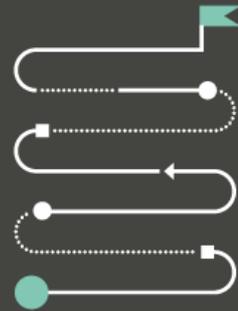


Funds Annual Briefing 2021

Our annual briefing highlighting the key 2020 legal developments which impact the funds' industry and previews what can be expected in 2021.



February 2021

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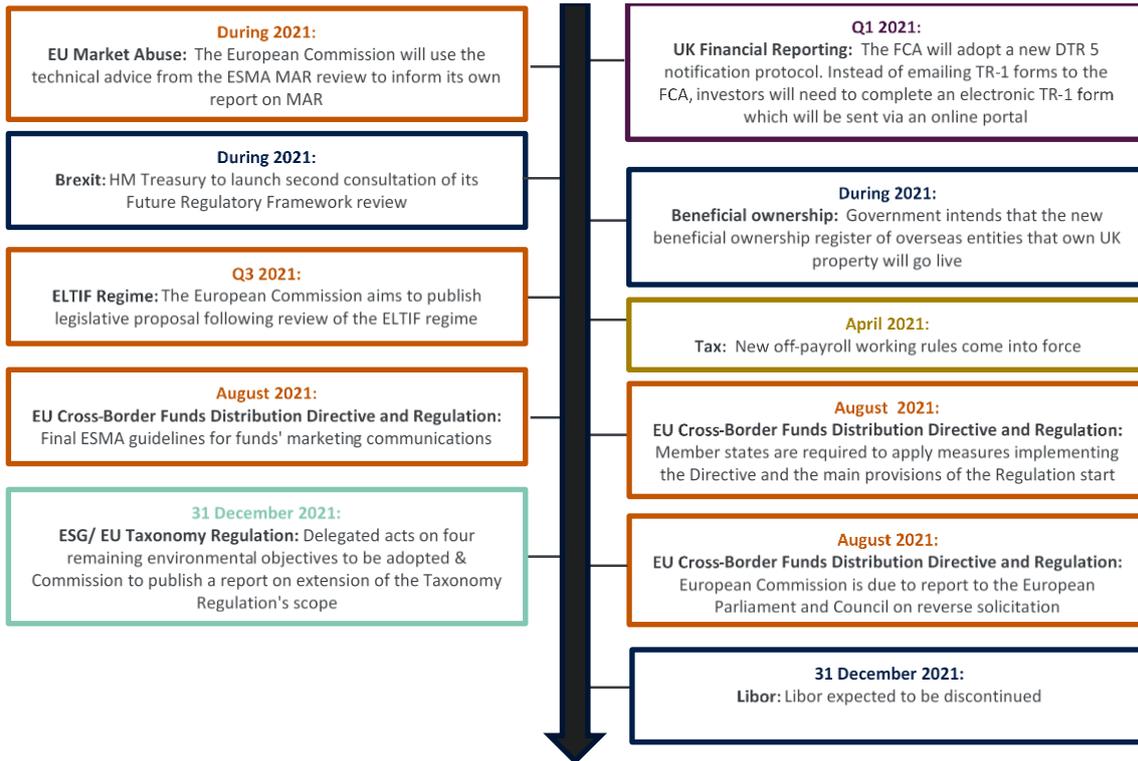
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1. TIMELINE OF UPCOMING DEVELOPMENTS





2. HEADLINE GRABBERS

BREXIT: KEY CONSIDERATIONS

Following the end of the Brexit implementation period on 31 December 2020 ("**IP completion day**"), the UK is no longer treated as an EEA Member State; from the perspective of the EEA, the UK is now a third country. Under the European Union (Withdrawal Act) (2018) all EU law in effect as at 31 December was, broadly, converted and preserved in domestic legislation (known as retained EU law), with amendments made by way of statutory instruments ("**SIs**") to correct "deficiencies" in retained EU law. These corrections were designed to ensure that the domesticated and onshored legislation makes sense and operates properly in the UK: the SIs are not intended to make policy changes other than to reflect the UK's new position outside the EEA.

The FCA has reiterated that it expects issuers, investors and other market participants to have taken reasonable steps to be able to comply with the new regulatory obligations from the end of the implementation period. Directions made by the FCA under its Temporary Transitional Power ("**TTP**") apply in some specific instances, allowing firms and other regulated persons to rely on the legislation or rules which applied before 31 December 2020 and giving them additional time (until March 2022) to prepare to meet the changes to their UK regulatory obligations brought about by onshoring.

On Christmas Eve 2020, the UK and EU finally agreed a post-Brexit [Trade and Cooperation Agreement](#). Much of the 1,259-page Agreement is devoted to matters of cooperation, trade and services in areas other than financial services.

What we can say about the Trade and Cooperation Agreement and financial services is as follows:

- **International standards:** The UK and EU agree to use their best endeavours to ensure that internationally agreed standards in the financial services sector are implemented and applied – these standards include those from the Basel Committee, IOSCO, FATF and OECD.
- **Prudential carve-out:** While general provisions relating to services and investment (including most favoured nation treatment) apply, specific provisions governing the supply of financial services apply to (and override) these, including a significant "prudential carve-out", meaning that neither Party is prevented from adopting or maintaining unilateral measures for the protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by the financial services supplier

or to ensure the integrity and stability of the Party's financial system.

- **Clearing and payment systems:** Financial service suppliers from the UK and EU will have access to each other's payment and clearing systems operated by "public entities" and to funding and refinancing facilities in the normal course of business (but not access to "lender of last resort" facilities).
- **Regulatory cooperation:** in a non-binding declaration outside the terms of the Trade and Cooperation Agreement itself, the UK and the EU will "aim to agree" by March 2021 a Memorandum of Understanding between them establishing a framework for regulatory cooperation on financial services.

What the Trade and Cooperation Agreement does not, and was not expected to, address, however, is the question of equivalence for financial services. This is a matter of respective unilateral decisions, not bilateral negotiation and takes account of national interests: it is not an objective assessment of "equivalence". In many ways, this is *the* critical question for financial services firms. The European Commission's process of assessing the UK is continuing. It remains to be seen how long it will take before there are meaningful mutual equivalency declarations and, if so, in which of the regulatory regimes there is such mutuality. It should be stressed that, while the assessment process might result in the introduction of something analogous to the passport if the European Commission assesses the UK's regulatory regime as "equivalent", it is not the same as single market access under a passport.

In the meantime, in January 2021 ESMA published a [statement](#) reminding firms of the requirements under MiFID II concerning the provision of investment services to retail or professional clients by firms not established or situated in the EU. The statement does not contain any new guidance but instead can be seen as warning to UK firms seeking to rely upon the reverse solicitation exemption now that the passporting regime has ended due to Brexit.

Some key points to note:

Considerations for AIFMs

Loss of AIFMD management passport:

UK alternative investment fund managers ("**UK AIFMs**") will now be regarded by the EEA as third country AIFMs and will therefore be treated in the same way as any other non-EEA AIFM. Therefore, if the local law of a relevant EEA jurisdiction governing an alternative investment fund established there ("**EEA AIF**") requires

the AIFM of such an AIF to have a passport or other local licence, a UK AIFM will be unable to manage such an AIF. Some Member States have implemented transitional contingency measures: UK AIFMs will be required to comply with applicable national rules and may need to apply to the relevant regulator for authorisation. This process will vary from Member State to Member State.

Loss of AIFMD marketing passport:

UK full-scope AIFMs which previously relied upon the AIFMD marketing passport to market their funds into EEA jurisdictions will instead need to identify on a jurisdiction-by-jurisdiction basis whether local law permits the fund to be marketed by a third-country AIFM. Where it does, the UK AIFM must continue to register under the Member State's national private placement regime ("**NPPR**"). Where the relevant jurisdiction does not offer an NPPR, investment in the AIF by investors in that jurisdiction will only be possible by way of valid reverse solicitation or by establishing an EEA AIFM.

Similarly, full-scope EEA AIFMs will no longer be able to use the AIFMD marketing passport to market their funds into the UK. As regards those funds which were in existence and being marketed in the UK prior to the termination of the transition period, EEA AIFMs had until 30 December 2020 to register to use the FCA's temporary marketing permission regime ("**TPMR**"). Under the TPMR EEA AIFMs can continue to market such pre-existing funds in the UK - in practical terms as if the passport was still in existence – for up to three years (although coverage is likely to end sooner than that in respect of specific funds depending on circumstances). Otherwise, and in respect of all new funds marketed after 31 December 2020, EEA AIFMs will need to rely on the UK NPPR regime instead.

There are two marketing scenarios not covered by the TPMR given that it only extends to marketing previously undertaken under the AIFMD passport. These are covered by transitional relief under directions made under the FCA's TTP which provide that:

- a UK AIFM can continue to market an EEA AIF in the UK that was being marketed in the UK immediately before IP completion day in accordance with the UK implementation of AIFMD as it stood immediately at that time: the effect is to relieve the UK AIFM from having to immediately re-notify the marketing under the UK NPPR (i.e. because the EEA AIF is now, from a UK perspective, a third country AIF), and
- an EEA AIFM can continue to market a non-EEA AIF (or a feeder AIF of a non-EEA AIF) that was being marketed in the UK immediately before IP completion day in accordance with the UK

implementation of AIFMD as it stood immediately before IP completion day: the effect is to relieve the EEA AIFM from having to immediately re-notify the marketing under a different provision of the UK NPPR (i.e. because the EEA AIF is now, from a UK perspective, a third country AIFM).

The TTP applies until 31 March 2022.

Sub-threshold UK AIFMs will continue to market into the EEA under NPPR regimes, if available. Sub-threshold AIFMs marketing into the UK under the NPPR must report transparency information to the FCA.

Under the EU AIFMD, the depositary of an EEA AIF must be established in the home member state of that AIF. Under the onshored AIFMD regime, an AIFM of a UK AIF must ensure the appointment of a depositary "established in the UK". "Established" in either case (when referring to an unauthorised AIF) means "having its registered office or branch in". Therefore, leaving aside other issues (such as licensing requirements and other factors, and unlike a specific location requirement under UK UCITS as regards depositaries) it remains possible for the depositary of a UK AIF to be the London branch of an EEA bank and for the depositary of an EEA AIF to be the EEA branch of a UK bank.

UK Market Abuse

The UK has adopted a broadly similar regime to the European Market Abuse Regulation ("**UK MAR**"). Under UK MAR, issuers that are based in an EU member state who have financial instruments admitted to trading or traded on a UK trading venue, will be required to:

- send notifications of delayed disclosure of inside information to the FCA;
- obtain consent from the FCA, in the case of credit and financial institutions, when delaying disclosure of inside information; and
- send (or their Persons Discharging Managerial Responsibilities ("**PDMRs**") must send) PDMR transaction notifications to the FCA.

Amendments to be made to the UK regime (as set out in the Financial Services Bill in October 2020), will consist of:

- clarifying who is required to maintain an insider list, establishing that issuers and any person acting on their behalf or on their account are all required to maintain such a list;
- extending the time allowed for companies to notify PDMR dealings to two working days after receipt of the notification; and
- extending the maximum criminal sentence for market abuse from seven to ten years, aligning

the sentence length to comparable economic crimes in the UK.

The UK MAR requirements are in addition to any notification requirements that continue to apply under EU MAR. This will require a broader scope of issuers to report to the FCA and, in some cases, result in dual reporting requirements.

Prospectuses

To make a public offer of securities in the UK or seek admission to trading on a UK regulated market, a prospectus will need to be approved by the FCA (as the existing prospectus passporting regime will cease to apply to the UK). This will be the case irrespective of whether the prospectus has already been approved by a national competent authority of an EEA member state.

Issuers will need prospectus approval by an EEA competent authority before being able to make a public offer in EEA jurisdictions. Issuers who have chosen the UK as their home Member State for prospectus approval, and issuers who currently have the UK as their home Member State for prospectus approval due to their registered office being in the UK, will have to choose a new home Member State.

For placing programme prospectuses approved by the FCA prior to 31 December 2020, from 1 January 2021, a prospectus will need to be approved in the issuer's new EEA home member state for the part of the offer that will take place in the EEA. This means that it is likely that the issuer will have to start a new offer once a prospectus is approved within the EEA.

For placing programme prospectuses approved by an EEA competent authority prior to 31 December 2020, the FCA has put in place grandfathering provisions and will continue to accept prospectuses approved by other EEA competent authorities prior to 31 December 2020 until their validity expires (i.e. 12 months from the date it was originally approved). These prospectuses will be treated as if they had been originally approved by the FCA. Supplements must be approved by the FCA.

PRIIPs regime

The UK has adopted the UK's PRIIPs KID regime, which is operationally equivalent to the EU PRIIPs regime although some divergence between the two regimes will occur once the UK implements its proposed targeted amendments to the UK regime ([see below](#)). Funds will therefore require (i) a key information document ("KID") in relation to anyone advising on, selling or otherwise making available a PRIIP to a retail investor in any member state of the EEA, pursuant to the EU PRIIPs Regulation; and (ii) a second KID in relation to any such retail investor in the UK.

The FCA's TTP apply in respect of PRIIPs KIDs which were first made available before 31 December 2020.

This means that a person can continue to rely on a KID that was prepared before 31 December 2020 in compliance with the EU PRIIPs Regulation and in respect of a PRIIP that was first made available to retail investors in the EU or the UK before 31 December. The powers apply until 31 March 2022.

For the most up to date Brexit analysis, please visit the [Travers Smith Brexit website](#).

POST-BREXIT LANDSCAPE FOR FUNDS OPERATING IN THE UK

The UK has already started to consider both short and long-term opportunities for reform brought about by Brexit.

Short term initiatives include the Financial Services Bill (the "**FS Bill**"), introduced to Parliament in October 2020, to ensure that the UK's regulatory framework continues to function effectively for the UK after leaving the EU. Included in the FS Bill is the introduction of a new Overseas Funds Regime to allow overseas domiciled retail funds (and money market funds) to be marketed to investors in the UK (see further details [here](#)).

