SPRING FUNDS FIRST UPDATE

Bryan Cave Leighton Paisner LLP

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INTRODUCTION

Welcome to our Spring 2021 Funds First Update: a snapshot of some of the main developments and upcoming changes that we think will be of interest to fund managers, fund investors and to the funds sector as a whole. Despite the ongoing focus on COVID-19, regulators and legislators have still been busy and there is much that managers and investors should be keeping watch on over the next few months. In particular, there is news of HM Treasury's review of the UK funds regime and of the European Commission's review of AIFMD. We take stock of the outlook for funds post-Brexit, including an update on ESG developments and DAC 6, as well as what to expect from the revised UK financial promotion approval regime. We finish with some observations on the real estate funds market, based on our recent experiences.

If you are interested in developments across the broader financial services sector, please also see the 2021 edition of our annual Emerging Themes in Financial Regulation publication with the team's latest insights into regulatory risks and opportunities, spanning six core themes: Brexit; Regulatory Change; Regulatory and Litigation Risk; Technology; Governance; and Sustainability and People. You may also be interested in our break out Emerging Themes webinar: Asset Managers - Managing the Most Significant Emerging Regulatory Risks in 2021.

Please feel free to call any of the BCLP Funds & Investment Management team or your usual BCLP contact if you would like to discuss any of the issues raised in this briefing in more detail, including how they may apply to your specific fund structures, business and planning.

HM TREASURY'S REVIEW OF THE UK FUNDS REGIME: A CALL FOR INPUT

Following the March 2020 Budget announcement, on 26 January 2021 HM Treasury published a 'call for input' on a review of the UK funds regime, covering tax and relevant areas of regulation. The overall aim is to identify options that make the UK a more attractive choice to set up, manage and administer funds and to support a wider range of more efficient investments better suited to both UK and international investors' needs (whilst upholding the UK's robust regulatory regime and approach on tax avoidance and evasion). It sits alongside the consultations on Asset Holding Companies in alternative fund structures and the expected 2021 review of the VAT treatment of fund management fees. Out of scope of the call for input is the onshoring of EU law and any new UK legislation on sustainable finance.

The paper is necessarily wide-ranging, covering direct and indirect tax, relevant areas of funds regulation and opportunities for wider reform. Consultations on specific proposals will follow after the feedback process (which closes on 20 April 2021). We have set out in the table below a few of the key areas the government is requesting input on.

Issue	Explanation	Comment
UK funds regime: the Long-Term Asset Fund (LTAF): a new open-ended authorised fund structure that can invest in a full range of illiquid asset classes	To help ensure the success of the LTAF, the call for input questions if there would be any issues in applying the current tax rules for authorised funds to LTAFs and if other tax considerations need to be considered in addition. The suggested LTAF structure involves adaptations to the current Non-UCITS Retail Scheme (**NURS**) regulatory framework, including a wider toolkit to manage liquidity. Anticipated target markets cover the DC pension market, private wealth/discretionary portfolio manager, professional investors, multi asset funds/funds of funds and LGPS investors.	The call for input focuses on the tax implications of the LTAF and reiterates the government's support for delivery of the LTAF structure by the end of 2021. An FCA consultation is expected imminently. HM Treasury also refers to an industry working group that is being convened to consider impediments to investment in long-term assets.
UK funds regime: gap in the UK's unauthorised professional investor fund range	A series of questions around the UK Funds Regime Working Group's proposals (such as a new 'professional investor fund') and how a new structure would add value and support the government's work on facilitating investment in long-term and productive assets. It also asks for feedback on specific tax treatments to be considered to support new unauthorised vehicles, including interaction with other aspects of wider UK tax policy.	The rationale is a competitor vehicle to other popular fund jurisdictions that offer unregulated fund structures with relatively few constraints. The government is considering: → an unauthorised UK corporate vehicle or unauthorised UK investment partnership; available to professional/semi-professional investors; open or closed ended; listed or unlisted and for any asset class or investment strategy; and → a contractual structure that is closed-ended and unlisted, but with tradable units.
Funds taxation	→ Feedback is requested on a variety of taxation issues, including: → Effectiveness of previous reforms over the last decade eg introduction of the CoACS and changes to the tax rules for unauthorised unit trusts → How to improve the tax efficiency of funds that invest in a mixture of debt and equity → Why uptake of Tax-Elected Fund Regime (TEF) has been	The government wants to hear more radical suggestions around fund taxation, in order to simplify the regime or achieve tax neutrality. This includes the possibility of: → exempting authorised funds from tax altogether; and → an exemption for unauthorised funds investing in alternative assets (see also new professional investor fund above).

