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Burges Salmon

Welcome to the Summer 2016 edition of ***Authorised Fund Horizons***, our practical guide to legal and regulatory developments in the UK authorised funds sector, published by Burges Salmon's Funds and Financial Regulation team.

In this edition we explore in some detail the relevance and practical impacts of the result of the UK's referendum on membership of the European Union as they apply to the authorised funds industry

To receive your own copy of Authorised Fund Horizons, please send your details to marketing@burges-salmon.com.

Not another Brexit briefing…

You will by now have received countless emails and briefings from lawyers and other professional services firms following the referendum result. So what can we usefully add that has not already been said? This article seeks to focus on what we *do* know in terms both of: (1) the immediate impact of the referendum result on the UK authorised fund industry; and (2) the preliminary steps being taken by the industry in response to the referendum and how you may be able to contribute.

Immediate impact on UK funds

Market disruption and volatility since the referendum result has, to date, been less widespread and pronounced than many commentators were predicting. This has meant there have been fewer issues for UK fund managers in obtaining accurate prices to value funds and fewer runs on redemptions. One notable exception to this has been property funds with the majority of funds in the UK Investment Association property sector (including Standard Life, Aviva, Columbia Threadneedle, Henderson and M&G) now having chosen to suspend dealings and the consequential trickle down impact for multi asset funds with holdings in suspended funds.

The general industry consensus has been that the steps being taken by fund managers in invoking suspensions are sensible and in the interests of investors. In particular, the Investment Association praised the decisions to suspend in a recent briefing note, stating the move is the "most important tool" that protects investors. However, concerns have also been raised by the FCA and (for some time) the Bank of England about the very nature of open-ended property funds given fundamental issues around the mismatch between dealing and liquidity under such funds. It will be interesting to see whether in due course there are industry or regulator-led initiatives to move such funds away from the current daily dealing model.

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As a result of these events the FCA published guidance on 8 July around the duties and obligations of fund managers in relation to fund suspensions. Interestingly the FCA guidance raises the issue that where a fund is suspended because it is holding assets that are illiquid or hard to value, the fund manager should consider lifting the suspension and giving investors the opportunity to redeem at a revised valuation of the units in the fund e.g. to reflect the price at which illiquid assets can be realised in a shorter than usual timeframe. In these circumstances, fund managers should ensure that:

- the revised redemption price and the opportunity to cancel are clearly communicated to investors who have submitted a request to redeem their investment before or during the suspension;
- the communication explains the investor's options and includes details of how to cancel the redemption requests; and
- investors are given sufficient time to make their decision and to seek appropriate advice.

What is the industry doing?

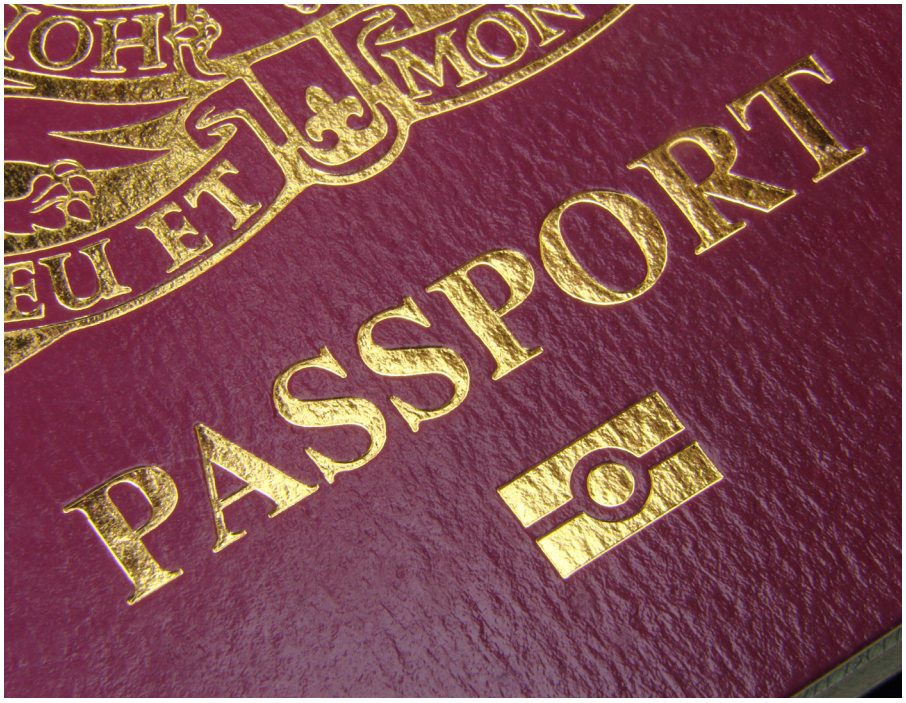
Clearly the impact of Brexit (in whatever form it ultimately takes) will vary from firm to firm depending on the business model of the firm in question. Firms that market UK funds to UK investors are unlikely to be significantly affected and may even benefit if it becomes more difficult for non-UK firms to market funds into the UK from the EU. Conversely those UK managers who market UK funds into other EU jurisdictions or manage non-UK EU funds from the UK may need to reconsider their existing models and will be watching developments with significant interest.