The government has also launched Lord Hill's review of the UK's listing regime by publishing Policy paper: [Call for Evidence – UK Listings Review](#). The review is driven by Brexit and will inform proposals to boost the UK's reputation as a destination for IPOs. Views are sought on the following areas:

- **Free floats** - In particular around whether the UK's 25% free float requirement is calibrated at the right level.
- **Dual class share structures** - Whether there is demand for, and whether they should be permitted, as well as how to address related corporate governance issues.
- **Track record requirements** - Whether they are a barrier to some companies listing and whether further flexibility in this regard is required.
- **Prospectuses** - Whether the requirements for when a prospectus has to be produced (currently harmonised at EU-level) are appropriate for the UK market, how these requirements could be change and if the general exemptions to a prospectus are widened whether the loss of disclosure or liability attached the prospectus document should be replaced.
- **Dual and secondary listing** - Whether the requirements around dual and secondary listing are a barrier to dual listing in the UK,

and whether anything could be changed to further encourage dual and secondary listings in the UK.

Many see Brexit as an opportunity to re-evaluate the choice of funds vehicles currently available in the UK and to carve-out a more suitable and competitive vehicle for today's markets. A number of longer-term initiatives have begun in relation to this. HM Treasury have published the [Future Regulatory Framework \(FRF\) Review: Consultation](#). The consultation is the second phase of the FRF Review, which considers how the regulatory framework for financial services needs to adapt to be fit for the future, in particular to reflect the UK's new position outside of the EU. Further details on the 'HMT launch the Future Regulatory Frameworks' section [here](#).

The Government's promised consultation on a wider review of the UK funds regimes is shortly due. Given the commitment of Rishi Sunak for a new fund structure for longer term investments being up and running within the year, it is likely that this will encompass the 2019 proposal by the Investment Association for a new UK Long-Term Asset Fund ("LTAF"). These proposals involve adapting the existing NURS framework, to create a new, more flexible, open-ended, FCA authorised fund for investing in long-term assets, while maintaining an appropriate degree of investor protection. While redemptions could be daily, it is anticipated that the fund could permit these to be more akin to the liquidity of the underlying investment, possibly up to 2 years. The Investment Association anticipates that the target market for the LTAF would be DC pension schemes, professional investors and private wealth/discretionary portfolio managers. The final structure of the LTAF is yet to be seen, but it is assumed that it could fit into one or more of the existing alternative investment ("AIF") structures and the existing AIF tax regime. Travers Smith has published a detailed paper '[The retailisation of alternative investment strategies](#)' which considers the opportunities (and pitfalls) of retailisation structures.

The Association of Real Estate Funds, also published proposals for a new fund vehicle, the Professional Investor und ("PIF"). This is intended to fill an important gap in the UK's fund offering for professional investors (when compared to other jurisdictions). In particular, fund managers looking for a flexible, unlisted, unregulated, income transparent fund to hold UK real estate investments, currently often have to use an offshore structure to achieve the required commercial and tax efficiency. The PIF would be a new UK contractual fund, largely modelled on the authorised contractual fund (ACS), but as an unregulated collective investment scheme (UCIS), open to professional investors investing at least £1m. Being unauthorised, it could offer considerable flexibility around liquidity, gearing and investment criteria: in particular, it could be

closed or open-ended or a hybrid. Ideally, the tax position should follow that of the ACS (broadly income transparent, with gains only taxable on disposal of interests by investors (not in the PIF) and transfers of units being outside the scope of stamp duty land tax and stamp duty). Seeding relief has also been asked for. While initially focussed on the real estate market, it is envisaged that it could potentially work for other types of investments also.

In addition, the government has proposed the introduction of a new tax privileged regime for asset holding companies (AHCs) in alternative fund structures. While the final rules need to be sufficiently simple to be operationally attractive, the proposals are nonetheless an exciting development, with the Government clearly having taken on board much of the industry feedback in relation to how the UK rules for AHCs could be improved and looking to introduce a regime which will make the UK a highly competitive jurisdiction for AHC location.

Travers Smith has published a detailed paper '[The UK Alternatives Asset Management Industry Blueprint for a Bright Future](#)'. The paper outlines the importance of the industry and details how it can now be protected in order to maintain the UK's status as a world leader in the sector.

WIDE-RANGING REVIEW OF UK FUNDS REGIME

What is this?

The Government is in the process of carrying out a wide-ranging review of the UK's fund regime covering tax and relevant areas of regulation.

Who does this apply to?

The review is relevant to the asset management sector generally.

When does this apply?

The review is underway.

In its March 2020 Budget, the Government announced that it would undertake a review of the UK funds regime, covering taxation and relevant areas of regulation. The overarching objective of the review is to identify options which will make the UK a more attractive location to set up, manage and administer funds and which will support a wider range of more efficient investments better suited to investors' needs. The review consists of three workstreams:

1. a "call for input" published on 26 January (the "CFI");

2. proposals for a new tax privileged regime for asset holding companies in alternative fund structures (discussed further [below](#)); and
3. a review of the VAT treatment of fund management fees, which the government intends to take forward this year (discussed further [below](#)).

The CFI is very broad in scope. A number of specific issues are raised but HMT makes clear that it also wants to hear about any other measures that enhance the UK funds regime. It does not discuss any potential changes to corporate law, so that may be one, though we understand that any initiative here would be led out of a different team in the Government.

One area covered by the CFI is the possible introduction of new fund structures.

Given the commitment of Rishi Sunak for a new fund structure for longer term investments being up and running within the year, it is unsurprising that the Investment Association's Long-Term Asset Fund ("LTAF") proposals are discussed. These proposals involve adapting the existing NURS framework, to create a new, more flexible, open-ended, FCA authorised fund for investing in long-term assets, while maintaining an appropriate degree of investor protection. While redemptions could be daily, it is anticipated that the fund could permit these to be more akin to the liquidity of the underlying investment, possibly up to 2 years. The Investment Association and HM Treasury (HMT) anticipates that the LTAF would be attractive for DC pension schemes.

The CFI explains that the FCA plans to consult early in 2021 on setting up a framework for the LTAF and that, in addition, HMT, Bank of England and FCA are convening an industry working group to address current impediments to investment in long-term assets, which will be important in supporting the successful delivery of the LTAF. To complement those workstreams the CFI itself focuses on the tax treatment of the LTAF, with the starting point being that the current rules for authorised investment funds are likely to be adopted. Notably here, different tax rules can apply for such funds, depending on the relevant legal and regulatory structure.

The CFI also discusses different options for a flexible, tax-efficient, unauthorised fund structure, capable of investment in alternative asset classes, which would be aimed at professional investors, aimed at filling another gap in the current UK offering. The proposals being considered which the CFI seeks views, are (1) those of the UK Funds Regime Working Group and the Alternative Investment Management Association that the fund could be structured as either a corporate or as a partnership; and (2) the Association of Real Estate

Fund's suggestion that it could be structured as a contractual scheme.

From a tax perspective, specific issues raised in the CFI include:

- considering whether authorised funds should be exempted from tax altogether (noting that this could make claiming treaty relief under double tax treaties difficult);
- improving the position of multi-asset/balanced authorised funds;
- after observing that the number of registrations of UK-domiciled limited partnership funds has declined over recent years, exploring whether bespoke partnership taxation rules could provide the opportunity for improved tax administration and certainty of tax outcomes;
- exploring how features of the UK's double tax treaty network could be enhanced for funds; and
- changing the REIT rules (see [below](#)).

PROPOSED INTRODUCTION OF A NEW REGIME FOR ASSET HOLDING COMPANIES IN ALTERNATIVE FUND STRUCTURES

What is this?

Government proposals for a new tax privileged regime for asset holding companies in alternative fund structures.

Who does this apply to?

The asset management sector generally.

When does this apply?

The consultation ends on 23rd February 2021, with a current aim to introduce the new regime next year (2022).

As part of the Government's review of the UK funds regime (see [above](#)), HMT, last year, undertook a consultation considering the attractiveness of the UK as a location for asset holding companies (AHCs) in alternative fund structures. Building on that, in December, HMT published a further consultation containing proposals for a new tax privileged regime for such AHCs.

While the proposals leave lots of points open for discussion, amongst other things, they envisage qualifying AHCs potentially benefiting from an exemption from tax on gains and being subject to tax on income at a level commensurate with their role. The

expectation here is that, on the basis that that role typically does not require much activity, this is likely to lead to AHCs being subject to very low levels of tax on income. In addition, the proposals envisage capital gains realised by AHCs retaining their character as capital when they are returned to investors. The new regime will not, however, be open to all and eligibility criteria, especially around non-close or widely-held requirements are anticipated.

The proposals recognise that the position of real estate is different, in particular, with the general taxation of income and gains at source level and, so, it is recognised that alternative mechanics may be needed here, at least for UK real estate. In addition, as part of the consultation, targeted reforms to the REIT rules are being considered (which are discussed further [below](#)).

The proposals are an exciting development, but it will be critical to the success of the new regime that it is sufficiently simple - operationally, technically and cosmetically - to compete with its offshore rivals in an international context and that it does not become mired down by local UK tax concepts and concerns. HMT and HMRC do seem to be listening, but they need (and are asking for) industry to give them sufficient anecdotal evidence and constructive solutions to help them develop their thinking and produce a competitive regime.

The timetable for the proposals for a new AHC regime is tight. Our understanding is the government is looking to publish draft legislation in the summer, with a view to enactment in 2022. While the consultation ends on 23 February 2021, HMT have said that they would be very happy to take comments and have discussions before then, in order to have as much time as possible to digest and then work through points raised. This is all actively happening, which is good news.

INTRODUCTION OF REVENUE RAISING MEASURES IN RESPONSE TO COVID-19 – OFFICE OF TAX SIMPLIFICATION CAPITAL GAINS TAX (CGT) REVIEW

What is this?

Introduction of revenue raising measures to fund the Government's response to Covid-19.

Who does this apply to?

Unknown, at this stage, but potentially a wide range of taxpayers. We may find out more in the upcoming Budget on 3 March.

When does this apply?

Unknown, as yet. We may find out more in the upcoming Budget on 3 March.

The UK Government's response to Covid-19 has come at a high financial cost to the exchequer. It is widely anticipated therefore that the Budget will include tax increases and there has been a lot of speculation about what measures may be introduced. Perhaps the most likely is a change in the tax treatment of the self-employed, as the Chancellor alluded to this in his announcement of the Self-Employment Income Support Scheme. This would likely be in the form of increased NICs for the self-employed at a rate more equal to that for employees.

Of particular interest to the Funds sector has been the question of whether significant changes could be made to the UK's CGT regime. The speculation here has been fuelled by the Chancellor's request to the Office of Tax Simplification ("OTS") last July to carry out a review of CGT and aspects of the taxation of chargeable gains in relation to individuals and smaller businesses and by the OTS' publication in November of its first report on the issue (another report is due soon on key technical and administrative issues).

That November report contained a series of recommendations that could have a significant impact on UK taxation of chargeable gains. Notably, however, it did not specifically recommend that CGT rates be aligned with income tax rates. It did, nonetheless (amongst other things), recommend that, if the government considers the simplification priority to be to reduce distortions to behaviour, it should consider either (1) aligning those rates more closely or (2) addressing boundary issues between the two taxes.

Other areas of speculation have included increasing corporation tax and introducing a new net wealth tax.

UK TASKFORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

What is this?

Outline of the UK's approach to mandatory climate-related disclosures.

Who does this apply to?

UK-authorized asset managers (AIFMs & UCITS management companies).

When does this apply?

In 2022 for large asset managers and large occupational pension schemes; 2023 for other asset managers; and 2024/2025 for other occupational pension schemes.

In November 2020, the UK's Joint Government-Regulator Taskforce on Climate-related Financial Disclosures ("TCFD") published its [Interim Report](#) accompanied by [A Roadmap towards mandatory climate-related disclosures](#).

These outline at a high level the UK's approach to making TCFD-aligned, climate-related disclosures mandatory across the UK economy by 2025 at the latest.

The proposals will apply to a number of financial services firms including UK MiFID investment firms which provide portfolio management services, UK AIFMs (including small AIFMs with managing permissions), UK UCITS management companies and UK UCITS funds without an external management company. UK occupational pension schemes will also be caught.

Further details can be found in our [briefing](#).

EU SUSTAINABLE FINANCE MEASURES

What is this?

New rules requiring firms to make disclosures in respect of sustainability.

Who does this apply to?

EU portfolio managers, investment advisers and AIFMs and UCITS management companies and non-EU firms marketing or distributing financial products in the EU.

When does this apply?

The first set of requirements apply from 10 March 2021.

Three important areas of EU sustainability legislation are set to be introduced in the EU: the [EU Regulation](#) on sustainability-related disclosures in the financial services sector ("SFDR"); the integration of sustainability risks and factors in existing EU legislation and the framework to facilitate sustainable investment ([Taxonomy Regulation](#)).

It has been confirmed that the UK will not implement those pieces of legislation directly but will instead put in place its own sustainable finance regime. It has already set the ball rolling with respect to climate-rated disclosures (see '[UK Taskforce on Climate-related Financial Disclosures](#)' above) and has confirmed that it will implement a UK-specific version of the EU's taxonomy. We also expect that the UK will implement a more principles-based version of the SFDR but an announcement is said to be "imminent" on that. In addition, EU sustainability legislation will continue to be relevant for UK and international firms marketing or distributing financial products in the EU.

EU sustainable finance disclosure regulation

The majority of the provisions in the EU SFDR will apply from 10 March 2021.

Broadly, EU SFDR requires disclosures on the integration of so-called "sustainability risks" by firms in their investment decision-making and an assessment of the likely impact of such risks on investment returns. Firms will also have to say whether they consider the "principal adverse impacts of investment decisions on sustainability" and, if they do, make disclosures in relation to those impact. Products which promote environmental and/or social characteristics, and those that have sustainable investment as their objective, are subject to further requirements. Disclosures are required to be made on the firm's website as well as at the pre-contractual stage and in periodic reports.

EU SFDR applies to portfolio managers, AIFMs, UCITS management companies, EuVECA managers and EuSEF managers as well as investment advisers. Although it principally applies to EU firms, some obligations in EU SFDR are also applicable to non-EU firms marketing or distributing financial products in the EU. UK and international firms will therefore be caught.

