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Brexit Law – your business, the EU and the way ahead

Brexit Statutory Instruments – a series of briefings

November 2018

The Collective Investment Schemes (Amendment etc) (EU Exit) Regulations 2018

This paper is part of a series of briefings for clients and contacts of Allen & Overy on the review of financial services statutory instruments (**SIs**) to be laid down under the European Union (Withdrawal) Act 2018 (the **Withdrawal Act**).

Introduction

The purpose of the SIs is to help with a range of legal issues caused by the UK's exit from the EU and to prevent, remedy or mitigate any failure of EU law to operate effectively or any other deficiency in retained EU law. SIs are not intended to make policy changes, other than to reflect the UK's new position outside the EU. The changes in the SI will not take effect on 29 March 2019 if a transitional agreement is reached.

The UCITS Directive

The Undertakings for Collective Investment in Transferable Securities (**UCITS**) Directive contains the operating framework for UCITS and their managers. In general terms, a UCITS is a highly regulated fund that can be marketed and sold to both retail and professional investors in the EEA. This is in contrast with an alternative investment fund (**AIF**), the managers of which are governed by the Alternative Investment Fund Managers Directive (**AIFMD**), although the SI issued in relation to the UCITS Directive is closely intertwined with that relating to AIFMD.

Among other things, the UCITS Directive:

– creates a common investment vehicle in the EEA which can be established and regulated in one member state and sold on a passported basis throughout the EEA
– enables managers authorised in one member state to provide their management services in relation to a UCITS established in another member state
– includes requirements for firms acting as a depositary for a UCITS

What does the UCITS SI do?

The Collective Investment Schemes (Amendment) (EU Exit) Regulations 2018 (**UCITS SI**) makes amendments to retained EU law related to UCITS to ensure that it continues to operate effectively in the UK once the UK has left the EU.

Some of the main amendments relate to the following:

New label – "UK UCITS"

Under the UCITS Directive, the "UCITS" label only applies to relevant funds established in a member state. Once the UK leaves the EEA, all funds previously authorised in the UK under the UCITS regime will therefore cease to satisfy this definition. The SI introduces a new label, "UK UCITS", essentially to refer to funds that fell within the EEA UCITS regime before exit day and those launched in future under the "onshored" UCITS regime.

The regulated activity of managing a UK UCITS will be changed to "managing a UK UCITS".

Establishment of Temporary Permissions Regime for EEA UCITS

The UCITS SI sets out the design and structure of a Temporary Permissions Regime (**TPR**) for EEA UCITS. Firms will need to notify the FCA of their intention to benefit from the TPR. It will last for a period of up to three years from exit day. To continue marketing the relevant EEA UCITS after the end of the TPR, the manager must either notify under the UK's national private placement regime (and comply with that regime) or apply for the UCITS to become a recognised fund under section 272 of the Financial Services and Markets Act (**FSMA**).

Managers of EEA UCITS will also be subject to new information and reporting requirements as regards the FCA.

New EEA funds to be marketed in the UK after exit day

EEA managers that wish to market a new UCITS fund into the UK post Brexit will need to either notify the FCA under the UK's national private placement regime (and comply with that regime) or have the fund recognised under section 272 of FSMA.

It is also important to bear in mind that, under the SI relating to AIFMD, an EEA UCITS will technically constitute an "AIF" under UK law from exit day, and will be required to comply with the "onshored" AIFMD regime as amended by the AIFMD SI.

New EEA sub-funds launched after exit day

Where an EEA manager has an umbrella fund with several sub-funds falling within the TPR, and wishes to launch a new sub-fund, the new sub-fund will not fall within the TPR. If the manager wishes for it to be marketed to retail investors in the UK, it must apply to have the sub-fund recognised under section 272 of FSMA.

Depositaries and managers

A depositary or UCITS manager from another EEA member state can currently operate from a branch in the UK (although the depositary will have a top-up permission from the FCA in respect of depositary activities). From exit day, however, these firms will technically be regarded as third-country firms and, under the UCITS SI, their position will be aligned with the position of firms from other third countries.