The role of industry bodies such as the Investment Association is to represent the industry as a whole to the extent there is sufficient community of interest. As such, the starting position of the IA is that the UK government should look to prioritise continued single market access and passporting rights for UK asset managers given the significance of the industry as a net exporter into the EU and the associated tax revenues. However, it is of course recognised that this will ultimately be a political decision – and, more generally, that such access would be unprecedented outside of EEA membership model (the so called Norway model) for which there would be wider challenges from a political perspective.

As such, it is noticeable that the IA has been analysing the consequences of the potential loss of access to the single market and canvassing the industry's views on what the negotiation priorities should be under such circumstances. Unsurprisingly their chief preliminary conclusion is that the priority issue for IA members would be preservation of access to clients and investors in the EU, whether by way of: (i) "third country" passporting rights as envisaged under AIFMD and MiFID II (but not UCITS), (ii) delegation or (iii) other means of access. The IA has produced an initial set of Brexit papers which flesh out some of the issues around these aspects based on the relevant EU regimes (some of which are touched on in the below articles). The IA has also stated that it welcomes input and observations from members - and engagement with industry bodies may well be the most effective way for firms to make sure their voice is heard during these eventful times.

If you would like to discuss the impact of Brexit on your asset management business, please contact Tom Dunn *or another member of the team.*

When is a UCITS not a UCITS? When there's a Brexit…



Until the UK leaves the EU, it will be "business as usual" for UK UCITS - but what will "business as usual" look like post-Brexit for funds that are currently UK UCITS?

We are leaving the EU … Where's my (UCITS) passport?

The key impact of Brexit from a UCITS perspective is that, unless otherwise agreed, a UK UCITS management company will become a non EU-AIFM under the AIFMD and a UK UCITS will cease to be a UCITS and become a non-EU AIF instead. Consequently, access to the UCITS management company passport and the UCITS marketing passport will be lost. Asset managers for whom the passport is a vital part of their business will therefore need to re-think

their distribution strategy. In contrast, asset managers whose current strategy is UK-focused (and whose funds and asset management company are also UK based) are unlikely to be significantly affected.

The 30% rule

The redesignation of UK UCITS as non-EU AIFs could impact the flow of investment into UK funds from UCITS that are domiciled in other EU countries. In particular, a UCITS can hold no more than 30% in a non-UCITS fund, so there may be cases where, for example, an Irish or Luxembourg UCITS which invested in a UK UCITS pre-Brexit is forced to disinvest in order to comply with the 30% limit. This may also affect UK UCITS themselves to the extent they currently invest in other UK UCITS and it may be necessary to restructure portfolios accordingly.

So, where (in the EU) shall we go?

Firms for whom the UCITS brand is a key aspect of their distribution strategy will clearly have some important decisions to make. Some firms are already taking steps to relocate aspects of their business (or key operations) to other jurisdictions as part of their post-Brexit strategy. Other firms are adopting a "wait and see" approach until there is greater certainty as to when the UK will leave the EU and what the terms of the exit will look like. (Some still think this might not happen at all – but that's a debate for another day!).

Can we get a new (AIFMD) passport?

As with the UCITS Directive, AIFMD provides for both a marketing and management company passport. Currently such passports are only available to EU firms. Consequently, as things stand following Brexit UK AIFMs would:

- not be able to utilise the marketing passport and could only market AIFs to EU investors under the National Private Placement Regime (NPPR) of each member state (clearly this would be subject to the vagaries of national restrictions in each case e.g. we understand there is no such regime in Germany as this was abolished in conjunction with the implementation of AIFMD!); and
- not be able to manage non-UK EU AIFs (e.g. UK AIFMs currently managing Luxembourg or Irish AIFs would not be able to continue to do so).