A consultation on a [draft technical standards](#) was published in April 2020 but was widely criticised and is expected to change significantly before being finalised in 2021. As a result of COVID-19 and in order to allow firms time to prepare, the date on which the implementing measures will come into force has been delayed until (probably) January 2022. This has inevitably created some difficulties for firms which are now faced with having to comply with the high level provisions in EU SFDR but without having the details of the final technical standards which will specify how they should be doing this, for instance by way of more

granular details of the presentation and content of the information to be disclosed.

It has also become clear that there remain a number of areas of uncertainty which may not be clarified in implementing measures in any event. These include the extent of the application of EU SFDR to non-EU firms marketing or distributing financial products in the EU, the application of SFDR to legacy products and the circumstances in which a financial product is considered to be promoting environmental or social characteristics.

Integration of sustainability risks and factors - MIFID II, AIFMD and UCITS directive

The European Commission has now issued draft [delegated regulations](#) on the integration of sustainability risks and factors. These are in the form of amendments to certain existing EU legislation including the Alternative Investment Fund Managers Directive ("AIFMD") Delegated Regulation, the MiFID II Delegated Regulation and Delegated Directive and the UCITS Delegated Directive.

The draft delegated regulations require AIFMs, UCITS management companies and MiFID investment firms (including portfolio managers and adviser/arrangers) to integrate sustainability risks and factors into their policies and procedures. This includes by taking sustainability into account when complying with organisational requirements, including (where relevant) risk management and conflicts of interest requirements. MiFID investment firms will also need to factor sustainability factors and preferences into their product governance processes. In addition, AIFMs and UCITS management companies will need consider sustainability risks when selecting and monitoring investments and when carrying out investment decisions.

It is not yet clear when these changes, if adopted, would apply to EU-regulated firms – or whether the UK will adopt them – but (since drafts suggest that the changes will be effective 12 months after publication in the Official Journal) it is unlikely to be before the end of 2021.

EU taxonomy regulation

The Taxonomy Regulation introduces an EU-wide taxonomy or classification system for determining whether and to what extent an economic activity can be considered environmentally sustainable. Environmental sustainability is one element of sustainability under SFDR. Parts of the Taxonomy Regulation take effect as from 1 January 2022 with the remainder coming into effect as from 1 January 2023.

The Taxonomy Regulation sets out six environmental objectives: climate change mitigation; climate change adaptation; sustainable use and protection of water and marine resources; transition to a circular economy;

pollution prevention and control; and protection and restoration of biodiversity and ecosystems. In order to be "taxonomy compliant" (meaning the relevant activity is classified as environmentally sustainable according to the EU's criteria and is also compliant with basic social standards) an activity must contribute substantially to at least one of these and do no significant harm to any of the others. The activity must also comply with certain social safeguards.

A [draft Commission Delegated Regulation](#) has now been issued setting out the (very granular) technical screening criteria for determining whether an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation (which are the first two of the environmental objectives in the Taxonomy Regulation and which will come into effect first, on 1 January 2022) and for determining whether that economic activity causes no significant harm to any of the other environmental objectives in the Taxonomy Regulation.

In addition, ESMA issued a [consultation paper](#) on its draft advice to the European Commission under Article 8 of the Taxonomy Regulation. This addresses the obligation for undertakings which fall under the Non-Financial Reporting Directive (and which are therefore required to disclose how/to what extent their activities are associated with environmentally sustainable economic activities) to publish information on how and to what extent their activities are associated with economic activities that qualify as environmentally sustainable under the Taxonomy Regulation. Broadly, the Non-Financial Reporting Directive applies to "large undertakings" (as defined by the EU Accounting Directive) which are "public-interest entities" (as defined in the same Directive), with more than 500 employees. There are, however, [proposals](#) to expand the scope to cover more companies and in some EU member states the Directive has already been applied more widely.

The draft advice covers the content, methodology and presentation of the three key performance indicators (turnover, capital expenditure and operating expenditure) to be used by non-financial undertakings under the Non-Financial Reporting Directive when making the disclosures required under Article 8. It also includes advice on the content, methodology and presentation of those three key performance indicators for asset managers. In both cases, it recommends that the disclosures should be provided in a standardised table. The final advice is to be provided by the end of February 2021.

3. RECAP: WHAT YOU MAY HAVE MISSED

IMPLICATIONS OF COVID-19 FOR FUND MANAGERS

The global Covid-19 pandemic is an unprecedented situation that will have a long-term impact on the alternative funds industry, stretching beyond the current period of lockdown and altering the way in which funds are raised and operated. Whilst there will be some market participants who have navigated prior economic downturns, the current crisis is throwing up challenges that few people will have prepared for. There will also be some within the industry who have only known a period of relatively steady growth over the last 10 years. There is little doubt that the period of calm is being replaced by a period of turbulence.

The private funds market has not stood still over the last 10 years and there are a number of recent innovations and developments that are now being tested, from the prevalence of subscription line facilities, to the way that valuations and fund reporting are carried out to the increasing interest in GP-led transactions as a form of liquidity. But this crisis will also give opportunity for new products and approaches to be developed and put into practice.

In his article, '[Private Fund Management Issues arising from Covid-19](#)' (published as part of ICLG's Guide to Alternative Investment Funds), Funds Partner Sam Kay examines in detail the key issues that private fund managers should be considering in the short and medium term to best adapt to the new environment and to prepare for the future. This covers operational issues, effective investor relations during the market dislocation, liquidity and risk management and some considerations for future planning.

As to investment companies, the government and regulators have introduced the relaxation of a number of regulatory and statutory requirements to allow funds and their managers time to deal with the impact of the crisis. The majority of these relief measures were temporary and have come to an end although, in some cases, the measures have been extended and continue under review. The measures still in place at the time of writing include:

- **Virtual company meetings and flexibility in holding AGMs:** the government has extended the relaxations to the company meeting requirements until 30 March 2021, with the relaxations applying to meetings held on or before that date. Under the relaxations, shareholder meetings can take place by electronic or any other means, notwithstanding the provisions contained in
- the Companies Act 2006 or a company's articles of association. The participants need
- not be in the same place and shareholders do not have a right to attend in person; and
- **Extension of company filings:** the deadlines relating to both annual and half-yearly financial statements have also been extended. Listed companies have an additional month to submit their interim reports and an additional 2 months from their year-end to publish their audited financial statements. The end dates for these relaxations depends upon on individual companies' interim and year end dates but, at a minimum, are available in respect of financial periods ending before April 2021.

For the latest developments relating to Covid-19, see the [Covid-19 page](#) of our website.

AIFMD REVIEW BY THE EUROPEAN COMMISSION

What is this?

Public consultation on potential amendments to the EU AIFMD.

Who does this apply to?

EU AIFMs and EU AIF depositories.

When does this apply?

Not yet known.

In October 2020, the European Commission published its [consultation](#) on its review of the AIFMD. The publication of the consultation, which is in the form of a questionnaire, follows a previous report it had previously carried out in June 2020 and to which the European Securities and Markets Authority ("ESMA") had responded in a [letter](#) to the European Commission in August 2020 which contained a wide-ranging set of comments highlighting areas where ESMA believed improvements could be made.

The European Commission's consultation covers a wide range of subjects, including:

Functioning of the AIFMD regulatory framework, scope and authorisation requirements

The Commission seeks views on the overall functioning of the AIFMD framework and its effectiveness, the capital requirements for AIFMs, the provision by AIFMs of ancillary services (eg portfolio management services)

and whether a Supervisory Review and Evaluation Process should be introduced into the AIFMD.

Investor Protection

The Commission asks whether the AIFMD should continue to cross-refer to the client classification sections in MiFID II in order to determine categories of investors or whether and how investor classification could otherwise be improved. It also considers how access to retail investors might be improved for AIFMs, including the possibility to structure a specific AIF for retail investors. Views are sought on the possibility of introducing a depositary passport and whether investor Central Security Depositories ("CSDs") should be treated as delegates. Questions relating to valuation are also included including a question on asset valuation during the recent pandemic and questions about the liability of external valuers.

International Relations

Of particular significance are questions raised on delegation, including whether the delegation rules are effective in preventing letter box entities, ensuring effective risk management, whether quantitative criteria or a list of core functions (that cannot be delegated) should be specified, which elements of AIFM Regulation's delegation rules could be applied to UCITS and whether the AIFMD standards should apply regardless of the location of a third party to which AIFM has delegated the collective portfolio management functions. The Commission also asks whether NPPRs create an unlevel playing field between EU and non-EU AIFs.

Financial Stability

The Commission asks whether the framework relating to financial stability should be enhanced, in particular around liquidity management and the availability of liquidity tools for AIFMs and supervisors. There are a number of questions on regulatory reporting, including whether LEIs should be mandatory, on AIF classification, and whether a similar reporting requirement should be introduced for UCITS. Feedback is also sought on the leverage requirements, including the current leverage measures in connection with the IOSCO principles and whether the leverage calculation methods for UCITS and AIFs should be harmonised. This consultation also includes questions on remuneration, leveraged loans and CLOs and on loan originating AIFs.

Investing in Private Companies

The Commission asks if the AIFMD rules regulating investing in private companies are achieving their aim to increase transparency and accountability of AIFs holding controlling stakes in non-listed companies, and if there are other ways of achieving these objectives more efficiently and effectively.

Sustainability/ESG

The consultation explores the appropriateness of the AIFMD rules when assessing sustainability risks, and the interaction with the Sustainable Finance Disclosure Regulation. The Commission asks about the quantification of sustainability risks, which is not currently required under the Sustainable Finance Disclosure Regulation, and whether to integrate principal adverse impacts and the EU Taxonomy into AIFM's investment decision processes.

ESMA GUIDELINES ON LIQUIDITY STRESS TESTING IN AIFS AND UCITS

What is this?

New guidelines providing management tool aimed at increasing the standard, consistency and, in some cases, frequency of liquidity stress testing.

Who does this apply to?

Leveraged closed-ended EU AIFs, open-ended EU AIFs, and UCITS plus fund managers, depositaries and national competent authorities.

When does this apply?

Now.

ESMA's [guidelines](#) on liquidity stress testing ("**Liquidity Guidelines**") began to apply from 30 September 2020. In terms of scope and application, the guidelines apply in respect of leveraged closed-ended AIFs and also open-ended AIFs (and UCITS), (including exchange-traded funds) and, and will supplement the existing liquidity management requirements as set out in AIFMD (and the UCITS Directive).

Liquidity stress testing ("**LST**") is a risk management tool, within the overall liquidity risk management framework of a manager, which simulates a range of conditions, including normal and stressed conditions, to assess their potential impact on the funding, assets and overall liquidity of a fund and any necessary follow-up actions.

The Liquidity Guidelines state that fund managers should have a strong understanding of the liquidity risks arising from the assets and liabilities of the fund's balance sheet, and its overall liquidity profile, in order to employ LST that is appropriate for the fund it manages.

The Liquidity Guidelines include obligations to design and build LST models and to produce an LST policy. The guidelines recommend that the LST policy should be documented within the AIF's Risk Management Policy (or the UCITS's Risk Management Process). The guidelines also impose governance principles which require LST to be properly integrated and embedded into a fund's risk management framework and subject

to appropriate governance and oversight. LST should employ historical scenarios, hypothetical scenarios and, where appropriate, reverse stress testing. Where appropriate, managers should aggregate LST across funds under management to better ascertain the liquidation cost or time to liquidity of each security.

The Liquidity Guidelines also impose an obligation on depositaries to have appropriate verification procedures to check that fund managers have documented LST procedures in place.

Under the Liquidity Guidelines, LST should occur at least annually but quarterly or more frequent LST is recommended.

EU WIDE SECURITIES FINANCING TRANSACTIONS' REPORTING OBLIGATIONS NOW INCLUDES AIFS AND UCITS

What is this?

Reporting regime whereby counterparties are required to report details of securities financing transactions they have entered into to a Trade Repository.

Who does this apply to?

In a funds context, EU AIFs and EU authorised AIFMs, UCITS, UCITS management companies.

When does this apply?

Now.

The EU Securities Financing Transactions Regulation ("SFTR") has applied from 12 January 2016, although certain of its requirements entered into force on a phased basis. The commencement date for AIFs and UCITS in respect of the final set of substantive obligations under the SFTR (which relate to the requirement for counterparties to SFTs to report details of those transactions to a trade repository) was 11 October 2020 for AIFs.

In order to be able to comply with the reporting requirements, AIFs (and UCITS) need to establish internal procedures and relevant external legal arrangements (regarding, amongst other things, the collection of data and its onward transmission to a trade repository (or to a third party service provider who will report on their behalf)).

Points to note with regards to the reporting obligation include:

- In terms of territorial scope, the reporting requirement applies:

- to the principal counterparty to the transaction where it is established in the EEA; and
- to an EEA branch of a non-EEA entity where the transaction is concluded through the branch (noting however that a non-EEA AIF would never in practice be operating out of an EEA branch and cannot therefore be within the scope of the SFTR reporting obligation);
- according to ESMA, to a non-EEA AIF with an AIFM registered or authorised under AIFMD (i.e. regardless of the fact that the AIF is established outside the EEA). However, this was a passing comment from ESMA in its Final Report which accompanied its *Guidelines on reporting under Articles 4 and 12 SFTR* published on 6 January 2020; but this comment was not reflected in the Guidelines themselves nor does it appear to be consistent with the provisions of SFTR itself);
- A reporting counterparty may appoint a third-party service provider as its delegate to report on its behalf (although the reporting counterparty will remain responsible and legally liable).

Reportable SFTs will include repos, securities and commodities lending transactions/securities and commodities borrowing transactions, buy sell backs and sell-buy backs and margin lending transactions.

ASSET MANAGEMENT TASKFORCE REPORT ON INTEGRATING STEWARDSHIP INTO INVESTMENT PROCESS

What is this?

An HM Treasury-led taskforce report which provides a blueprint for integrating stewardship into the investment process.

Who does this apply to?

All asset managers with a UK nexus.

When does this apply?

Now.

In November 2020, the Asset Management Taskforce ("AMT") published [Investing with Purpose: placing stewardship at the heart of sustainable growth](#), a report

containing proposals designed to integrate stewardship more deeply into the investment process.