Issue	Explanation	Comment
	limited in response to this issue and how this can be addressed → Potential changes to the REIT regime → The UK's double taxation treaty network – any issues the government should take into account → Barriers to the use of UKLPs and PFLPs (the number of registrations has declined in recent years) and how tax changes may help address them	In response to concerns about mixed funds it is open to exploring: → lowering tax rates applied to UK authorised funds; → deemed deductions for distributions at fund level; and → amending the TEF regime. In relation to REITs, the government is seeking views on further reforms to the REIT regime in addition to those proposed in the second stage of AHC consultation (see our blog for the REIT changes). In relation to a decline in the number of UKLPs and PFLPs, the government is considering bespoke partnership taxation rules. The VAT treatment of fund management services (which can create incentives for funds to domicile outside the UK currently) will form a separate government work stream.
Funds regulation	Feedback points we would highlight: → Fund authorisation process (including timelines) and suggested improvements → Reform/improvements to the Qualified Investor Scheme (**QIS**) regulation (eg permitted investments, borrowing cap, sub-fund structure) → The introduction of a Direct2Fund unit dealing model that would allow investors to transact direct with funds and remove the Authorised Fund Manager as a counterparty	Under consideration is the appeal of authorised funds to the UK and international market (beyond access to retail investors). There is a suggestion that the statutory target for QIS authorisations be reduced, from 6 months to 1 month, which would align with the FCA target for completed applications received. HM Treasury has an eye on how any changes would impact on regulatory risks, given that the QIS is open to sophisticated retail investors and therefore distinct from some vehicles it is often compared to.

ASSET HOLDING COMPANY CONSULTATION

Alongside HM Treasury's wider review of funds the government is proposing a beneficial new tax regime for asset holding companies (**AHC**) in investment fund structures. This is intended to make the UK a more competitive location for holding companies, recognising that increasingly there are reasons to locate these entities in the same jurisdictions as the funds themselves.

The goal is to find an AHC regime that will work as an intermediate investment vehicle in a range of different investment funds, for example private equity funds, credit funds, infrastructure funds, and potentially multi-jurisdictional real estate funds.

One challenge the government faces is creating a regime which is sufficiently simple and certain to compete with established regimes, such as in Luxembourg. Another is for the regime to switch off a series of existing tax rules which would otherwise create a barrier to an attractive AHC regime.

The consultation on AHCs is wide-ranging at this stage. Many ideas are being considered, with scope for fine-tuning down the line. In terms of timing, we are expecting the regime to be introduced in Finance Act 2022 with draft legislation being provided this year.

To read further, see our blog on the consultation here.

REIT REFORM

The government is considering several measures to make the UK's REIT regime more competitive. These are intended to stop barriers to entry to the regime and improve the operation of it. Some of the measures are being prioritised and, if implemented, will be introduced alongside the AHC (ie in Finance Act 2022.)

To read further, see our blog on all of the possible REIT changes here.

AIFMD – EUROPEAN COMMISSION'S CONSULTATION ON 'AIFMD II'

The European Commission (the **Commission**)'s long-awaited Consultation on AIFMD closed on 29 January 2021. It covers a range of subjects, under the broad headings of authorisation/scope, investor protection, international relations, financial stability, investment in private companies, sustainability/ESG and miscellaneous. Industry in general is advocating a fine-tuning of some of the AIFMD measures without amending AIFMD itself – the point being significant changes at this point would be unnecessary and could potentially create disruption, undue costs and inefficiencies. Pending the Commission's feedback, we have flagged in the table below the proposals we think are likely to cause the biggest impact in the funds arena.

Issue	Explanation	Comment
Limits on the use of delegation	The Commission draws attention to various aspects of the delegation rules, including the extent that they ensure effective risk management, prevent letter box entities and provide for consistent enforcement. It also picks up on ESMA's points raised in its August 2020 letter on whether or not the delegation rules should be complemented by: (i) imposing quantitative criteria; (ii) providing a list of core or critical functions that have to be performed by the AIFM; or (iii) any other requirements. Also (without specific mention of Brexit and an expected uptick in delegation of portfolio management to non-EU entities) if the rules should apply regardless of a delegate's location,	These proposals potentially have a wide impact on fund structuring, being an area of strong industry pushback, in particular as the current models are standard industry practice. Fund managers will also be keen to ensure they can preserve delegation arrangements set up as part of their Brexit planning. Sentiment is that the AIFMD delegation rules work well and achieve effective risk management and that imposing limits would limit competition and innovation in the EU AIF market. Therefore that the status quo should be preserved. If anything, the challenge is perhaps one of supervisory harmonisation so that the delegation rules are interpreted and enforced

