

11 May 2020

Personal Finances & Funds
1 Blue, HM Treasury
1 Horse Guards Road
London SW1A 2HQ



Dear Sir or Madam

Consultation: Overseas Funds Regime

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

In March 2020, HM Treasury published a Consultation (the "**Consultation**") on a proposal for an Overseas Fund Regime (the "**proposed OFR**"), which will establish a new process to allow investment funds domiciled overseas to access the U.K. market, with the objective of replacing the existing regime.¹ Currently, E.U. funds access the U.K. market under the provisions of Section 264 of the Financial Services and Markets Act 2000 ("**FSMA**"), whilst the authorisation of non-E.U. funds is governed by section 272 of FSMA.² The proposed OFR will establish equivalence regimes for overseas retail funds (i.e., Undertakings for Collective Investment in Transferable Securities ("**UCITS**") and Money Market Funds ("**MMFs**")), to come into effect after the U.K.'s withdrawal from the U.K., whereby HM Treasury may grant equivalence to a Third Country (including E.U. Member States) and allow funds domiciled in those countries to market in the U.K. Individual funds that are not eligible to be recognised through the proposed OFR will continue to be able to utilize section 272 of FSMA, to which the Consultation also proposes changes.

Whilst the Consultation sets out, in broad strokes, its future approach to non-U.K. funds, much of the specificity around the criteria, timing and process of the equivalence assessments remains unknown. The FMLC is grateful for the opportunity to highlight legal uncertainties which arise in respect of the proposed OFR. Fund managers with a significant presence in the U.K., use UCITS to access the U.K. market. Uncertainties with regards the regulation of UCITS in the U.K. might lead to business interruption. Clarification on these issues early in the process would therefore be helpful.

Timing and overlap

The existing system—governed, as mentioned above, by sections 264 and 272 of FSMA—will cease at the end of the Brexit Implementation Period.³ Under the Collective Investment Schemes (Amendment etc.) (EU Exit) Regulations 2019 (the "**CIS EU Exit Regulations**"), a temporary marketing permissions regime ("**TMPR**") has been introduced for E.U. UCITS that have exercised their rights to market in the U.K. before the end of the Implementation Period, allowing them to continue to access the UK market in a very similar way as under the current "passporting" system for a limited period after the end of the transition period. It is intended that the proposed OFR be available to Third Country—including E.U.—funds at the end of the TPMR.⁴ The compressed timeline within which the TPMR will cease and the proposed OFR needs to be established results in uncertainty around timing: it is not clear whether the regimes will overlap, for instance, or when "umbrella" funds will need to start using the proposed OFR and cease using the TPMR. Greater clarity on this point and on

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how the equivalence regime will be updated over time, as the U.K. minimum standards evolve, would also be helpful.

Equivalence—criteria

The Consultation states that equivalence determinations made under the proposed OFR will be “outcomes-based”. This means that HM Treasury will consider whether the regulatory regime of the Third Country in question provides a level of protection that is broadly comparable to that which applies to U.K.-authorised funds/MMFs. The Consultation recognises that provisions in the overseas state do not need to be identical to the U.K. regime.⁵ It remains unclear, however, which specific areas of the Third Country’s regime will be examined by the “outcomes-based equivalence” assessment. Currently, in its consideration of applications by Third Country funds under section 272 of FSMA, the Financial Conduct Authority (the “FCA”) focuses on rules set out in its Collective Investment Schemes Sourcebook (the “**COLL Rules**”). It seems likely that equivalence with these rules will be considered in an assessment under the proposed OFR but it is not clear whether other areas—for example, consumer protection laws—will also be a part of that same assessment. The Consultation contains no discussion of the rules introduced in the U.K. following the FCA’s Asset Management Market Study, and it is unclear how these new measures will affect the equivalence determination.⁶

A similar issue arises in respect of any “additional requirements” which might be imposed by HM Treasury. Section 3 of the Consultation proposes that, in the event a Third Country meets the baseline standard of equivalent investor protection but it would nevertheless be desirable to impose additional requirements as a condition of marketing in the U.K.—perhaps to address potential inconsistencies—these additional requirements will be set out in the statutory instrument giving effect to the equivalence determination. Whilst the FMLC welcomes such legislative clarity, it would urge HM Treasury to provide clarification as which aspects of law it might consider important to include as an additional requirement. It might be beneficial for those marketing vehicles in the U.K. to be given a full list of the rules and legislation that will apply.

Finally, the Consultation envisages limiting equivalence decisions to particular types of funds. Greater clarity is needed as to which types of vehicles are eligible, and whether certain fund types, for example a UCITS, will be treated as the broad equivalence standard or whether the FCA will prioritise certain fund types.

Equivalence—withdrawal and timing

The proposed OFR gives HM Treasury the power to modify or withdraw equivalence decisions. Chapter 6 of the Consultation proposes that HM Treasury and the FCA should engage with the competent authority in the overseas jurisdiction to identify “within an appropriate amount of time” steps by which a required standard of equivalence may be achieved; if this isn’t possible, equivalence may be revoked. More specific timeframes in this regard would allow market participants both to determine alternative measures in the event an equivalence decision was revoked and to implement any transitional measures were revocation likely to be forthcoming. A clear and transparent process for the modification and withdrawal of equivalence decisions would provide legal certainty and operational continuity.