The AMT, led by HM Treasury, is a group of the UK's leading investment managers, stakeholders and regulators. The AMT's proposals aim to assist investment managers and asset owners in expanding their stewardship activity across different asset classes, and are set out under three pillars:

- **stewardship behaviours** – which includes practical steps for strengthening stewardship across the full range of investments;
- **stewardship for clients and savers** – to generate sustainable value and achieve clients' investment goals; and
- **economy wide-approach to stewardship** – which aims to ensure the collective responsibility of market participants and stakeholders.

ESMA GUIDELINES ON PERFORMANCE FEES IN UCITS AND CERTAIN TYPES OF AIFs

What is this?

Guidelines on the calculation and disclosure of performance fees.

Who does this apply to?

UCITS management companies and EU AIFMs of certain types of AIFs marketed to EU retail investors.

When does this apply?

Now.

In April 2020, ESMA published its [final guidelines](#) on performance fees (the "**Performance Fee Guidelines**") applicable to undertakings for collective investments in transferable securities ("**UCITS**"). Official translations were published in November 2020.

The publication of the Performance Fee Guidelines follows a consultation by ESMA in 2019. Whilst the purpose of the guidelines is to harmonise regulations relating to UCITS performance fees across the EU, the consultation also asked if the guidelines should also be applicable to AIFs marketed to retail investors in order to ensure equivalent standards in retail investor protection which caused some concerns within the closed-ended funds industry. Thankfully, the Performance Fee Guidelines expressly exclude closed-ended AIFs from the scope of the guidelines and clarify that the guidelines apply to (i) UCITS funds; and (ii) where Member States allow AIFMs to market to retail investors in their territory units or shares of AIFs they

manage in accordance with Article 43 of the AIFMD, the guidelines also apply to AIFMs of those AIF.

The guidelines applied on 6 January 2021, and will be effective immediately for any UCITS or in-scope AIF created or starting to apply for the first time a performance fee model on or after such date. A transitional period is in place for existing UCITS and in-scope AIFs created prior 6 January 2021.

ILPA PUBLISHES MODEL DOCUMENTATION

What is this?

New and updated model LPAs, term sheets, NDA and updated guidance on subscription credit lines.

Who does this apply to?

General Partners and institutional investors.

When does this apply?

Now.

The Institutional Limited Partners Association ("**ILPA**") has published a number of new and updated model LPAs and guidance over the course of 2020.

Deal-by-Deal Model LPA and Term Sheet

A new Model LPA funds using a 'deal-by-deal' waterfall structure, and accompanying Term Sheet, have been made available. The Model LPA is drafted for a Delaware limited partnership and includes the following provisions:

- **Clawback period:** in addition to a final clawback, interim clawback calculations will be calculated by reference to a hypothetical final distribution of its assets. The Model LPA provides for annual interim clawback periods beginning one year from the end of the commitment period/GP removal/return of distributions by LPs to satisfy indemnities etc.;
- **Fiduciary Duty:** Language has been added to clarify, for the avoidance of doubt, that, in exercising its discretion under the Agreement, the General Partner may not place its interests ahead of the interests of the fund or the Limited Partners; and
- **Expenses:** ILPA has stated that it is wary of what it sees as a continuous shift of expenses to funds. The Model LPA seeks to clarify what should not be charged to the fund.

The Deal-by-Deal Model LPA includes footnotes containing lots of guidance and a number of provisions offer choices, the idea being that GPs and LPs can use the document as a starting point for negotiations, or as

a benchmark. Both the Deal-by-Deal Model LPA and Term Sheet are available on the ILPA website [here](#).

Whole of Fund Model LPA and Term Sheet

ILPA has also made a number of updates to its Whole of Fund Model LPA and published a related Term Sheet. A summary of the changes made to the Model LPA has been made available by ILPA [here](#) and, broadly, relate to transparency, governance and alignment of interest.

Both the Whole of Fund Model LPA and Term Sheet are available on the ILPA website [here](#).

Follow-on guidance on subscription credit lines

In June 2020, ILPA published [follow-on guidance on subscription credit lines](#) to guidance published in 2017 on best practices related to the use of subscription lines of credit, intended to foster clearer and more informed dialogue between limited and general partners. The follow-on guidance has been published in response to the growth of utilisation of subscription credit lines since the original publication. ILPA states that this growth has made limited partner's ability to measure and assess both exposure and performance at the fund level and for their private equity programmes significantly more difficult. ILPA also states that both general partners and limited partners indicate that the means for providing this transparency varies widely, and related disclosures are not being systematically provided to limited partners.

The follow-on guidance regarding subscription lines of credit disclosures is intended as a follow-on to the 2017 guidance; both sets of guidance should be read in tandem. ILPA states that the aim of this subsequent guidance is to lay out more specifically the incremental disclosures that will aid limited partners and general partners in gaining clarity around the impact of subscription lines, particularly with respect to a limited partner's cash flow modelling and commitment pacing, as well as the performance impacts posed by subscription lines.

Non-Disclosure Agreement

In January 2021, ILPA published a [model Non-Disclosure Agreement](#) ("NDA"). ILPA hopes that the model NDA will reduce the time-consuming process of negotiating NDAs for both general partners and limited partners.

THE COMPANIES (SHAREHOLDERS' RIGHTS TO VOTING CONFIRMATIONS) REGULATION 2020

What is this?

New requirement that, where a vote is cast on a poll by electronic means, the fund must ensure that confirmation of receipt of the vote is sent.

Who does this apply to?

Traded companies, which includes funds listed on the Main Market and Specialist Funds Segment, but not those listed on AIM.

When does this apply?

Now.

In July 2020, the Companies (Shareholders' Rights to Voting Confirmations) Regulations 2020 were published. The regulations transpose into UK law certain provisions of the Shareholder Rights Directive (as amended by the Shareholder Rights Directive II).

The regulations insert the following provisions into the Companies Act 2006:

- an obligation on a traded company to provide a confirmation of receipt of those votes which are cast on a poll electronically; and
- the right for a shareholder to request information from the company to enable them to determine that their vote has been validly recorded and counted.

The regulations apply to "traded companies" as defined in section 360C of the Companies Act 2006, being those admitted to trading on a regulated market, which includes the Main Market and the Specialist Funds Segment, but not AIM.

The regulations require that where a vote is cast on a poll by electronic means, the company must ensure that, as soon as reasonably practicable after the vote has been received, confirmation of receipt of the vote is sent. This includes any vote cast at a meeting, at an electronic meeting and in advance of a meeting or electronic meeting. The regulations also give shareholders the right to request information from the company to enable them to determine that their vote on a resolution at a general meeting where a poll has been taken has been validly recorded and counted. This must be requested by the shareholder and provided by the company within certain timeframes

The regulations came into force on 3 September 2020.

EUROPEAN COMMISSION LAUNCHES PUBLIC CONSULTATION ON THE ELTIF REVIEW, FOLLOWING INCEPTION IMPACT ASSESSMENT

What is this?

Review of the EU ELTIF Regulation.

Who does this apply to?

Fund managers.

When does this apply?

Now.

In September 2020, the European Commission launched a webpage on the review of the EU rules on long-term investment funds ("ELTIFs") and published an inception impact assessment.

A review of the ELTIF framework is mandated by Article 37 of the ELTIF Regulation. The inception impact assessment launched the review into how well ELTIF is working. Since the ELTIF Regulation came into force, only around 28 ELTIFs have been established, with a very low asset base (below 2 billion euros).

Following the inception impact assessment, in October 2020, the European Commission launched a [consultation](#) of the ELTIF framework. The consultation is in the form of two surveys; a short survey asking general questions, and a longer one requesting detailed responses and numerical figures. The surveys request stakeholder feedback in several areas including why the take up of ELTIFs has been so low to date, the possibility of broadening the investment scope, broadening the retail investor base that can invest in ELTIFs and reforming the suitability process while maintaining investor protections, reviewing the mandatory redemption terms, whether to change the borrowing/leverage levels permitted or have separate levels for professional only ELTIFs, and the marketing of ELTIFs.

The consultation ended on 19 January 2021.

REFORMS TO THE IRISH INVESTMENT LIMITED PARTNERSHIPS REGIME

What is this?

Modifications to the Irish legislation relating to limited partnerships.

Who does this apply to?

Irish investment limited partnerships.

When does this apply?

Legislation is due to come into force imminently.

In December 2020, the Irish Government introduced legislation to modernise the rules governing Irish private equity funds. Amendments will be made to the Investment Limited Partnership Act 1994, to make the investment limited partnerships ("ILPs") more attractive for private equity, venture capital and real assets investment strategies in Europe. The aim of the amendments is to make the vehicle 'fit for purpose' compared to similar vehicles in other jurisdictions.

The key changes include; (1) expanding the list of protected activities that a LP may undertake without prejudicing its limited liability status, for example permitting LPs to serve on an advisory committee or board of an ILP or to appoint a representative to serve on any such committee or board without such activity constituting involvement in the management of the ILP; (ii) clarifying the circumstances in which LPs are permitted to withdraw capital from an ILP, including removal of the 4 month clawback period which applied previously in cases where the GP had not certified that the ILP was capable of paying its debts in full as they fell due; and (iii) updating the registration and record keeping requirements for ILPs, in particular clarifying the list of parties entitled to inspect the registers of an ILP.

In anticipation of the new regime, the Central Bank of Ireland issued an updated [AIFMD Q&A](#) which removes one of the main issues with regard to the establishment of private funds in Ireland which was the previous requirement that a general partner of an Irish limited partnership itself be approved as an AIF management company and maintain €125,000 minimum regulatory capital. The change represents a significant enhancement of Ireland's limited partnership regime.

PROHIBITION ON BEARER CERTIFICATES INTRODUCED FOR COLLECTIVE INVESTMENT SCHEMES

What is this?

Prohibition on the issuance, creation and/or cancellation of bearer units in a collective investment scheme.

Who does this apply to?

UK operators of collective investment schemes.

When does this apply?

Now.

In November 2020, the [Bearer Certificates \(Collective Investment Schemes\) Regulations 2020](#) (the "Regulations") were made and came into force on 1 January 2021.

The Regulations amend the Financial Services and Markets Act 2000 to prohibit "bearer units" for all collective investment schemes based in the UK. Bearer units for these purposes means units where the title is evidenced by a certificate or any other documentary evidence of title transferable by delivery and not through a register entry. The prohibition is being introduced as it is required under international standards on anti-money laundering and tax transparency. Bearer certificates are already prohibited for most businesses in the UK but, due to a technical loophole, two types of collective investment scheme registered in the UK had maintained the power to issue bearer certificates: open-ended investment companies incorporated before 26 June 2017 and unauthorised unit trusts. The Regulations were introduced to remedy this.

The Regulations also include transitional provisions for converting or cancelling pre-existing bearer certificates within a year of the Regulations coming into force, the payment of dividends or other distributions during that year and giving notice to those who hold bearer certificates.

From 1 January 2021, all newly-issued shares or units must be in registered form, whether certificated or uncertificated, and their ownership registered.

EU PROSPECTUS REGULATION: REVISED ESMA GUIDELINES ON DISCLOSURE REQUIREMENTS

What is this?

Revised disclosure guidelines following the introduction of the EU Prospectus Regulation.

Who does this apply to?

Offers to the public and applications for trading within the scope of the EU Prospectus Regulation.

When does this apply?

During 2021.

In July 2020, ESMA published a [Final Report](#) on disclosure guidelines under the Prospectus Regulation. The revised Guidelines were previously referred to as the "CESR Recommendations" (CESR being the predecessor of ESMA) and their aim is to provide market participants with a consistent understanding of the relevant disclosures required in the various annexes to the Commission Delegated Regulation on the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

The Guidelines are set out in Annex III to the Final Report. ESMA took the opportunity to convert the majority of the recommendations into Guidelines when updating them so that the comply-or-explain mechanism would apply. The Guidelines cover a variety of financial and non-financial topics including:

- pro forma information;
- working capital statements;
- capitalisation and indebtedness;
- profit forecasts and estimates;
- historical financial information;
- operating and financial review;
- options agreements; and
- collective investment undertakings.

The Guidelines broadly replicate the content of the CESR recommendations, but with some changes made to drafting for clarity. However, there are a limited number of new Guidelines included, and ESMA specifically draws attention to changes made to profit forecasts, pro forma financial information, working capital statements, and capitalisation and indebtedness statements. In particular, the Guidelines clarify ESMA's expectations on working capital statements and pro forma information. The final Guidelines will become effective two months after being published on ESMA's

website. In its [Primary Market Bulletin 31](#), the FCA stated that, since the guidelines were not published in all the official languages by 1 November 2020, they did not become effective before the end of the post-Brexit implementation period on 31 December 2020. This means that for prospectuses approved in the UK, issuers and their advisors should continue to have regard to the ESMA CESR recommendations.

NEW REQUIREMENT FOR SHARE RIGHTS TO BE DISCLOSED ON THE NSM

What is this?

New requirement to have a summary of the rights attaching to shares published on the National Storage mechanism.

Who does this apply to?

All listed companies.

When does this apply?

Now.

In April 2020, a new Listing Rules continuing obligations requirement came into force which requires all listed companies to have published on the National Storage mechanism ("**NSM**") a summary of the rights attaching to their shares. Accordingly, one of the following should be uploaded to the NSM:

- the approved prospectus for its listed shares;
- the relevant agreement or document setting out the terms and conditions on which its listed shares were issued; or
- a document describing: (i) the rights attached to its listed shares; (ii) limitations on such rights; and (iii) the procedure for exercise of such rights.

The information must be kept up to date. Many listed investment companies will already have a prospectus available on the NSM, which will fulfil the requirements. If, however, the articles of association have been subsequently amended, either a document meeting the criteria above, or the articles of association itself, should be filed.

HMT LAUNCH THE FUTURE REGULATORY FRAMEWORK REVIEW CONSULTATION

What is this?

Consultation on the UK's post-Brexit regulatory framework.

Who does this apply to?

Everyone.

When does this apply?

Not known.

HM Treasury have published the [Future Regulatory Framework \("FRF"\) Review: Consultation](#). The consultation is the second phase of the FRF Review, which considers how the regulatory framework for financial services needs to adapt to be fit for the future, in particular to reflect the UK's new position outside of the EU.

The key aim of the FRF Review is to achieve an agile and coherent approach to financial services regulation in the UK, with appropriate democratic policy input to support a stable, innovative and world leading financial services sector. Phase 1 of the review focused on improving the effective coordination of regulatory activity in the UK (between regulators and firms), and sought input on how this is currently operating and how they can work together to coordinate their activities to ensure the best outcome for the financial services sector, consumers of financial services, and the UK as a whole.