One result is that, subject to a three-year "grace period" under the TPRs, the branches will no longer be able to fulfil their current roles and will have to migrate their functions to another entity that complies with the following requirements:

– the manager and trustee of an authorised unit trust must each be a body corporate incorporated in the UK, and with a place of business in the UK
– the operator and depositary of an authorised contractual scheme must each be a body corporate incorporated in the UK, with a place of business in the UK
– the depositary of an open-ended investment company (**OEIC**) must be a body corporate incorporated in the UK, with a place of business in the UK
– the authorised corporate director of an OEIC must be a body corporate incorporated in the UK

Supervisory cooperation

Provisions in legislation relating to cooperation and information sharing have been removed. However, this will not preclude UK supervisors from sharing information with EU authorities where necessary.

The approach towards retained direct EU legislation

The SI seeks to amend UK domestic law that implements the UCITS Directive and accompanying regulations incorporated into UK law by the Withdrawal Act with the aim of ensuring the continued functioning of UK statute. In addition to the UCITS SI, the UK regulators will update their rulebooks and policies to take account of and rectify any deficiencies resulting from the UK's withdrawal from the EU – and the consultation process for this has recently commenced.

Legislation amended by the UCITS SI[1]
Financial Services and Markets Act 2000
Undertakings for Collective Investment in Transferable Securities Regulations 2011
Rehabilitation of Offenders Act 1974 (Exceptions) Order 1975
Rehabilitation of Offenders (Exceptions) Order (Northern Ireland) 1979
Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001
Open-Ended Investment Companies Regulations 2001
Financial Services and Markets Act 2000 (Collective Investment Schemes Constituted in Other EEA States (Regulations) 2001
Financial Services and Markets Act 2000 (Transitional Provisions) (Authorised Persons etc) Order 2001
Financial Services and Markets Act 2000 (Transitional Provisions) (Partly Completed Procedures) Order 2001
Rehabilitation of Offenders Act 1974 (Exclusions and Exceptions) (Scotland) Order 2013

Areas identified by industry as requiring further consideration

Although the intention of the SI is to onshore the UCITS regime with as little change as possible to ensure the continued functioning of UK law, there are a number of issues arising as a result of Brexit that the industry has identified as potentially requiring further consideration.

Section 272 FSMA regime

If an EEA UCITS manager wishes to launch a new UCITS into the UK after exit day, it will need to apply for the UCITS to be recognised under section 272 of FSMA. However, it is not clear if this regime is "fit for purpose" in this context, with the regime having seen limited use to date. For example, as of February 2018, only seven standalone funds and seven umbrella funds had been recognised under section 272. In contrast, 7,291 EEA UCITS funds currently passport into the UK.

Treasury has indicated that it is committed to reviewing the section 272 regime and proposes to separately consult on this in due course, but their timing is unclear. In the interim, it is not certain whether it will be practicable for firms to use the current regime.

New EEA sub-funds launched after exit day

Where an EEA manager has an umbrella fund with several sub-funds falling within the TPR, and wishes to launch a new sub-fund after exit day, the new sub-fund will not fall within the TPR. If the manager wishes for it to be marketed to retail investors in the UK, it must apply to have the sub-fund recognised under section 272 of FSMA.

The umbrella and any of its sub-funds that (as at the relevant time) fall within the TPR will need to be included in the section 272 application. This is because it will not be possible for some sub-funds in an umbrella to fall within the TPR and others to fall within section 272.

[1] **Retained direct EU legislation revoked by the UCITS SI**: Commission Regulation (EU) 2010/583; Commission Delegated Regulation (EU) 2016/438.

This point is causing considerable issues in the industry, and lobbying on the point is therefore ongoing.

UK AIFMD regime to apply to EEA UCITS

If an EEA UCITS manager has a new UCITS recognised under section 272 of FSMA after exit day, the manager will have to satisfy all the requirements of the UK "onshored" AIFMD regime – ie this will apply in parallel to the requirements under the UCITS Directive (to which the manager will of course remain subject). It is not clear whether this is commercially practicable or viable, or whether it is necessary from a public policy perspective.