Issue	Explanation	Comment
	in order to avoid 'regulatory arbitrage' when structuring.	consistently by the National Competent Authorities (**NCAs**). HM Treasury's call for input (as set out above) refers to the government commitment to supporting portfolio delegation to/from the UK.
Eliminating alleged barriers for sub-threshold AIFMs	The Commission's questions raise one of the known deficiencies of AIFMD, being that small AIFMs are often unable to comply with all the requirements of AIFMD and are therefore restricted in their ability to raise capital unless they can overcome significant barriers to market access. The introduction of a small AIFM marketing passport is raised.	This is, of course, only really an issue for those small AIFMs looking to access investors in one or more of the more restricted jurisdictions in relation to the National Private Placement Regimes (**NPPRs**). Otherwise, the small AIFM regime enables managers to benefit from a lighter touch form of regulation. More small AIFMs may opt in if the regulatory costs of full compliance were reduced.
Supporting competitiveness and enhancing cross-border marketing and investor access	The Consultation raises the functioning of the EU AIFMD passport, whose competitiveness can be limited due to the inconsistent application of the AIFMD marketing rules, coupled with additional national requirements. No proposals are put forward, and no mention of the marketing passport extension to third country firms.	Our view remains that the preferred option would be to retain the NPPR framework, even if the non-EU third country passports are introduced, as it would ensure that managers are given the option to market in the most efficient way possible for them.
Improving AIFM access to retail investors	The AIFMD marketing passport is limited to targeting professional investors, which in turn has limited the cross border activities of AIFMs who are looking to approach semi-professional and retail investors and are therefore required to comply with varying and restrictive requirements.	The ELTIF regime is also under review, and may be the more suitable vehicle to fine-tune, given it's aimed at the retail investor base. The upshot of the ongoing review of the MiFID II regime[1] will impact any amendments to the definitions of the types of investors in AIFMD (given that AIF distribution is subject to the MiFID II regime).
External valuer liability	In light of recent valuation issues due to COVID-19, the Commission asks various questions around the AIFMD valuation rules. ESMA proposed in its August letter that	This would be a welcome amendment for real estate funds in particular, as in some jurisdictions the current simple negligence provision acts as a

[1] The Commission is in the process of reviewing the effectiveness of a wide range of MiFID II/MiFIR requirements, with a view to proposing legislative changes and/or endorsing changes to guidance. ESMA has been mandated to produce numerous review reports to feed into the Commission's review, some of which are due in March/July 2021. Overall timing is uncertain.

Issue	Explanation	Comment
	AIFMD is amended so that an external valuer is only liable to the AIFM for any losses suffered because of the external valuer's gross negligence.	disincentive for external valuers and is not always an insurable risk.
Integrating AIFMD and the EU sustainable finance legislative package	Draft delegated legislation seeks to ensure that the rules in the EU's Sustainable Finance Disclosure Regulation (SFDR) are integrated within an AIFM's organisational, operating and risk management processes. For instance, AIFMs will have to take into account sustainability risks and adverse impacts of investment decisions on sustainability factors in their due diligence policies and processes. In addition, AIFMs must have the necessary resources and expertise for the effective integration of sustainability risks.	A set of questions in the Consultation probes the extent of these rules and whether or not AIFMs should take into account additional sustainability impacts, principles and requirements when making investment decisions. In our view there are likely to be many cases when investors expect a particular approach to be taken, or managers may voluntarily decide to implement specific policies, and it is therefore not necessary to mandate additional obligations to those set out in the SFDR and draft sectoral delegated legislation.

UK AIFMs will not be directly impacted by the above proposals, unless the UK applies equivalent changes (in due course and once any draft amending legislation is produced by the EU legislators) through the FCA Handbook and UK AIFM regulations. To the extent that the UK does not take an aligned approach, a UK manager could still be subject to the EU rules, where it is marketing cross-border using the NPPRs, or acting as a delegate of an EU27 AIFM, or to set a baseline compliance standard across its global group. Alternatively a UK AIFM may choose to opt into any new EU requirements, on a voluntary basis, for competitive/commercial advantage or in response to investor expectation.

BREXIT – UPDATE AND MARKETING UK-EU27 AND VICE VERSA

A reminder of the UK's position vis-à-vis financial services

The UK withdrew from the EU and the EEA on 31 January 2020. Following its withdrawal, the UK entered a transition period until 31 December 2020, during which EU law continued to apply in the UK. On 24 December 2020 the UK and the EU announced they had agreed a UK-EU Trade and Cooperation Agreement (the **TCA**) to apply in principle from 1 January 2021, prior to being ratified in the UK and EU Parliaments. The financial services provisions of the TCA are very limited: there are no equivalence decisions and, as anticipated, neither does the TCA include any rights for UK firms to passport their services into the EU from 1 January 2021. Further, UK investment firms cannot benefit from temporary access arrangements to the EU27 markets akin to the FCA's Temporary Permissions Regimes.