Phase 2 will be conducted in two stages, starting with this consultation which sets out an overall blueprint for financial services regulation, focusing on the split of responsibilities between Parliament, the government and the financial services regulators. In doing so, it highlights the importance of ensuring appropriate and effective arrangements for accountability, scrutiny and public engagement with the policy-making process, particularly in relation to the UK's financial services regulators.

The consultation will close on 19 January 2021. The government will use the responses to inform a second consultation in 2021, which will set out a final package of proposals and how they will be delivered. The consultation provides an opportunity for the funds industry to shape the post-Brexit regulation of funds.

DEVELOPMENTS IN RELATION TO THE VAT EXEMPTION FOR FUND MANAGEMENT

What is this?

Developments in the scope of the VAT exemption for fund management around (1) the definition of what constitutes "management" and (2) the range of funds in scope.

Who does this apply to?

Fund managers and their clients.

When does this apply?

Now.

Under the EU's VAT Directive, the VAT exemption for fund management has two elements:

- the relevant activities must constitute "management"; and
- such management must be of a "special investment fund" (SIF).

Management

The meaning of management is not defined in the VAT Directive and has been developed through the case law of the Court Justice of the European Union ("CJEU"). In the case of *Blackrock Investment Management (UK) Ltd v Commissioners for Her Majesty's Revenue & Customs (C-231/19)*, Blackrock had been arguing that a supply of a management platform that had been used for both SIFs and non-SIFs should be treated as within the exemption insofar as the supply related to SIFs. In July, the CJEU disagreed. There is concern that, in its decision, the CJEU may have indicated that, for a service to constitute "management", it must be of a type that can only be made to SIFs. This would narrow the scope of the exemption a great deal, as most management services can be provided to all types of fund (e.g. investment advice). Our view is that the exemption should not be interpreted in that way, but the position is not free from doubt.

What this means for asset managers?

Where supplies of potential "management" services are made to SIFs and non-SIFs, the parties should consider the arrangements and the extent to which they can legally and economically separate the services relating to SIFs from those relating to non-SIFs (e.g. through separate contractual and billing arrangements). Such an approach will not help address the concern raised by the case that the exemption is limited to services that can only be made to SIFs. On that point, asset managers will want to see how the industry reacts to the decision, whether the CJEU takes a similar approach to *Blackrock* in the upcoming fund management exemption case of *DBKAG* and what emerges in relation to the issue from

the expected Government review of the VAT treatment of fund management fees (discussed in more detail [here](#)).

SPECIAL INVESTMENT FUND ("SIF")

In April, the UK legislation implementing the fund management exemption into UK law was amended. Under the amendments the relevant statutory provisions were expanded to cover a wider range of entities, so as to bring the exemption more into line with the EU law definition of SIF. Prior to then, HMRC had operated an informal practice of allowing fund managers to use either the (narrower) UK statutory definition or the (wider) EU law definition. This gave managers of funds that fell within the EU law definition, but not the UK statutory one, the choice of whether to treat their supplies as exempt or taxable.

Under the changes:

- the "closed-ended collective investment undertaking" UK statutory category of SIF was widened by removing the words "wholly or mainly in securities" from the end of one of the requirements (i.e. the requirement that the undertaking's sole object is to invest capital, raised from the public *wholly or mainly in securities*); and
- a new UK statutory category of SIF was introduced which, broadly speaking, applies to defined contribution pension schemes established in the UK or EU. It should be noted that this new category has itself now been amended with effect from 1 January, so that it no longer applies to schemes established in the EU. This restriction of the exemption should generally allow managers to recover their own input VAT on supplies of fund management services to EU established funds, but to treat those supplies as outside the scope of UK VAT. This will be particularly welcome where the relevant member state in which the pension fund is established does not charge VAT on the supply under domestic "reverse charge" rules.

COMPANY RESIDENCE AND PERMANENT ESTABLISHMENT IN LIGHT OF COVID-19 TRAVEL RESTRICTIONS

What is this?

Difficulties, caused by Covid-19 travel restrictions, in ensuring that a company maintains its residence solely in the desired jurisdiction and does not have unwanted (taxable) permanent establishments.

Who does this apply to?

Companies with directors and employees working outside the relevant company's jurisdiction of tax residence, due to Covid-19 restrictions.

When does this apply?

Now.

Travel restrictions caused by the Covid-19 pandemic have led to difficulties for directors, who are not tax resident in the same jurisdiction as their company, physically attending board meetings in the company's jurisdiction. If such directors attend remotely or, in the absence of board meetings, make important decisions where they are located, there is a risk that the company could be considered resident where the relevant directors are located. Similarly, where travel restrictions lead to directors and employees who normally work in one jurisdiction having, instead, to work in another, this can give rise to concerns that the presence of the individual gives rise to a taxable permanent establishment of the company in that other jurisdiction.

Although some jurisdictions have given express comfort that presence in a state caused by Covid-19 travel restrictions will be disregarded for corporate tax purposes, others (including the UK) have, in effect, taken the view that the normal rules should apply but that, in practice, it is likely to be possible to get comfortable that the temporary presence of individuals in the "wrong" jurisdiction should not, under those rules, cause residency or permanent establishment concerns.

As the "temporary" travel restrictions become longer term, it may become increasingly difficult for companies to get comfortable on these issues.

Post-Covid 19, workers may want to remain in their home jurisdictions, in that case companies will not be able to rely on any Covid-19 related comfort given by jurisdictions.

Those in the funds sector should monitor the situation carefully and consider taking appropriate steps. This may include for example, appointing new directors resident in company's intended jurisdiction of residence and providing directors and employees with clear

policies of what actions they can take and decisions they can make from their home jurisdictions without generating corporate residence or permanent establishment concerns.

EU MEMBER STATES BEING OBLIGED TO APPLY MOST OF THE HYBRIDS MEASURES IN ATAD II (THE ANTI-TAX AVOIDANCE DIRECTIVE) FROM 1 JANUARY 2020

What is this?

EU member states being obliged to apply most of the hybrids measures in ATAD II (the anti-tax avoidance directive) from 1 January 2020.

Who does this apply to?

Companies within EU member states and counterparties to transactions with them.

When does this apply?

Member states became obliged to apply most of the measures from 1 January 2020.

The EU's Anti-Tax Avoidance Directive ("ATAD I") was amended in May 2017. This amendment ("ATAD II") extended the scope of the directive so that it applies to more hybrid structures. Member states became obliged to apply most of the measures from 1 January 2020. If they have not done so already, those in the funds sector should be reviewing their structures to assess the impact of these rules on them.

DAC 6 – RESTRICTION OF SCOPE AND INTENDED REPEAL OF UK RULES

What is this?

The UK has recently enacted rules which mean that DAC 6 reporting will only be implemented in the UK in a very limited way, with the intention being that even that is replaced by the UK's implementation of the OECD's mandatory disclosure rules.

Who does this apply to?

Those entering into cross-border arrangements.

When does this apply?

Now. The first UK reports are due shortly.

EU directive 2018/822 ("DAC 6") introduces a new tax reporting regime in the UK which came into force on 1 July 2020. Under the original timeline, the first reports

were due to be made last summer (2020). However, due to the Covid-19 pandemic the deadlines for the first reports were pushed back in the UK and most (but not all) EU member states.

The EU rules catch “cross-border” transactions which satisfy certain “hallmarks”. The rules aim to ensure that tax authorities across the EU receive information about matters which may involve tax planning at an early stage, to enable swift challenges or changes to the law to counteract aggressive planning. The hallmarks are, however, widely drafted and are likely to capture certain transactions which do not have a tax avoidance motive, and, so, will need to be carefully considered in all transactions with a “cross-border” element.

However, on 30 December last year, regulations were laid before the House of Commons which have significantly restricted the scope of the regime in the UK. In particular, most of the categories of hallmarks that are reportable under the EU rules are now not reportable under the UK regime. Reporting under DAC 6 will still be required by UK intermediaries and taxpayers, but only for arrangements which trigger the category D Hallmarks (broadly, arrangements which obscure beneficial ownership or which thwart effective reporting under the Common Reporting Standard). The changes will apply retrospectively so that historic transactions that would otherwise have been reportable as a result of containing one of the other hallmarks will not now need to be reported. Further, over the coming year, the UK Government intends to repeal the legislation implementing DAC 6 in its entirety and implement the OECD's mandatory disclosure rules instead.

Given the cross-border nature of many fund and asset management structures, it is likely that many arrangements with a UK element will still remain reportable, albeit under the DAC 6 rules of another jurisdiction, rather than domestic UK law.

To the extent this has not been done already, relevant taxpayers and intermediaries should put processes in place to identify and report relevant transactions and communicate these internally. If this has already been done, then these processes should be reviewed in light of the change to the UK rules.

When dealing with third parties, consideration should be given to what (if any) DAC 6 related arrangements may be appropriate (e.g. in relation to co-ordinating reporting) and care taken that suitable provisions are included in the relevant documentation.

COVID-19 TRAVEL RESTRICTIONS – TAX ISSUES FOR INDIVIDUALS

What is this?

Concerns that individuals will become tax resident in jurisdictions where they are “temporarily” located due to Covid-19.

Who does this apply to?

Individuals “temporarily” located in jurisdictions, due to Covid-19, and their employers.

When does this apply?

Now.

The increasing length of time for which many travel restrictions have been in place due to Covid-19 is generating various tax concerns for individuals and their employers, including that employees will become tax resident in the country in which they are “temporarily” located (e.g. if they have stayed with family during the pandemic, the country in which their family is located). Residence tests in many jurisdictions are linked to time spent in those jurisdictions. Some jurisdictions (including the UK) have introduced relaxations to their usual rules but these relaxations may be time limited.

Those in the funds sector should review the position of their team members and consider the extent to which their working arrangements could trigger tax obligations in the jurisdictions in which the individuals are located. Contractual provisions should also be reviewed to establish who bears the cost of any increased tax burden.

FURTHER DEVELOPMENTS OF, AND DELAY TO REACHING AN AGREED POSITION ON, THE OECD'S BEPS PILAR ONE AND PILAR TWO PROPOSALS

What is this?

The development of the OECD's Pillar One and Pillar Two tax proposals and the pushing back of the timeline for reaching agreement on them.

Who does this apply to?

This is still being discussed, but likely to be large multinational enterprise groups.

When does this apply?

The aim is to reach a consensus by the middle of the year, but any rules are unlikely to be implemented for at least two or three further years.

Building on its original BEPS project, the OECD is working on two proposals that could have huge consequences for international taxation.

“Pillar One” seeks to introduce a new taxing right for countries in relation to non-resident companies that do not have a permanent establishment there and “Pillar Two” seeks to introduce a global minimum tax rate.

It had been intended that a consensus would have been reached in relation to both pillars by the end of 2020. However, in October the OECD published blueprints for both pillars in which it set out the revised timetable of reaching consensus by mid-2021.

Pillar One is aimed at “consumer” facing businesses and those providing automated digital services.

The Pillar One blueprint indicates that the OECD's current thinking is that there will be an exemption for financial services and that this would include investment funds and their managers. The blueprint for Pillar Two envisages there being an exemption for investment funds (but not fund managers). As the proposals are by no means finalised, those in the funds sector will want to monitor their progress during the course of 2021.

Even if consensus is reached by mid-2021, the timetable for implementation is unclear and we would expect it to take at least two to three further years for reforms as fundamental as those being considered to be implemented internationally.

NON-RESIDENT CORPORATE LANDLORDS BECOMING LIABLE TO CORPORATION TAX (RATHER THAN INCOME TAX) FROM 6 APRIL 2020

What is this?

Non-resident corporate landlords have been liable to corporation tax (rather than income tax) since 6 April 2020.

Who does this apply to?

Non-resident corporate landlords.

When does this apply?

Now.

Prior to 6 April 2020, non-resident corporate landlords were liable to income tax – not corporation tax – on UK property income profits. However, from that date these rental profits became subject to corporation tax, with different rates, computational rules and payment and filing requirements.

For an earlier briefing on this topic please click [here](#).

4. SPOTLIGHT: ON YOUR RADAR

UK'S PROPOSED NEW OVERSEAS FUNDS REGIME

What is this?

New alternative route to recognition for non-UK funds wishing to market to UK retail investors.

Who does this apply to?

A wide range of non-UK retail funds, including EEA UCITS.

When does this apply?

Not known yet.

In October 2020, the [Financial Services Bill](#) (the "FS Bill") was introduced to Parliament to ensure that the UK's regulatory framework continues to function effectively for the UK after leaving the EU. Included in the FS Bill is the introduction of a new Overseas Funds Regime ("OFR") to allow overseas domiciled retail funds (and money market funds) to be marketed to investors in the UK. This follows the HM Treasury [consultation](#) in March 2020 in which the government sought views on how overseas funds could be recognised in the UK following the end of the Brexit implementation period (and in respect of which HM Treasury published a [summary](#) of consultation responses).

Overseas funds must apply to be individually recognised by the FCA under s.272 of FSMA before they can be promoted to retail investors. Before 31 December 2020 this would occur automatically for EEA UCITS funds making use of a passport. Now, an EEA UCITS fund is in the same position as a non-EEA fund and (subject to the temporary transitional arrangements referred to below) may only be marketed to UK retail investors if it has been individually recognised under s.272.

Given that a s.272 application is on an individual fund's basis and requires a time-consuming assessment by the FCA, the OFR will be introduced to provide an alternative and more streamlined route to FCA recognition based on equivalence. In outline, the OFR will give HM Treasury the power to determine that certain overseas jurisdictions provide protection to investors equivalent to that which they would receive in a comparable UK collective investment scheme and to approve certain types of collective investment scheme from those jurisdictions. Certain other criteria apply, for instance that there is a cooperation arrangement in place between the FCA and the supervisor of the non-UK fund. Once this equivalence has been granted by HM Treasury, an overseas retail funds will then be able to apply to the FCA for recognition. Once granted, the

fund would then be able to market in the UK as a recognised fund.