Reporting

The Consultation envisages the FCA having information-gathering powers and the need for proactive reporting to the FCA, not only at the registration stage but also on

an ongoing basis. It is expected that firms will have to report to the FCA changes that may impact the fund's eligibility for recognition; the FCA can request further information on an ongoing basis. It is important that there is clarity as to the nature of these reporting requirements and the types of changes to the fund that may impact eligibility.⁷ In most jurisdictions deemed equivalent, it is expected that the local regulatory framework will oversee changes to the fund; an additional requirement that changes are also reported to the FCA will increase the burden on the fund, impacting its efficiency.

Financial promotion

Currently, operators of E.U. funds are deemed, under section 264 of FSMA, to be “authorised persons”, enabling them to issue financial promotions without the approval of a U.K. authorised person. Financial promotions for Third Country funds recognised under section 272 of FSMA must be made or approved by a U.K. authorised person. Operators of funds marketing into the U.K. under the proposed OFR will not be deemed authorised persons; they will have to rely upon a U.K. authorised person to make or approve their financial promotions, unless the financial promotion falls within the scope of an exemption.⁸ Limited exemptions are available for retail funds which means, in practice, operators of Third Country funds (which will include E.U. funds) will only be able to market funds through U.K. authorised partners or affiliates.

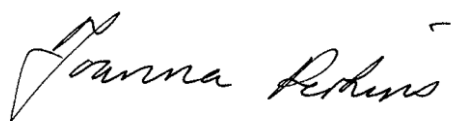
If U.K. authorities wished to avoid this result for a more seamless transition, the equivalence regime could require OFR-recognised operators to meet the U.K.’s standards on financial promotions which apply to U.K. authorised persons (such as those set out in the FCA’s Conduct Business Sourcebook (“**COBS**”)). Greater clarity might be achieved if the status of recognised funds under the new regime from a financial promotions perspective were made clear within the COBS rules, incorporating any differences between different types and classes of recognised funds.⁹

Amendments to section 272 of FSMA

Funds which are unable to access the U.K. markets through the proposed OFR must apply for recognition under section 272 of FSMA. The Consultation proposes some welcome changes to section 272, including providing clarity as to what changes to overseas funds are viewed as material and requiring notification and approval from the FCA. One further aspect on which clarity would be helpful, however, is the timeline of the recognition process under section 272, including the period within which the FCA will be required to make a decision.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

A handwritten signature in black ink that reads "Joanna Perkins". The signature is written in a cursive style with a large initial 'J' and a small flourish at the end.

Joanna Perkins
FMLC Chief Executive¹⁰

¹ HM Treasury, *Overseas Funds Regime: A Consultation*, (11 March 2020), available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871744/Overseas_Fund_Regime_Consultation_Publication_for_publication.pdf

² FSMA transposes E.U. Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (the “**UCITS Directive**”) into domestic legislation. Alongside Directive 2011/61/EU on Alternative Investment Fund Managers (the “**AIFMD**”), it provides the main “passporting” and/or licensing regimes for funds in the E.U.

³ The Withdrawal Agreement between the U.K. and E.U. provides for a “transition or implementation period” under Article 126. This period ends, by default, on 31 December 2020.

⁴ The CIS EU Exit Regulations specified that for E.U. funds to continue to be recognised in the U.K. after the end of the TMPR, the fund must obtain such status by applying under section 272 of FSMA, which provides access to Third Country (non-E.U.) funds. The proposed OFR will be available to E.U. funds at the end of the TMPR.

⁵ See paragraph 3.13 of the Consultation.

⁶ One instance of these rules is the introduction of the requirement for independent Non-Executive Directors on the boards of authorised fund managers, and the requirement to perform value assessments. When the U.K. undertakes an equivalence assessment of third countries, some of these features will be quite different. For example, in many European markets there is a requirement instead for the Non-Executive Directors to be on the board of the fund (as opposed to the management company) and there may be no value assessment.

⁷ The current regime for non-E.U. funds that wish to market in the U.K. is governed by section 272 of FSMA. Section 277 of FSMA requires that an operator of a scheme recognised by virtue of section 272 give written notice to the FCA of any proposed alteration to the scheme. The FCA must approve of the alteration in writing within one month. Stakeholders have commented that there is little already clarity as to which changes will be deemed material by the FCA.

⁸ See paragraphs 5.30 to 5.31 of the Consultation.

⁹ For example if promotions must be made or approved by a U.K. “authorised person”, and recognised OFR funds (or, at least, certain categories of them) are deemed “non-mainstream pooled investments” for the purposes of the COBS marketing rules this will effectively prevent promotion to retail clients in the U.K.

¹⁰ In view of the role of the Bank of England, the Financial Conduct Authority and HM Treasury in the U.K.’s preparations for withdrawal from the E.U., Rob Price, Karen Levinge and Peter King took no part in the preparation of this paper and the views expressed should not be taken to be those of the Bank of England, the FCA and HM Treasury.

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