However, unlike the UCITS regime, AIFMD also provides for "third country" (i.e. non-EU) passports which would potentially give non-EU AIFMs and non-EU AIFs access to the EU market subject to a number of conditions. The introduction of the third country passports is determined on a country-by-country basis. To date ESMA has issued positive assessments in respect of Canada, Guernsey, Japan, Jersey and Switzerland but the European Commission has not yet agreed to "switch on" the passport in respect of any country.

As the UK has implemented the AIFMD (and assuming that the post-Brexit UK regulatory landscape does not start to diverge significantly from AIFMD) one might expect that it would be a foregone conclusion for the passport to be extended to the UK. However, clearly there will be a significant political dimension to the considerations and the availability of a post-Brexit third country passport in respect of the UK will ultimately be a matter for determination by the Commission.

Please contact Victor Ondoro *or another member of the team with any queries.*

What about the other regulations?

The regulatory change programme currently underway in the retail funds space isn't only limited to UCITS and AIFMD. As we have reported in previous editions of Authorised Fund Horizons, other laws and regulations that are in the process of being made, or have recently been updated include among others the EU Regulation on Market Abuse ("MAR"), the Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (known as "EMIR"), and the Regulation on key information documents for packaged retail and insurance-based investment products ("PRIIPs"), not to mention the proposed changes to data protection law and the potential ramifications that the referendum could have on tax law.

Given the sheer volume of regulatory change at present, the FCA was quick to issue a statement to remind firms that they should continue to comply with existing regulation and to prepare to implement any proposed new regulations, though the sheer cost to firms for planning and implementing regulation that may not apply for longer than a year is likely to mean that the FCA's statement is merely a shorter-term holding position until there is greater clarity on the nature of Brexit.

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In this context we analyse in this article the potential effect of a Brexit on the current legislative change programme in order to give firms an idea of the potential fate of various new regulations in the UK. For the purposes of this article, we have assumed (although would not like to speculate) that the UK's relationship with the EU will not be on a basis that requires it to automatically implement the EU's laws relating to the internal market (e.g. a Norwegian model whereby membership of the EEA is retained).

MAR

The EU Regulation on Market Abuse ("MAR") became directly effective in the UK from 3 July 2016 and firms should implement and continue to comply with the applicable provisions until the UK leaves the EU. Following Brexit certain instruments currently captured by the expanded scope of MAR will fall out of scope, but those instruments that are traded in the EU will continue to be captured by the rules. The FCA was strongly involved in the development of MAR and has strong views on the need for a robust market abuse regime in the UK. As such, it is unlikely that a post-Brexit UK will deviate substantially, if at all, from the new MAR rules.

EMIR

The Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (known as "EMIR") has been in force since 16 August 2012, although various provisions and Level 2 measures are still to come into effect.

EMIR is the legislative result of the G20 commitment to reduce systemic, counterparty and operational risk and to increase transparency in over-the-counter ("OTC") derivatives. Given that the UK will continue to remain a member of the G20, it is difficult to see a world in which the post-Brexit UK would not continue to implement the requirements of EMIR in another guise.

In the post-Brexit world, where a transaction involves derivatives counterparties in the UK and the EU, the UK counterparty would effectively need to satisfy the provisions of EMIR regardless of the nature of the relationship between the EU and UK. EMIR would only cease to be directly relevant where both counterparties are non-EU and there is no sufficient nexus with the EU, nor is compliance with EMIR necessary for any anti-avoidance reasons.

PRIIPs

The Regulation on key information documents for packaged retail and insurance-based investment products ("PRIIPs") takes effect on 31 December 2016. Depending on the timing of Brexit it is therefore plausible that the regulation will only be in force in the UK for up to two years, in which case the creation of PRIIPs KIDs for all relevant product types would be a costly process for such a short period of time. Of course it may well be that a substantially equivalent regime will continue to apply in the UK over the longer term. In any event firms should continue to devote the necessary time to the development and implementation of the appropriate documentation required by PRIIPs.