Pending the introduction of the Overseas Funds Regime, the process of individual recognition under s.272 FSMA remains the only route by which a non-UK fund may obtain recognition enabling it to market to UK retail investors. This is subject to the temporary recognition regime ("TRR") which provides that an EEA UCITS which notified the FCA by 30 December 2020 will be deemed to be recognised for the purposes of FSMA for a temporary recognition period which is currently set at three years. (The TRR does not cover new, stand-alone EEA UCITS established after 30 December 2020, although it will cover new sub-funds of an umbrella UCITS which is authorised under the EU UCITS Directive by its EEA home state regulator provided that at least one other sub-fund of the umbrella UCITS did notify the FCA before 30 December 2020 and therefore entered into the TRR.)

The provisions of the FS Bill governing the Overseas Funds Regime also include a proposed amendment to the TRR extending the life of temporary recognition from three to five years. to allow for the establishment of the OFR and the completion of equivalence assessments by HM Treasury The FCA will be given power to create "landing slots" for funds that are leaving the TRR and applying for permanent recognition under the OFR. The two-month time limit for the FCA to consider applications under the OFR will also be disapplied for funds leaving the TRR.

The government's final policy is reflected in the FS Bill, which completed its committee stage in the House of Commons in December 2020. A [revised version of the FS Bill](#) was published, as amended in the committee stage. As the FS Bill proceeds through the legislative process, it is possible that some of the details relating to the measures outlined above will change before the Bill is finalised.

WELCOME CHANGES TO UK PROXY VOTING GUIDELINES FOR 2021

What is this?

A policy change (among other changes) by proxy advisory firm ISS to recommend support for share issue requests when investment companies provide an explicit commitment that shares will only be issued at or above net asset value.

Who does this apply to?

All issuers but the changes are of particular interest to investment companies and their sponsors.

When does this apply?

To shareholder meetings taking place on or after 1 February 2021.

The Institutional Shareholder Services ("ISS") has published [updates to its UK proxy voting guidelines for 2021](#). Of particular interest to investment companies, the amendments include the following beneficial policy changes:

Overboarding

ISS states that a more lenient view may apply to overboarding for directors serving on boards of less complex companies and explicitly gives the example of externally managed investment companies.

ISS' rationale for this is that, whilst the current policy emphasises the strict view that the ISS will take for those who serve on the boards of complex companies, in practice, ISS has been taking a more pragmatic approach view, recognising that mandates held at investment companies may require a lesser time commitment than those at an operating company.

Investment companies

ISS recommends generally voting for a resolution to authorise the issue of equity if there is a firm commitment (in the form of an explicit confirmation given to the ISS) from the board that shares would only be issued at a price at or above net asset value.

ISS has also aligned its policy with the position set out in the Pre-Emption Group guidelines such that current 10 % limit for disapplying pre-emption rights when shares are to be issued at a premium has been removed (the 5% limit for general purposes remains).

Also worth noting is, that in relation to Board gender diversity, whilst ISS will generally recommend against the nomination committee chair (or other directors on a case-by-case basis) of (i) FTSE 350 companies where the board does not comprise at least 33% women; and (ii) AIM companies with a market capitalisation over £500 million, investment trusts are explicitly excluded from this new policy.

In terms of timing, the ISS intends to apply the new guidelines to shareholder meetings taking place on or after 1 February 2021. A full mark-up of the ISS policies showing the changes is available [here](#).

LIBOR DISCONTINUATION AND THE TRANSITION TO A REPLACEMENT RATE

What is this?

The discontinuation of the use of LIBOR.

Who does this apply to?

Any fund and/or fund manager which currently relies on LIBOR in any way.

When does this apply?

Now – funds to take immediate action to develop and implement transition plans ahead of LIBOR cessation (expected by the end of 2021).

The London Interbank Offered Rate ("LIBOR") is expected to be discontinued by the end of 2021 and there has been increased pressure from the regulators (including the Financial Conduct Authority (the "FCA")) to ensure that market participants cease to use this benchmark well in advance of the "big bang" date.

The FCA has sent several "Dear CEO" letters relating to LIBOR cessation. Most of these letters were addressed to sell-side financial institutions but the FCA also sent a "Dear CEO" letter to asset managers in February 2020 (letter available [here](#)). The "Dear CEO" letters and the FCA's other statements on LIBOR transition stress the importance of engaging with LIBOR discontinuation as early as possible. The FCA expects regulated market participants to be taking immediate action to develop and execute a LIBOR transition plan.

"Risk free" reference rates (often referred to as "RFRs") are being developed to replace LIBOR in relation to specific asset classes and products. The Bank of England's Working Group on Sterling Risk-Free Reference Rates (the "RFR Working Group") has recommended Sterling Overnight Index Average ("SONIA") as its preferred replacement rate for LIBOR in sterling markets – and it has been working together with key industry bodies, including the Loan Market Association (the "LMA") and International Swaps and Derivatives Association, Inc. ("ISDA"), to establish the parameters around any adjustments to RFRs that should be applied by market participants when transitioning their existing contracts away from LIBOR to the replacement RFRs.

The RFR Working Group has set certain target milestones to manage the transition away from sterling LIBOR which includes the end of Q1 2021 as the date by which lenders should cease to issue sterling LIBOR

referencing loans maturing after 2021 (which is relevant not only to fund finance facilities but also to any acquisition facilities entered into by funds' investee companies).

What is likely to be impacted?

Most funds are likely to be affected by LIBOR discontinuation. A fund might use LIBOR as a benchmark for performance targets, and its administrators, managers and custodians as an input to their valuations and risk assessments. Also, LIBOR might feature in late payment clauses (such as for capital contributions), default interest provisions and across a fund's fund finance facilities (such as bridge or NAV facilities), hedging arrangements and investments (as it is commonly referenced in loans, bonds, notes and securitisations).

It is important for managers to work closely with their custodians and counterparties to assess their fund's universe of exposures to LIBOR and determine the steps they will need to take to ensure that the risks of transitioning to replacement RFRs are mitigated and that the transition is implemented as smoothly as possible.

Why does this matter?

LIBOR cessation, if improperly managed, may have adverse financial implications for market participants with LIBOR exposures. These implications could range from an economic impact (if the fallback rate chosen to replace LIBOR is less favourable), basis risk (if, for example, there is a mismatch between the fallback rate of a loan and the fallback rate of any hedging of the interest-rate of that loan) or, at worst, potential defaults under arrangements that apply an interest rate linked to LIBOR. The replacement of LIBOR interest rates will not be automatic, nor is there yet established market practice for moving to replacement rates. Different markets (e.g. the loan market and the derivatives market) may adopt different fallbacks. Moving to fallback rates will often require managers to consult with their counterparties and in many cases obtain their consent.

How should funds manage the impact?

Once funds have established what the impact of LIBOR transition will be, managers should focus on preparing a LIBOR transition plan to ensure that a consistent approach is taken and that they are not exposed to mismatches in replacement rates, imperfect hedges that result in basis risk, potential disputes and/or defaults. Consideration should also be given to regulatory guidance on managing conduct and compliance risks relating to client communications during LIBOR transition. All UK funds, but debt funds in particular, should be mindful of the FCA's focus on "treating customers fairly" as a "customer" relationship

exists between a debt fund and both its investors and borrowers.

The next step will be to engage with counterparties and commence the process of amending affected contracts. To assist with transition, industry bodies have been working on amendments to their standard form documentation and calculations to adjust to RFRs (such as SONIA).

Recent developments include:

- In the derivatives space, ISDA has launched important tools to assist market participants with the transition from LIBOR under their derivatives, repo and stock lending transactions, namely the ISDA 2020 IBOR Fallbacks Protocol and the IBOR Fallbacks Supplement to the 2006 ISDA Definitions, which took effect on 25 January 2021. You can find more details on these documents in our LIBOR Transition Toolkit note, available [here](#).
- In the loans space, the LMA has published [\(here\)](#) a proliferation of exposure drafts of RFR-linked loan templates, term sheets and commentaries including, most recently, multicurrency facility agreements (i) with initial lbor-based pricing, "hardwired" to switch to RFRs with effect from agreed trigger points, and (ii) providing for use of a compounded RFR pricing (where relevant), with forward-looking interbank term rates applying to other currencies (e.g. for EURIBOR). Whilst these are only "exposure drafts" (and only contemplate simple unsecured "investment grade" facilities), the pricing formulae and standardised definitions used here are likely to dictate the shape of future loan documentation. Although the market has not fully embraced RFR pricing, all new and re-financed loans typically now include some form of contractual arrangement designed to facilitate re-pricing at a future date, based on standard clauses published by the LMA.

What should funds be doing? – A Checklist

Funds should:

- scope the universe of impacts that LIBOR cessation will have on their business and prepare a transition plan setting out the steps they will take to manage those impacts and transition away from LIBOR to an appropriate replacement rate;
- work on amendments to their existing contracts to deal with LIBOR fallback mechanics and consider which replacement rate (e.g. SONIA; Bank of England base rate,

etc.) would be most appropriate for inclusion in those contracts; and

- assess any regulatory, accounting and tax implications resulting from amending (or opting not to amend) their contracts (e.g. loss of regulatory grandfathering, significant accounting or tax gains or losses).

The industry's work on LIBOR discontinuation is part of a broader benchmark reform which under the EU Benchmarks Regulation requires certain 'supervised entities' to ensure that they have robust written plans setting out the actions that they would take if a benchmark materially changes or ceases to be provided, and to reflect these plans in their contractual arrangements. Funds should also consider if and how this regulation might apply to their arrangements.

You can find more information about LIBOR transition in our briefing note, which is available [here](#).

UPCOMING (TARGETED) AMENDMENTS TO BE MADE TO THE UK PRIIPS REGIME

What is this?

Proposed amendments to the post-Brexit PRIIPS regime.

Who does this apply to?

Market participants advising on, selling or otherwise making available a PRIIP to a retail investor in the UK.

When does this apply?

Not known.

In July 2020, HM Treasury published a [policy statement](#) on proposed amendments to the retained EU law version of the PRIIPS Regulation (the "**UK PRIIPS Regulation**"). HM Treasury plans to make some amendments to improve its functioning in the UK. The changes, which represent targeted amendments rather than a wholesale reform, will comprise of:

- clarification of the scope of PRIIPs to address the uncertainty around the scope of the PRIIPS Regulation since implementation, particularly in respect of corporate bonds;
- giving the FCA power to clarify what information should be provided in the KID;
- replacing the 'performance scenario' section with 'appropriate information on performance' with the FCA amending what information to provide in this section; and

- allowing UCITS to be exempt from issuing Key Investor Information Document ("**KIDs**") for up to five years (the current exemption runs out in December 2021). Under this exemption, UCITS may use their KID instead of the PRIIPs KID.

The definition of PRIIPs will not be changed. A [related webpage](#) explains that HM Treasury intends to conduct a more wholesale review of the disclosure regime for UK retail investors in the longer term. This review will explore how to harmonise the PRIIPs regime with requirements contained in the MiFID II Directive.

There is no date set for these amendments. HM Treasury intends to legislate for these amendments when parliamentary time allows.

FCA CHANGES PROCESS FOR NOTIFYING DETAILS OF MAJOR SHAREHOLDINGS

What is this?

A new online portal which must be used for notifying the FCA of major shareholdings.

Who does this apply to?

Main market investors. Registration to use the new portal is required.

When does this apply?

The portal will be live on 22 March 2021.

In Q1 2021, the FCA will be changing the way in which Main Market investors notify the FCA of major shareholdings under DTR 5. Instead of emailing TR-1 forms to the FCA, investors will need to complete an electronic TR-1 form which will be sent via an online portal. That form will be able to be downloaded and sent to the issuer. After the launch of the new portal, Main Market investors will no longer be able to submit TR-1 Forms to the FCA via email. In order to use the new portal, issuers will need to complete a two-step registration process (detailed on the FCA's [webpage](#)) and early registration is encouraged so that investors are ready to send electronic TR-1 Forms as soon as the portal is launched. A Main Market investor will have two weeks within which to complete its registration. In the meantime, Main Market investors should continue to submit their TR-1 Forms to the FCA in email format. The new process does not apply to investors of AIM companies (who have to notify the issuer but not the FCA).

NATIONAL SECURITY AND INVESTMENT BILL: IMPACT ON SHARE AND ASSET ACQUISITIONS

What is this?

Draft legislation designed to strengthen the government's powers to scrutinise transactions on grounds of national security.

Who does this apply to?

A wide range of transactions.

When does this apply?

Not known.

In November 2020, the [National Security and Investment Bill 2019-21](#) (the "NSI Bill") was introduced to the House of Commons and given its first reading. The Bill will establish a new statutory regime for government scrutiny of, and intervention in, investments for the purposes of protecting national security and follows the government's 2017 and 2018 Green and White Papers on the national security and infrastructure investment review.

The NSI Bill will broaden the range of investments which can be reviewed by the UK government on national security grounds and introduce a statutory requirement for parties to notify relevant transactions in the most sensitive areas of the economy. Alongside a mandatory requirement, the government will also have a more extensive "call-in" power to enable it to assess deals which may give rise to national security risks. In each case, the review process will be subject to statutory time limits.

A number of direct and indirect share and asset acquisitions may be caught by the NSI Bill.

- **Share acquisitions.** Various types of share acquisition may fall within the scope of the NSI Bill depending on the circumstances. However, as a broad guide, acquisitions of 15% or more of the votes or shares in an entity will likely fall within the scope of the NSI Bill, as will increases in shareholding through certain bands (e.g. from 25% or less to more than 25%, from 50% or less to more than 50%, or from less than 75% to 75% or more).
- **Asset acquisitions.** A wide range of asset acquisitions may also fall within the scope of the NSI Bill. In particular, attention should be paid to the acquisition of a right or interest in an asset providing the ability to: use the asset, or use it to a greater extent than prior to the acquisition; or direct or control how the asset is used, or direct or control how the asset is used to a greater extent than prior to the acquisition. Assets within the scope of the NSI

Bill are land, tangible moveable property, and (covering intellectual property) any idea, information, or technique with industrial, commercial or other economic value (including assets/land outside the UK which are used for activities in the UK or for supply of goods/services to persons in the UK). Examples of assets within that last category include: (a) trade secrets; (b) databases; (c) source code; (d) algorithms; (e) formulae; (f) designs; (g) plans, drawings and specifications; and (h) software.

