ADDLESHAW GODDARD

Marketing interests in funds to UK investors post-BREXIT

At 11 pm on 29 March 2019, the United Kingdom will leave the European Union. If this takes the form of a "hard" Brexit, EEA-based investment managers will be impacted in their ability to continue to market interests in the funds that they manage to investors in the UK.[1] Fortunately, this is not new territory – there is a well-established solution for third country managers wishing to market to UK based investors. In addition, the UK government has put in place a special regime for EEA-based investment managers. This Regulatory Spotlight explores these regimes and highlights some other issues facing EEA-based investment managers.

Background

Third country managers (i.e., investment managers currently based outside of the EEA) wishing to market interests in the funds that they manage to UK-based investors face three regulatory hurdles:

- first, whether they are undertaking a "regulated activity" in the UK (namely, arranging deals in investments) which requires UK authorisation under the Financial Services and Markets Act 2000 (**FSMA**);
- second, whether their client communications amount to "financial promotions" subject to restrictions in FSMA; and
- third, whether they have notified the UK Financial Conduct Authority (**FCA**) under the Alternative Investment Fund Managers Directive (**AIFMD**, text available here) of their intention to market interests in their funds in the UK and whether they have complied with the relevant disclosure requirements.

At present, EEA-based alternative investment fund managers (**AIFM**) can clear the first and third hurdles by relying on the so-called marketing "passport" under the AIFMD to market interests in their alternative investment funds (**AIFs**) cross border into other Member States (including the UK). Third country investment managers (i.e., those located outside of the EEA) on the other hand, are generally able to clear the first two hurdles through a combination of exemptions and the use of placement agents–a solution that is also potentially open to EEA-based investment managers post-Brexit.

EEA-based investment managers

After 29 March 2019, the AIFMD marketing "passport" may no longer be available to EEA-based investment managers with respect to the UK. The UK government has published a statutory instrument (available here) providing for a temporary permissions regime (**TPR**) under which EEA-based investment managers may continue to market their funds in the UK.

The TPR will, in effect, allow incoming passports to continue provided that the incoming manager has notified the FCA of its intention to make use of the TPR provisions. The FCA has published a guide on how to apply to enter the TPR. The TPR will operate by granting those incoming managers "deemed" permission to carry on the relevant regulated activity in the UK for the duration of the TPR. The notification window opened in early January 2019 and is currently scheduled to close on 28 March 2019, after which it will no longer be possible to make new notifications under the TPR (details available here).

While the TPR offers comfort to incoming EEA-based investment managers doing business in the UK, the regime is designed to assist those incoming EEA-based investment managers intending to seek full UK authorisation and so there are still potential issues for consideration for firms which have not yet committed to making such an application for UK authorisation. Firms that enter the TPR but either fail to submit an application for full authorisation within the allotted deadline or whose application is unsuccessful may be required to withdraw from the TPR.

The key elements of the TPR are set out below.

- **Three year timeframe:** the TPR is proposed to be in place for the next three years, i.e., until 11 pm on 29 March 2022 although that period may be extended by HM Treasury by twelve-month increments in specified circumstances. Whilst not a permanent solution, EEA-authorised firms looking to raise funds in the short to medium term may find the TPR helpful.
- **Additional requirements:** those operating under the TPR will be subject to the applicable rules and guidance in the FCA Handbook. Incoming UK branches of EEA firms will, for example, be within scope of the Financial Services Compensation Scheme. The FCA has also confirmed that further rules and guidance from the FCA Handbook may be applied where the FCA believes it is necessary to provide appropriate consumer protection (as set out in the FCA's published statements on the TPR, available here).

[1] For the purposes of this briefing, hard Brexit refers to a scenario where either no withdrawal agreement is reached and therefore the "implementation period" agreed in principle as part of the withdrawal agreement does not come into effect or a withdrawal agreement is reached but is deemed insufficient to trigger the "implementation period". In this scenario, from 11 pm on 29 March 2019, all EU law (directives, regulations and so on) would cease to have the force of law in the UK.