Data Protection

The General Data Protection Regulation 2016/679 ("GDPR") will replace the existing Data Protection Directive 95/46/EC from 25 May 2018. Unless Brexit negotiations between the UK and the EU are finalised before then, it is very likely that the UK will experience life under the GDPR. After the UK leaves the EU, the GDPR will cease to apply. However, the reality for many UK-based fund managers (regardless of whether their funds are domiciled in the UK or the EU) is that compliance with the GDPR will be necessary irrespective of the terms on which Brexit occurs. This is because one of the many changes under the GDPR is that the GDPR will apply whenever EU residents' personal data is processed in connection with the offer of goods or services or monitoring of behaviour within the EU. This will apply even if the organisation processing such data has no physical presence in the EU. For now, compliance with current data protection legislation and preparation for the GDPR is likely to also be the best preparation for the UK's data protection regime post-Brexit.

Conclusion

In summary, from a compliance perspective the short term message for firms is very much business as usual: for as long as the UK is a member of the EU it will continue to be subject to all existing laws and regulations, including any legislation required to be implemented during this time. With regard to the longer term outlook, only time and the conditions on which Brexit is agreed will tell the extent to which UK financial services regulation diverges from the EU framework but, whilst there may be tinkering around the edges, significant rolling back of existing core legislation appears unlikely.

Please contact Gareth Malna *or another member of the team with any queries.*

A view from the Continent - France

Olivier Moriceau

august & debouzy avocats

As part of our series of articles published by firms in our International Funds Network, Olivier Moriceau, Avocat – Counsel at August & Debouzy summarises the latest market trends, developments and hot topics in France.

European long-term investment funds – the AMF's point of view

On December 9, 2015 regulation went into effect authorizing the creation of European long-term investment funds (ELTIFs). The French Market Authority, ("**AMF**") (Autorité des Marchés Financiers) has published a guide containing all of the information needed to create, manage and market ELTIFs in France.

In France, securitization vehicles, professional private equity investment funds (FPCIs), professional specialized funds (FPSs), including those set up as limited partnerships and potentially professional real estate collective investment undertakings (OPPCIs) and real estate investment companies (SCPIs) seem to be the funds whose characteristics are the most compatible with the requirements of the regulation (French ELTIFs).

Only a manager of an Alternative Investment Fund (AIF) established in the European Union and authorized under the Alternative Investment Fund Managers Directive (AIFMD) can manage a French ELTIF. As such, Brexit

may have an impact in relation to the selection of managers for French ELTIFs. A management company needs no additional authorizations to manage a French ELTIF. However, when a fund applies for French ELTIF authorization, the AMF will verify that the French ELTIF's investment strategies and target clientele are compatible with the management company's activities.

Last May, the AMF issued its first two French ELTIFs authorizations to two French SLPs. They aim to invest €1.2 billion of equity or quasi-equity in long-term infrastructure projects. They will not originate loans, are only open to professional investors, and will offer set terms for redemptions over their 25-year life span.

Alternative Loan Origination

Furthermore, within the framework of the ELTIF Regulations, the AMF has issued a guidance under no. DOC-2016-02 dated 27 June 2016 (French AIF Loan Origination Guidance) which highlights the requirements that an asset management company must meet to obtain authorization allowing it to originate loans. Pursuant to the French AIF Loan Origination Guidance such ability will be available not only the ELTIFs but also French AIFs being: securitization vehicles, professional private equity investment funds (FPCIs) and professional specialized funds (FPSs), including those set up as SLPs.

Asset management companies have to undertake a legal analysis, before granting loans, to ensure that these loans respect all obligations applicable to the lenders in the relevant jurisdiction.

However, further to the abovementioned developments, we must point out that it shall still be confirmed whether the AMF will not change or alter its tax position on both (i) the existing AIFs shareholder's loans regime and (ii) the ability for AIFs to carry out transactions relating to establishing an investment portfolio which are characterized as banking services falling outside the banking monopoly.

French limited partnerships (SLPs)

One year ago, for purposes of management flexibility and to give managers and investors legal certainty, the French legislature established a new kind of organizational structure, the French limited partnership ("SLP") (*société de libre partenariat*), which is an alternative investment fund (AIF) with legal personality that is similar to the English limited partnership (save that an English LP does not have legal personality) or the Luxembourg limited partnership (*société en commandite simple*).

It should be noted that SLPs do not require AMF authorization. However, they have to be registered with the AMF within one month of their establishment. Since 2015, four SLPs have been registered with the AMF. These were set up by private equity and infrastructure managers.

UCITS V Directive for asset management companies

As in the UK, UCITS V was transposed into French law on 18 March 2016 with the new rules taking effect immediately on that date. A delegated level 2 regulation, intended to implement the Directive and published on 17 December 2015, will be directly applicable, but shall not enter into force prior to Autumn 2016.