OUTCOME OF THE EUROPEAN REGULATOR'S CONSULTATION ON THE APPLICATION OF THE MARKET ABUSE REGIME TO COLLECTIVE INVESTMENT UNDERTAKINGS

What is this?

Comprehensive ESMA review of the functioning of EU MAR.

Who does this apply to?

All persons (although for the purposes of this section we focus on the recommendations made in respect of collective investment undertakings).

When does this apply?

Not yet known.

In September 2020, ESMA [announced](#) the outcome of its 2019 consultation on EU MAR.

By way of background, the European Commission is required, under Article 38 of EU MAR, to submit a report to the European Parliament and the Council of the EU to assess various provisions under the regulation. In March 2019, it formally requested technical advice from ESMA on the report and ESMA published a [consultation](#) in response to this request in October 2019. The consultation covered the topics included under Article 38 of EU MAR, together with a set of additional elements arising out of the Commission's request to ESMA. In addition, it incorporates several other issues ESMA has identified as closely linked to some of these topics and connected elements, which ESMA considers should be addressed jointly.

The consultation included a chapter focussing on collective investment undertakings ("CIUs") (notwithstanding the fact that the Commission's Mandate refers to all CIUs, ESMA considers the consultation to be of relevance to only those CIUs admitted to trading or trading on a trading venue). ESMA acknowledged that there might be elements

making the application of EU MAR to CIUs vis-à-vis other issuers more difficult: the fact that a significant number of CIUs do not have legal personality, and the role played in CIUs by external companies (e.g. management companies, asset managers, depositaries), the specificities of CIUs in terms of investment strategies and the determination of net asset value (both for CIUs with and without personality), led ESMA to analyse whether it is necessary to apply the EU MAR provisions for issuers to them.

The [MAR Review Report](#) is therefore the first in-depth review of the functioning of EU MAR since its implementation in 2016, and its recommendations will feed into the European Commission's review of the Regulation. The Report concludes that, overall, MAR has worked well in practice and is fit for purpose.

Key areas addressed in the report and specifically relating to CIUs were:

- ESMA had asked for views on whether CIU should be differentiated from other listed issuers. Whilst it received responses suggesting that the characteristics of CIUs admitted to trading or trading on a trading venue made market abuse unlikely, ESMA concluded that there are no compelling arguments to exempt CIUs from the scope of EU MAR as to do could create an objective risk for other market participants if inside information was generated, in the absence of an obligation to disclose it under EU or national law;
- MAR should include a specific reference excluding self-managed CIUs from “persons discharging managerial responsibilities” (“PDMR”) obligations;
- ESMA does not propose extending the PDMR obligations to the managers of funds as the managers may not have influence on the value of the CIUs, the public disclosure of transactions by the manager will not have an impact on the CIUs's share price, and that some controls are in place already in measures such as the AIFMD and UCITs;
- ESMA remains of the view that EU MAR should be amended such that the management company is made responsible for disclosing inside information, and keeping insider lists, on behalf of the fund (such proposals, ESMA acknowledges, did not form part of its 2019 consultation).

Other key areas covered by the report include:

- **market soundings:** clarification that the EU MAR requirements represent an obligation for disclosing market participants that, if complied with, will protect them from the allegation of

having unlawfully disclosed inside information. ESMA requests flexibility from the European Commission to amend its guidelines to introduce recommendations to market sounding recipients that are tailored to their size, sophistication, and nature;

- **inside Information and delayed disclosure:** ESMA will issue further guidance in relation to the application of the definition and for specific scenarios concerning delayed disclosure; and
- **buyback programmes:** proposals to improve the reporting and transparency obligations derived from buyback programmes.

The European Commission will now use the technical advice to inform its own report on EU MAR which it will present to the European Parliament and the Council of the EU. Specific legislative amendments may therefore follow. See above, for the amendments the UK government intends to make to UK MAR under the Financial Services Bill.

EMIR AND UK EMIR

What is this?

Regulations on OTC derivative transactions, central counterparties and trade repositories.

Who does this apply to?

Managers of AIFs who use, or may use, derivatives.

When does this apply?

Now.

The main derivatives regulation in the EU, the European Market Infrastructure Regulation on OTC derivative transactions, central counterparties and trade repositories (Regulation EU 648/2012) (“EMIR”), and its on-shored UK equivalent (colloquially referred to in the market as “UKMIR”), will continue to be relevant for managers in 2021.

Recap of 2020:

- In June of 2020, the definition of financial counterparty (“FC”) under EMIR was broadened to include all EEA AIFs, whether or not they are managed by a manager authorised or registered under AIFMD. Previously, EEA AIFs that were not managed by a manager authorised or registered under AIFMD were categorised as non-financial counterparties (“NFCs”). This means that it is more likely that a manager will find its funds subject to more onerous regulation. In particular where, in the past, non-EEA AIFs

managed by a non-EEA manager were *deemed* NFCs, those are now *deemed* FCs when facing EEA brokers/banks. The key implication of the change in classification is that NFCs are generally not required to exchange collateral as variation margin or to clear any derivatives transactions. FCs are however required to exchange collateral as variation margin in respect of most uncleared derivatives transactions on a daily basis and, depending on the product, clear certain derivatives transactions.

Looking ahead to 2021:

- **Notification to the FCA:** all UK FCs and UK NFCs that exceed the clearing thresholds (or that have chosen not to calculate whether or not they exceed such thresholds) must make a clearing threshold notification to the FCA. By way of recap, the thresholds are EUR 1 billion for credit and equity derivatives, and EUR 3 billion for interest, FX, commodities and other types of derivatives. The notification obligation applies even where such entities have already made such a prior notification to the FCA under EMIR. The deadline for the FCA to receive the first notification under UKMIR is **17 June 2021**.
- **Initial Margin Phase 5:** managers who manage funds with an aggregate average notional amount of OTC derivative transactions in excess of EUR 50 billion will be required to exchange collateral as initial margin from **1 September 2021**. This threshold will reduce to EUR 8 billion on 1 September 2022 and so will capture more funds than. Initial margin is in addition to variation margin (the requirements for which have been in force since 2017) and must be segregated and held subject to security. Managers cannot offset initial margin amounts against initial margin held by their derivatives counterparties. This obligation therefore comes with not insignificant cost, legal complexity, and administrative and operational considerations.
- **Post-Brexit cross-border arrangements:**
 - **General:** the impact of Brexit on funds with cross-border derivatives arrangements will largely depend on the type of transactions that those funds enter into and where the counterparties to those transactions are located. Some examples are set out below however, for more details, please see our separate [client note](#).

- **Clearing:**
 - For EU managers who use UK clearing houses to clear their derivatives, the EU has provided an 18 month window in which EU managers should transition to EU clearing houses. This is because, from **30 June 2022**, UK clearing houses will no longer meet the requirements under EMIR for EU managers who use derivatives clearing services.
 - Certain cleared interest rate and credit derivatives need to be executed on a regulated market. The EU no longer regulates or recognises UK markets, so EU managers that have been trading in London may need to consider this issue further with their UK bank/broker specifically, whether such derivatives should be moved to another market (for example certain US markets are recognised by both the EU and UK).
- **Reporting:** all transactions subject to EMIR must be reported to a trade repository. UK trade repositories will cease to be permitted recipients of reports that EU counterparties are required to make under EMIR, so EU managers will need to make arrangements to report to EU trade repositories instead (UK managers reporting to UK trade repositories will be unaffected). Managers who have delegated reporting to their counterparties should consider whether those reporting arrangements will need to be revisited, particularly because under EMIR responsibility for reporting falls on the manager itself and not on the fund.

Managers of AIFs who use, or may use, derivatives should think carefully about the implications of EMIR and UKMIR, as applicable. There are ways we can assist you with planning, structuring, reviewing and negotiating legal documents as well as regulatory advice and optimisation work. We would also be happy to discuss the impact of Brexit on the derivatives used by your funds.

ESMA CONSULTATION PAPER ON GUIDELINES FOR FUNDS' MARKETING COMMUNICATIONS

What is this?

Consultation on guidelines for funds' marketing communications.

Who does this apply to?

EU AIFMs, UCITS management companies, EuSEF managers and EuVECA managers. Also fund distributors.

When does this apply?

2 August 2021.

In November 2020, ESMA issued a [consultation paper](#) on its draft guidelines for funds' marketing communications. These supplement the requirements in the [Regulation](#) on cross-border fund distribution regarding marketing communications.

The draft guidelines include the following:

- **Identification of marketing communications:** Marketing communications should include sufficient information to make it clear that the communication has a purely marketing purpose, is not a contractually binding document or an information document required by any legislative provision, and is not sufficient on which to take an investment decision. A marketing communication should include a prominent disclosure of the terms "marketing communication" and a disclaimer.
- **Description of risks and rewards:** Both risks and rewards should be described equally prominently and in the same font, size and position. Information on risks should not be disclosed in footnotes or in small characters within the main body of the communication.
- **Fair, clear and not misleading information:** The level of information and its presentation may be adapted to the type of investor (i.e. retail or professional). The information should also be consistent with the other legal and regulatory documents of the relevant fund. Any description of the features of the investment should be kept up to date and contain sufficient information to enable the key elements of those features to be understood.
- **Information on costs:** Information on the costs associated with purchasing units or shares should allow investors to understand the overall impact of costs on the amount of their investment and on the expected returns.

- **Information on past performance and expected future performance:** Information on past performance should not be the main information of the marketing communication and any change that affected significantly the past performance of the fund should be prominently disclosed. Expected future performance should be based on reasonable assumptions supported by objective data and disclosed on a time horizon which is consistent with the recommended investment horizon of the fund. Certain disclaimers may also be required.
- **Information on sustainability-related aspects:** Information on the sustainability-related aspects of the fund should not be disproportionate to its relevance in the fund's strategy and marketing communications should indicate that any decision to invest in the fund should take into account all the characteristics or objectives of the fund.

The draft guidelines also include some examples of what ESMA proposes should and should not be considered a marketing communication for these purposes. Examples of marketing communications include communications describing the characteristics of a fund provided to distributors which are then sent to investors (regardless of whether that was the intention) and advertising messages, irrespective of their medium. Examples of communications which are not marketing communications include legal and regulatory documents of a fund, corporate communications describing market developments which do not refer (explicitly or implicitly) to a specific fund and/or short online messages linking to marketing communications but which do not themselves contain any information on a specific fund.

The consultation closes on **8 February 2021** and the final guidelines are expected to be issued by **2 August 2021**.

SOCIAL SECURITY FOR INTERNATIONALLY MOBILE WORKERS FROM 1 JANUARY 2021

What is this?

The post-Brexit rules on social security for internationally mobile workers.

Who does this apply to?

Internationally mobile workers going to the EU from the UK or vice versa and their employers.

When does this apply?

Now.

For UK employers with workers in the EU, the EU/UK Trade and Cooperation Agreement ("TCA") contains some welcome clarification on their social security obligations from 1 January. Importantly, a new Protocol on Social Security Co-ordination has been agreed, replicating many of the existing EU rules, including those for 'posted' workers (to be known as 'detached' workers). Crucially, however, each EU member state had until 1 February 2021 to decide whether it wanted to adopt the new rules in respect of detached workers (which effectively replicate the previous rules for posted workers). We have had confirmation that all EU member states have opted to apply the detached worker rules.

POTENTIAL CHANGES TO THE REIT RULES

What is this?

Potential changes to the UK REIT as part of the review of the UK funds regime (discussed [above](#)).

Who does this apply to?

REITs, their investors, joint ventures and those considering how to structure real estate investments.

When does this apply?

The Government is currently aiming to introduce a first batch of changes next year (2022).

As part of the fund review, the Government is considering changes to the REIT regime in two phases.

The first phase, running in parallel with the new AHC regime proposals (discussed [above](#)), considers prioritised, targeted reforms to the UK REIT rules to reflect practical concerns and offer more operational flexibility. These include the option of an unlisted REIT for certain institutional investors, restricting the effective prohibition on corporate shareholders having an interest of 10% or more so that it only applies to those not entitled to receive gross distributions from the REIT (so would not apply to UK companies), more flexibility of the 75% "balance of business test" and the extension of the list of eligible institutional investors (relevant to the "non-close" requirement), alongside the introduction of a widely held rule into the relevant definition. For more detail, please click [here](#).

The second phase, forming part of the call for input (also discussed [above](#)), includes proposals to abolish the interest cover test, allow a REIT to hold a single property and amend the three year development rule.

Suggestions on improving the tax position for international investment by REITs are also on the table, though it is not clear yet whether these will be able to be moved to the first phase.

These proposals are very welcome. In particular, the option of an unlisted REIT should facilitate the use of REITs in joint venture and clubs deals and as a vehicle for institutional investment, without the need for the additional costs and administration of listing offshore. We expect, however, to see the listing requirement retained for the regime in relation to the wider market. Other changes mooted should help offer more operational flexibility and would get rid of a few quirks.

The introduction of a widely held requirement in the institutional investor rule, may, however, mean that some investors who currently qualify as "institutional investors" may cease to do so.

DEVELOPMENTS IN RELATION TO VAT

Review of VAT treatment of fund management fees

What is this?

An upcoming Government review on the VAT treatment of fund management fees.

Who does this apply to?

Fund managers and their clients.

When does this apply?

It is currently unclear when the review will start. It is hoped that it will be early this year.

The Government announced in the 2020 March Budget a review of the VAT treatment of fund management fees. This has been delayed due to Covid-19 and we do not know exactly what the review will cover. However, as the current scope of the VAT exemption for fund management services is unclear, Brexit should provide the UK with the opportunity to consider this area afresh, allowing it to adopt a more coherent approach than its European competitors, and it is hoped that this is what the fund review will address.

Increased VAT recovery for supplies of financial services to EU member states

What is this?

A change of rules allowing greater recovery of input VAT for those making certain supplies of financial services to EU member states.

Who does this apply to?

Those making relevant supplies to the EU.

When does this apply?

Now.

Prior to 1 January, input tax associated with most VAT exempt supplies of financial services could be recovered

where the supply is made to a person belonging outside the EU. Since 1 January this ability to recover input VAT has been extended so that it applies to supplies made to persons belonging outside the UK (i.e. it applies also to supplies to the EU). Relevant exempt supplies include making loans and transferring shares but do not include exempt fund management.

VAT grouping call for evidence

What is this?

