewis@traverssmith.com)  
T: +44 (0)20 7295 3321



### Jane Tuckley

Partner, Financial Services and Markets

E: [jane.tuckley@traverssmith.com](mailto:jane.tuckley@traverssmith.com)  
T: +44 (0)20 7295 3238



### Phil Bartram

Partner, Financial Services and Markets

E: [phil.bartram@traverssmith.com](mailto:phil.bartram@traverssmith.com)  
T: +44 (0)20 7295 3437



### Stephanie Biggs

Partner, Financial Services and Markets

E: [stephanie.biggs@traverssmith.com](mailto:stephanie.biggs@traverssmith.com)  
T: +44 (0)20 7295 3313



### Sam Kay

Head of Investment Funds

E: [sam.kay@traverssmith.com](mailto:sam.kay@traverssmith.com)  
T: +44 (0)20 7295 3334



### Aaron Stocks

Partner, Investment Funds

E: [aaron.stocks@traverssmith.com](mailto:aaron.stocks@traverssmith.com)  
T: +44 (0)20 7295 3319



### Jeremy Elmore

Partner, Investment Funds

E: [jeremy.elmore@traverssmith.com](mailto:jeremy.elmore@traverssmith.com)  
T: +44 (0)20 7295 3453



### Will Normand

Partner, Investment Funds

E: [jeremy.elmore@traverssmith.com](mailto:jeremy.elmore@traverssmith.com)  
T: +44 (0)20 7295 3616