AMF doctrine regarding asset management: updated general guidelines on the obligation to report to TRACFIN1[1]

The AMF updated its position regarding TRACFIN reporting obligations to take into account recent legislative and regulatory developments: the updated version of the General Regulations as part of the AIFMD transposition, the law on the separation and regulation of banking activities and the crowd-funding order. The AMF uses this update to carry out modifications, especially concerning means of disclosure to TRACFIN.

Update of regulatory guidance

The AMF takes into account the different impacts of the AIFMD transposition by updating the legislative or regulatory guidance in its position guidance DOC-2010-23.

Extension of the scope

In accordance with the crowd-funding order, crowd-funding advisors (CIP) are subject to obligations regarding anti-money laundering and the financing of terrorism, so the AMF has updated the scope of its guidance DOC-2010-23 by adding crowd-funding advisors.

The elimination of systematic reporting dispositions

The law aiming to separate and regulate the banking activities resulted in the obligation being removed to report systematically to TRACFIN certain operations considered to be particularly sensitive, namely:

- Operations where a doubt remains on the identity of the originator, the beneficiary or the settlor of a trust or any other wealth management instrument, despite the procedures taken;
- According to conditions defined by decree, operations taken for oneself or on behalf of others on behalf of third parties carried out by individuals or by legal entities, including their subsidiaries and establishments that are domiciled, registered or established in one or more States or territories of which the legislative weaknesses or policies are an obstacle to combating money laundering and terrorist financing.

The AMF has therefore deleted all provisions relating to the systematic reporting in its guidance DOC-2010-23.

Methods of disclosing to TRACFIN

The AMF has updated the TRACFIN disclosure methods:

- Professionals under AMF supervision, except financial investments advisors (CIF) and crowd-funding advisors (CIP), have an obligation to disclose on the TRACFIN website via the ERMES system;

  The CIF and CIP can use a disclosure model on the TRACFIN site and send it to TRACFIN rather than use the EMES system.

The introduction of the concept of "premarketing" of funds in France

The AMF updated last July its recommendation n°2014-04, Guide to UCITS and AIF marketing regimes in

France by introducing the notion of "pre-marketing" to improve the French financial market competitiveness. Management companies and third parties acting on their behalf, that offer a new fund, are allowed to measure interest in the fund by pre-marketing to a maximum of 50 prospective investors whose are professional investors or non-professional investors with a minimal initial subscription of € 100,000.

Management companies:

may provide

- potential investors with draft by-law;
- private placement memoranda;
- term sheets or fact sheets regarding the fund.

may not provide

- a subscription agreement; or
- comparable document allowing potential investors to subscribe to such fund's shares or units.

The updated recommendation also clarifies that certain activities are not precluded by the marketing rules e.g. the management company's response to an offer made by a professional investor to set up an AIF or a UCITS.

[1] *The French Ministry of Finance service against illegal financial operations, money laundering and terrorism financing.*

In other news

Please note the following updates:

Responses to ESMA Discussion Paper on Share Classes

ESMA has published the responses received to its Discussion Paper on UCITS share classes (as covered in our Spring edition). By way of brief recap, the UCITS Directive recognizes the possibility for UCITS to offer different share classes to investors but does not prescribe whether, and to what extent, share classes of a given UCITS can differ from one another – and ESMA has identified diverging national practices as to the types of share class that are permitted.

The response of the Investment Association in particular makes for interesting reading. The IA clarifies that the only type of hedging permitted at share class level for UK funds is currency hedging and states that it believes that it should also be possible to hedge (at share class level) other forms of risk such as duration and interest rate risk. In particular, there is nothing in the UCITS Directive which requires the equation of having the same investment strategy with having the same outcome for all investors. However, the key point is that the same range of share classes should be available to investors throughout the EU regardless of the domicile – in particular given that certain other jurisdictions have authorised UCITS that make use of other forms of hedging (e.g. duration hedging and equity market hedging) in order to meet investors' requests.

The IA response highlights the issues from an investor/performance perspective in UCITS managers being restricted from using cash received through repurchase transactions to post margin for derivatives transactions - and calls upon ESMA to consider (as part of its work on UCITS share classes) allowing repos to be used to transform securities to cash in order to meet margin calls.

The next steps are for ESMA to consider the responses and decide what form of instrument it will choose to issue on the subject (e.g. an ESMA opinion addressed to EU institutions or national competent authorities).