A change of rules allowing greater recovery of input VAT for those making certain supplies of financial services to EU member states.

Who does this apply to?

Member and potential members of UK VAT groups.

When does this apply?

This is currently uncertain.

In November, an HM Treasury call for evidence in relation to VAT grouping closed. The call included views on potential changes to the current rules which would, if adopted, significantly recast the UK's VAT grouping framework. We do not yet know which, if any, of the proposals contained in the call for evidence will be taken forward and so this is something to keep an eye out for this year. Of particular interest to asset managers will be the review of VAT grouping rules for limited partnerships and the impact of any changes to those rules on the VAT treatment of management fees.

NEW OFF PAYROLL WORKING RULES COME INTO EFFECT ON 6 APRIL 2021

What is this?

The introduction of new employment tax rules for off payroll workers.

Who does this apply to?

Medium and large clients in the private sector who use workers that provide their services through intermediaries.

When does this apply?

On and after 6 April 2021.

New rules relating to off-payroll working come into effect on 6 April 2021 (having been delayed by a year due to the Covid-19 pandemic).

The new rules will apply to medium and large clients in the private sector that have a UK connection. They will affect fee payments made in respect of workers who provide their services through intermediaries such as

personal service companies (PSCs). Asset managers and others in the funds sector engaging such intermediaries will need to decide whether, if the existence of the intermediary were ignored, the worker would be regarded as their direct employee (or office holder) for income tax purposes. If they would, then the client (or the agency paying the intermediary if different) must deduct income tax and NICs from the fees paid to the intermediary and account for employers' NICs (and apprenticeship levy if relevant) as if the fees were payments of salary.

Those in the funds sector engaging workers through PSCs should be assessing which of these engagements they will have in place as at 6 April 2021 and ensuring that the contracts governing relevant ones provide for the new rules. For example, they should enable tax and NICs to be deducted from payments, (where possible) permit a repricing of the arrangement to take account of the additional costs to the firm (such as employers' NICs charges and apprenticeship levy) and contain appropriate indemnities. Clients also need to put in place internal processes for making decisions about whether the new rules apply, issuing "status determination statements" and operating payroll on payments within the rules. The legislation prescribes a disagreement process which the client must follow if the worker or agency challenges its decision on status. Clients should review existing engagements that will continue beyond 6 April 2021 to see whether they come within the new rules. If they take on new workers and think the contract will extend beyond 6 April 2021, clients need to ensure that the contract takes the changes into account.

For more information on whether the new rules will apply to you and what needs to be done under them please click [here](#) and [here](#).

ECONOMIC CRIME LEVY

What is this?

The Government is planning to introduce a levy to fund combatting economic crime.

Who does this apply to?

Those in the AML regulated sector.

When does this apply?

The intention is for the first set of levy payments to be made in the financial year 2022/23 but this is subject to the findings of a consultation on the levy.

Government is planning to introduce a levy, to be imposed on all relevant persons under the UK Money Laundering Regulations, in order to pay for enhanced government action to tackle money laundering. It has

consulted on different options for collecting the levy and it is now considering responses. If (as seems likely) it is introduced it will likely to apply to many within the asset management sector including portfolio managers, collective investment undertakings and investment advisers. The government intends for the first set of levy payments to be made in the Financial Year 2022/23. However, this timeline is subject to the findings of the consultation. Further detail on the new levy will be something to watch out for this year.

CHANGES TO THE UK'S "HYBRID" ANTI-AVOIDANCE RULES

What is this?

Proposed changes to the UK's "hybrid" anti-avoidance rules.

Who does this apply to?

UK corporation taxpayers and counterparties to transactions with them.

When does this apply?

Assuming they are introduced, the different proposals have different dates for coming into force with some being retrospective back to 1 January 2017.

Following on from a consultation that closed in the summer, on 12 November 2020 HMRC proposed a number of significant changes to the UK rules which aim to counteract "tax mismatches" which arise from arrangements with a hybrid element or which are designed to create that mismatch (the Regime). We set out below some of the key proposals relevant to the Funds sector.

Acting together

It is proposed that the situations in which parties are considered to "act together" for the purposes of the Regime are reduced. This is important because when parties act together in relation to another person, broadly, the aggregate rights and interests those parties have in the other person are attributed to each other when assessing whether either of those parties controls or is related to another person. The presence of a control relationship or persons being related is often critical for the hybrids rules to apply.

One aspect of the proposals relating to the "acting together" concept is that a partner in a partnership will, from the date of royal assent to the Finance Bill 2021, no longer be deemed to be acting together with all the other partners where the partnership in question is a collective investment scheme in which the partner holds an interest of less than 10% (subject to rules preventing partners with larger interests fragmenting

them in order to fall within the new exclusion). We do not have any draft legislation for this change and so will have to wait for the detail, but it is potentially good news for investment funds and sounds as if it may be a similar approach to that taken by Luxembourg in its adoption of ATAD II.

Dual inclusion income

The Regime includes provisions that counteract arrangements that generate double tax deductions for payments made by a hybrid entity that are also deductible for an investor in it. Broadly, these provisions can apply if the hybrid or the investor is within the charge to corporation tax and either they are related or the arrangement is designed to deliver (or share the economic benefit of) the double deduction.

An example of when the provisions could potentially apply would be expenses (e.g. employee salaries) incurred by a UK subsidiary of a US parent where a "check the box election" (**CTB Election**) has been made to disregard the subsidiary for US tax purposes. Absent the Regime, these expenses would be deductible for both the US parent and UK subsidiary (subject to any normal (non-hybrid) restrictions on deductibility).

There is an exemption from the disallowance where the double deduction is used against "dual inclusion income" but that term has been too narrowly defined, leading to UK taxpayers being unable to claim tax deductions in some common benign situations, typically involving supplies between a UK service provider which has been subject to a CTB Election and a related overseas customer.

In 2018 HMRC tried to remedy the situation by allowing the deduction to be set off against a further type of income ("**section 259ID income**") as well as dual inclusion income. However, the concept of section 259ID income is itself too narrowly drawn to be relevant in many situations and, under the proposals, will be replaced, with retrospective effect back to the introduction of the Regime, by a definition of "dual inclusion income" that will be expanded (in double deduction situations) to catch "inclusion/no deduction income" of a hybrid payer. Broadly, that is taxable income of the payer which is not deductible for any person where the reason for such non-deductibility is the hybridity of the payer.

The proposed extension of the definition of dual inclusion income is an improvement on the concept of section 259ID income but, unfortunately, not a complete answer. Helpfully, it should broaden the situations in which payments from US parents to UK subsidiaries are eligible to count as dual inclusion income and should also potentially apply where the payment is made by a US sister entity which has also been disregarded for US tax purposes as a result of a CTB Election. However, payments from related entities

in other jurisdictions are still unlikely to fall within the definition (as the related entities are likely to get a local tax deduction for the payments they make to the UK company).

The definition of dual inclusion income is proposed to be similarly extended in the section of the Regime that potentially denies deductions where a UK company that has been subject to a CTB Election for US purposes makes a payment to its US parent. In that situation, as the US parent would not recognise any taxable income (due to the election), the Regime would potentially deny the UK company a corporation tax deduction unless there is dual inclusion income from the arrangement.

In addition, the proposals envisage introducing rules that will enable companies to surrender dual inclusion income to other members of their group who would otherwise be subject to a counteraction under the hybrids rules. This proposal would come into effect in relation to accounting periods of claimant companies ending after 1 January 2021.

Tax exempt investors

Currently, under the Regime, situations in which a corporation tax deduction can be denied to a UK corporation tax payer include where:

- a payer makes a potentially tax deductible payment to a hybrid entity which does not give rise to taxable income for either the hybrid or an investor in it (e.g. if the hybrid is tax transparent in its own jurisdiction but seen as opaque in the jurisdiction of an investor); or
- a (potentially) tax deductible payment is made by a hybrid which is not recognised as taxable income for the investor (e.g. where a payment is made to its US parent by a UK company that has made a CTB Election for US tax purposes).

However, a problem with the rules is that this counteraction is not disapplied where there would be no tax on the receipt of the payment, even if there was no hybridity present, due to the recipient being a tax exempt investor (e.g. a pension fund). Under the proposals these rules will be amended, from the date of royal assent to the Finance Bill 2021, to prevent counteraction where the recipient falls within a category of tax exempt investor akin to the category of "qualifying institutional investor" within the corporation tax substantial shareholding exemption. We do not have any draft legislation for this change and so will have to wait for the detail.

Imported mismatches and equivalent regimes

The Regime contains provisions which can deny deductions to UK corporation tax payers where, in essence, the payment funds a hybrid mismatch between two non-UK entities. A key condition for these

"imported mismatch" rules to apply is, broadly, that there is no "equivalent provision" under the laws of a foreign jurisdiction which would apply to the mismatch. HMRC recognises that this can be problematic because, in order to determine equivalence, consideration is required of specific provisions within the foreign regimes which must be equivalent to specific provisions of the Regime, rather than the overseas regime as a whole being assessed. In addition, it also raises the question of whether equivalent provisions can be said to "apply" where no counteraction ultimately results. To address both these issues, under the proposals, the condition will be changed so that it tests whether an overseas regime as a whole can be seen as equivalent to the Regime as a whole. Again, we do not have the draft legislation for this measure (which is proposed to come into force from the date of royal assent of the Finance Bill 2021) and so will have to wait for the detail.

TAXATION OF GAINS REALISED BY NON-RESIDENTS ON DISPOSALS RELATED TO COLLECTIVE INVESTMENT VEHICLES HOLDING UK REAL ESTATE: INTRODUCTION OF 10% HOLDINGS THRESHOLD FOR NON-RESIDENT INSURANCE COMPANIES AND FUNDS

What is this?

The proposed introduction of a 10% holdings threshold before the non-resident CGT rules apply to certain disposals involving non-resident funds and insurance companies.

Who does this apply to?

Funds and insurance companies in certain UK property holding structures.

When does this apply?

Under the proposals, the change would have retrospective effect back to 6 April 2019.

Since April 2019, where non-residents hold an interest in a UK property rich collective investment vehicle (CIV), they will potentially be subject to UK tax on gains on any disposal of that interest, regardless of the size of their holding (ie the usual 25% threshold is disapplied). Helpfully, the government proposes to change this, with retrospective effect to 2019, and has published draft regulations, for consultation, for a new 10% threshold before the charge bites for disposals of interests in CIVs for, broadly, (i) a non-resident life insurance company that does not have a UK permanent establishment, and (ii) a widely held offshore CIV for whom holdings of UK land and UK property rich companies are not expected to be more than 40% of the market value of its investments.

We expect the Government to introduce the proposed changes in a form substantively similar to the draft to date.

This will be a welcome development for UK real estate funds with actual or potential non-resident investors that are either overseas insurance companies or collective investment vehicles. To date, the lack of such a threshold has made it unattractive for those investors to take minority stakes in UK real estate funds, not only because of the UK tax liabilities that may arise on any disposal, but also due to the consequential administrative burden that would otherwise result.

INTRODUCTION OF A 2% STAMP DUTY LAND TAX (SDLT) SURCHARGE ON NON-RESIDENTS ACQUIRING UK DWELLINGS

What is this?

Introduction of a 2% stamp duty land tax (SDLT) surcharge on non-residents acquiring UK dwellings.

Who does this apply to?

Non-residents (and some UK residents) acquiring UK dwellings.

When does this apply?

To transactions with an effective date on or after 1 April 2021.

For transactions with an effective date on or after 1 April 2021, a new 2% SDLT surcharge will apply (subject to transitional rules) to most acquisitions of a major interest in one or more dwellings, where one or more purchasers is "non-resident". In determining "residence", there is a brand-new test for individuals and different rules for companies and other entities (such as partnerships and trusts). In addition to companies that are not UK resident for corporation tax purposes, the new rules also treating as non-resident companies that are UK resident if, broadly, they are close companies and under the control of non-resident participators.

Importantly for the asset management sector, there is no exclusion from the surcharge for offshore funds.

FOR FURTHER INFORMATION, PLEASE CONTACT



Aaron Stocks
Head of Funds
aaron.stocks@traverssmith.com
+44 (0)20 7295 3319



Sam Kay
Partner, Funds
sam.kay@traverssmith.com
+44 (0)20 7295 3334



Will Normand
Partner, Funds
will.normand@traverssmith.com
+44 (0)20 7295 3169



Jeremy Elmore
Partner, Funds
jeremy.elmore@traverssmith.com
+44 (0)20 7295 3453



Emily Clark
Head of Tax
emily.clark@traverssmith.com
+44 (0)20 7295 3393



Elena Rowlands
Partner, Funds Tax
elena.rowlands@traverssmith.com
+44 (0)20 7295 3491



Cathryn Vanderspar
Consultant, Funds Tax
cathryn.vanderspar@traverssmith.com
+44 (0)20 7295 3337



Tim Lewis
Head of Financial Services & Markets
tim.lewis@traverssmith.com
+44 (0)20 7295 3321



Stephanie Biggs
Partner, Financial Services & Markets
stephanie.biggs@traverssmith.com
+44 (0)20 7295 3433



Phil Bartram
Partner, Financial Services & Markets
phil.bartram@traverssmith.com
+44 (0)20 7295 3437



Michael Raymond
Partner, Financial Services & Markets
michael.raymond@traverssmith.com
+44 (0)20 7295 3487



Jane Tuckley
Senior Consultant,
Financial Services & Markets
jane.tuckley@traverssmith.com
+44 (0)20 7295 3238



Simon Witney
Senior Consultant,
Financial Services & Markets
simon.witney@traverssmith.com
+44 (0)20 7295 3957



Charles Bischoff
Partner, Fund Finance
charles.bischoff@traverssmith.com
+44 (0)20 7295 3378



Katie McMenamin
Partner, Fund Finance
katie.mcmenamin@traverssmith.com
+44 (0)20 7295 3350



Danny Peel
Partner, Fund Finance
daniel.peel@traverssmith.com
+44 (0)20 7295 3441



Jonathan Gilmour
Head of Derivatives &
Structured Products
jonathan.gilmour@traverssmith.com
+44 (0)20 7295 3425



Manisha Shukla
Knowledge Counsel, Funds
manisha.shukla@traverssmith.com
+44 (0)20 7295 3218