- **Regulatory enforcement:** whilst under the current passporting regime the supervisory role remains with the home state regulator, EEA-based investment managers making use of the TPR will be subject to the FCA's jurisdiction. Some may find this additional regulatory burden to be too onerous.

EEA-based investment managers who choose not to make use of the TPR may still be able to market their funds in the UK on the same basis as third country investment managers (set out below), which may be a more commercially feasible option.

Third-country investment managers

Brexit should have little or no impact on the ability of or mechanism by which third country managers market interests in their funds in the UK. At present, third country managers tend to navigate the three hurdles set out above as follows:

- **Regulated activities:** in marketing interests in their funds to UK-based investors, third country managers could be characterised as undertaking the regulated activity of "arranging deals in investments" under Article 25 of the FSMA 2000 (Regulated Activities) Order 2001 (the **RAO**). Whilst there is an exclusion available under article 72 of the RAO where the arrangements are made with an FCA authorised person (such as an FCA regulated pension scheme manager), this is not a complete solution. As a result, some third country managers appoint an authorised placement agent to undertake marketing activities on their behalf. It is worth also noting that in practice, some third country managers take the view that the "arranging" takes place outside of the UK, although this is a fact dependant analysis.
- **Financial promotions:** the FSMA 2000 (Financial Promotions) Order 2005 (as updated, the **FPO**) sets out a number of exemptions to the UK regime restricting financial promotions which EEA based investment managers can rely on to market interests in their funds in the UK. EEA-based managers should be familiar with these as they are likely currently to be relying on them. These include the exemptions set out in articles 19 of the FPO for investment professionals and article 49 of the FPO for high net worth companies, unincorporated associations etc.
- **AIFMD:** third country managers would still need to notify the FCA in advance of their intention to market in the UK. They would also be expected to comply with the disclosure requirements imposed under article 42 of the AIFMD. The FCA has issued guidance to the effect that certain marketing-type activities fall outside the definition of marketing for AIFMD purposes including reverse solicitation (also called passive marketing) and communications in relation to draft documentation such as promotional presentations (as set out in PERG 8.37.6, text available here). However, it should be noted that, even where a "marketing" activity is outside the scope of the AIFMD, it could well remain within the UK regulatory perimeter for financial promotions purposes.

To the extent that they are unable to make use of the TPR set out above, we would expect EEA-based investment managers to be able to use the same route currently available to third country managers to market interests in their funds in the UK.

Other considerations: Delegation and asset allocation

Delegation: the management of a large number of EEA-based funds has historically been delegated to UK-based managers. On 23 August 2018, HM Treasury suggested that "*asset management firms can continue to plan on the basis that the delegation model will continue*" (full text available here). The FCA provided greater certainty on 1 February 2019 when it announced that it has agreed a multilateral MoU with EU and EEA National Competent Authorities covering supervisory cooperation, enforcement and information exchange (FCA press release available here). This satisfies a key pre-requisite for the delegation model, namely the requirement for cooperation arrangements between the EU27 and the UK post-Brexit. There have been also media reports that some EEA jurisdictions (notably Ireland and Luxembourg) have entered into negotiations with the FCA to allow the present system of delegation to continue.

Asset allocation: as UK financial instruments and markets will no longer be EEA financial instruments and markets, investment managers may need to rebalance their holdings in order to meet their investors' asset allocation requirements. Similarly, interests in UK funds would themselves no longer be considered EEA financial instruments, which could lead to significant redemptions over a short time horizon around the Brexit date.

If you have any questions, please do not hesitate to contact your usual AG contact or one of the lawyers listed below:

Lorna Finlayson, Partner	0131 222 9579	lorna.finlayson@addleshawgoddard.com
Mike Hinchliffe, Partner	020 7880 5742	mike.hinchliffe@addleshawgoddard.com
Jonathan Powling, Partner	020 7160 3245	jonathan.powling@addleshawgoddard.com
Richard Small, Partner	020 7160 3004	richard.small@addleshawgoddard.com
Jan Gruter, Legal Director	0141 574 2327	jan.gruter@addleshawgoddard.com
William Robertson, Managing Associate	020 7160 3398	william.robertson@addleshawgoddard.com