Please contact Tom Dunn in the first instance with any queries.

Derivatives use reporting and depositary reporting

The FCA has in its Handbook Notice No.35 published its feedback statement and consequential amendments to the FCA Handbook following the consultation in CP 15/27 in relation to proposals to clarify and standardise some of the FCA's reporting requirements around: (i) derivatives usage by UCITS AFMs, and (ii) depositary reporting of breaches and depositary reporting in respect of oversight visits. The FCA will provide feedback on the other issues it consulted on in CP 15/27 at a later stage.

Derivatives use reporting

UCITS AFMs have previously been required to report to the FCA at least annually with details about their use of derivatives and the methods they use to estimate risks arising from derivatives usage.

With effect from **1 August 2016** firms should be aware of: a) the introduction of a new standardised form (the "derivatives use report") for UCITS AFMs to report the use of derivatives in their funds and how the resulting risks are being managed; and b) a requirement for UCITS AFMs to submit the report annually within 30 days of 31 October. The FCA has also added guidance in the COLL rules with a non-exhaustive list of examples of changes to a fund's risk profile that might be considered significant for the purposes of submitting an updated report.

Firms should already have the information required for the derivatives use report available for their own internal risk management and NAV calculation. As such it should largely be a question of ensuring that appropriate processes and procedures are in place in order to collate and submit the relevant information to the FCA in the prescribed format and to meet the new timing requirements.

Depositary reporting requirements

The changes have been introduced because the current reporting requirements for depositaries were considered to be limited in scope and detail. The FCA therefore wished to formalise certain voluntary reporting arrangement which it had previously agreed with members of DATA and which it had consulted on in CP 15/27.

The FCA intends to proceed with the rules broadly as consulted on but with some changes of detail to take into account comments received from DATA. Under the revised rules (which will apply from **1 January 2017**) the Supervision manual (SUP) of the FCA Handbook is to be modified by replacing the current quarterly reporting requirements with:

- monthly reporting of COLL and FUND breaches recorded by a fund's depositary including a declaration, for each AFM for which the depositary provides oversight, as to whether the depositary considers the AFM's controls over valuation and pricing and box management to be adequate; and
- quarterly reporting of issues that arise as a result of depositaries' monitoring of AFMs' operations.

Management companies will need to engage with their depositaries on how the new reporting requirements will work - in particular the practicalities of moving from quarterly to monthly reporting.

Please contact Victor Ondoro *in the first instance with any queries.*

Securities Financing Transactions Regulation (SFTR) – FCA consultation

Since our SFTR update in our Spring Edition of Authorised Fund Horizons, the FCA published a consultation (CP 2016/14) in May on proposed amendments to the FCA Handbook resulting from the SFTR.

Catch-up

The SFTR imposes certain disclosure and reporting requirements in relation to securities financing transactions (SFTs), total return swaps and the re-use of financial instruments received under a collateral arrangement. We considered these requirements in detail in the Spring Edition.

Why and what is the FCA consulting on?

The SFTR is an EU Regulation that came into force on 12 January 2016. As a regulation it is directly applicable and does not require transposition by Member States. However, given the interaction between these requirements and other sections of the FCA Handbook the FCA is proposing to copy out the relevant SFTR provisions into COLL and FUND in order to help firms comply with the disclosure requirements under SFTR for managers of UCITS and AIFs to disclose their use of SFTs and total return swaps in the funds' pre-contractual documents and periodic reports to investors.

It should be noted that the SFTR also contains other provisions which are directly applicable for managers of UCITS and AIFs but these are not considered in the consultation. As such, subject to the outcome of the consultation, not all of the relevant requirements under SFTR will appear in one place in the FCA Handbook.

Timing and next steps

The periodic investor reporting requirements will apply from 13 January 2017. There is a transitional provision running to 13 July 2017 for the pre-contractual disclosure requirements for funds constituted before 12 January 2016. Sub funds constituted after 12 January 2016 do not benefit from the transitional provisions (even where the "umbrella" fund entity was in existence prior to this date). However, the FCA noted that the European Commission may issue a clarification on this and other points concerning the SFTR; and that the FCA will take any further communication from the European Commission into account when finalising the FCA Handbook provisions in due course.

*The deadline for responses was **19 July 2016**. The FCA's policy statement is due in Q3 2016.*

Please contact Gareth Malna *in the first instance with any queries.*

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