The same point will apply in relation to EEA UCITS that (immediately following exit day) fall within the TPR, when the three-year TPR period comes to an end. It is not clear on the drafting of the AIFMD and UCITS SIs whether the UK AIFMD regime also applies during that period, but the FCA will hopefully clarify in due course that this was not the intended result.

Historic UK investors

At the end of the three-year TPR period, a particular EEA UCITS manager may decide that it is not possible or convenient for it to apply to have its funds recognised under section 272 of FSMA. However, it is unclear whether the manager will be able to continue to deal with historic UK retail investors into the fund – ie without breaching UK law, given that the TPR will have fallen away. This uncertainty would be resolved by adding grandfathering provisions to the AIFMD SI or UCITS SI (as appropriate) to permit EEA UCITS managers to continue to interact with UK holders – eg deal with redemption requests, provide annual reports/updates, conduct corporate actions etc.

Key information document under PRIIPs

Concerns have been raised as to whether, making an EEA UCITS subject to the new "onshored" AIFMD regime will mean its manager has to prepare a key information document (**KID**) under the onshored Packaged Retail and Insurance-based Investment Products (**PRIIPs**) Regulation, or whether it can continue to prepare a key investor information document in compliance with the UCITS regime. This is currently permitted under the PRIIPs regulation until 31 December 2019.

We currently expect HM Treasury to apply the "status quo" on this, ie to carry across the current exemption to the PRIIPS regime for UCITS when "onshoring" the PRIIPs regime. However, this will need to be checked when the SI in relation to PRIIPs is issued.

ISA and SIPP eligibility

There is an outstanding question as to whether an EEA UCITS (during the TPR or afterwards) will be eligible for ISAs and SIPPs, which is uncertain under the UCITS and AIFMD SIs.

Temporary permission regime

Under the UCITS SI, an EEA UCITS manager or depositary would essentially be treated as if it is an authorised person under FSMA. The implications of this are unclear (eg whether this requires compliance with home or host state rules) and also if certain other requirements under FSMA need to be excluded or modified as applied to these types of firms, such as the requirements as regards threshold conditions.

What does this mean for you?

The onshoring of the UCITS regime has structural implications for EEA and UK firms which manage EEA UCITS and market them in the UK, associated with the loss of passporting and recognition. Most firms are now well advanced with their planning. The SI affects the Brexit planning process as follows:

– The TPR affects Brexit planning with respect to the 'inward' (EEA to UK) activities undertaken by EEA UCITS managers or with respect to EEA UCITS: firms undertaking such activities should update their Brexit contingency planning to take account of the availability of the TPR, and the obligations associated with the temporary permission regime, noting the comments above on the various areas of uncertainty in the regime as currently contemplated.

- In particular, EEA UCITS managers that wish to take advantage of the TPR should monitor FCA announcements as to the launch of the online notification process.
- UK managers managing EEA UCITS on a cross-border passport will need to factor the TPR requirements into their contingency plan for the migration of the management of such UCITS to an EEA manager.
- EEA depositaries operating in the UK via a branch will have to update their contingency plans, and in particular, consider plans to migrate their depositary functions in respect of UK UCITS (if any) to a UK domiciled entity.
- EEA UCITS managers that wish to launch new UCITS funds into the UK after exit day will need to prepare for compliance with the new “onshored” AIFMD regime, in parallel to the requirements of the UCITS Directive to which they will remain subject – they should also monitor HM Treasury’s proposal for a “refit” of the current section 272 regime within FSMA and prepare the necessary filings in due course.
- EEA UCITS managers with funds falling within the TPR will also need to prepare for the application of the UK AIFMD regime to them in due course.
- UK and EEA UCITS managers generally should consider the need to update fund documentation and marketing material to reflect the new regime and remove stale information – eg as regards the application of the UCITS Directive. They should also monitor FCA announcements as to their regulatory expectations on this front.

Next steps

- HM Treasury intends to put the SI before Parliament this autumn.
- FCA has begun to consult on its approach to the binding technical standards and on amendments required to its FCA handbook.
- HM Treasury proposes to review the section 272 regime and separately consult on this but their timing is presently unclear.

Your Allen & Overy contacts

For further information please speak to your usual Allen & Overy contact.