Firms need to mindful that the precise boundaries around licensing rules and principles are very likely to continue to evolve in the post-Brexit regulatory environment. This may, in turn, require some firms to rethink their post-Brexit compliance strategy for doing business into the EU from outside it.

UK AIFMs as third country managers: what it means in practice

For the purposes of AIFMD, from 1 January 2021 UK AIFMs are 'third country firms' who are unable to use the AIFMD marketing and management passports. Pending (and subject to) the adoption and extension of the third country passport to the UK, UK AIFMs marketing AIFs in the

EU can now only access investors in each of the EU27 member states pursuant to the Article 42 NPPRs. One of the external preconditions has been met, that of a regulatory co-operation agreement to cover supervisory co-operation, information exchange and enforcement: the multilateral Memorandum of Understanding between the FCA, ESMA and the EEA regulatory authorities was agreed in February 2019 and came into effect on 1 January 2021. Alongside other conditions, the AIFM is subject to the AIFMD rules relating to disclosing information to investors in advance of their subscription; preparing and providing an annual report to investors; and reporting to the EU27 regulators, as relevant. In addition, individual member states can (and some have) imposed additional requirements on AIFMs and in certain jurisdictions an NPPR has not been made available. Marketing using NPPRs is therefore piecemeal, and can be time-consuming and costly, whereby managers need to apply on a country-by-country basis for permission to market individual funds.

UK firms are still able to conduct portfolio management with respect to EU AIFMs on a delegated basis, subject to satisfaction of the AIFMD delegation conditions (eg an objective reason for the delegation, and regulatory approval) and therefore benefit from the AIFMD marketing passport. For houses that do not have an EU entity, the (outsourced) EEA AIFM/ delegation model is an option.

EU AIFMs marketing in the UK

For EU27 AIFMs marketing into the UK, where they are not eligible for the FCA's Temporary Marketing Permission Regime, Temporary Transition Power or the Overseas Persons Exemption, they can market into the UK under the NPPR by way of notification to the FCA.

New AIFMD cross-border distribution rules

In August 2021 a new concept of and provisions on 'pre-marketing' are being introduced pursuant to EU legislation on the cross-border distribution of investment funds (**CBD framework**). EU AIFMs can carry out 'pre-marketing' activities in relation to AIFs pre-launch, or for established AIFs that are not yet notified for marketing in the member state where the investor is domiciled or has its registered office. To qualify, pre-marketing must not amount to an offer or placement (no subscription documents can be available, whether draft or final form) and for funds pre-launch, only draft fund and offering documents can be in circulation. In practice, this means marketing teaser documents and draft PPMs and fund documents can be used at this early stage, provided it is clear that they are subject to change and do not constitute an offer or invitation to subscribe. The CBD framework also makes reverse solicitation a less viable option where there is 'pre-marketing'.

ESMA recently consulted on guidelines on marketing communications addressed to AIF investors (that is also applicable to UCITS), for instance that the material is identifiable as marketing material; describes the risks and rewards of purchasing units or shares of an AIF, or units of a UCITS, in an equally prominent manner and contains information that is fair, clear and not misleading. The guidelines are due to be finalised in time for the CBD framework applying in August 2021.

At first blush it seems those outside the EU (ie UK managers) are not subject to the CBD framework and guidance: the UK has not onshored the CBD framework and non-EU AIFMs are out of scope anyway. However, there is an expectation that NCAs apply the new approach across the board – the CBD Directive refers to the harmonised rules not disadvantaging EU AIFMs over non-EU AIFMs. This may also be a point of clarification that comes out of the Commission's current review of AIFMD.

BREXIT – ESMA REMINDER ON MIFID II REVERSE SOLICITATION RULES

For UK investment firms that provide services under the MiFID II Directive, reverse solicitation remains a possibility: it allows a firm to service EU clients without triggering local licensing requirements. Reverse solicitation is when a client established within the EU initiates "at its own exclusive initiative" the provision by a third country firm of investment services or activities. The third country firm cannot then market new categories or investment products or services to that client (as that would no longer be reverse solicitation).

On 13 January 2020 ESMA issued a public statement on the MiFID II rules on reverse solicitation. ESMA reminds the market of three principles:

→ First, that clients or potential clients can be solicited by all means of communications - phone calls and meetings as well as press releases, internet advertising and brochures. ESMA also flags questionable practices being employed to evidence that the transaction is at the investor's own initiative, such as box-ticking in client terms of business.

→ Secondly, that any solicitation, promotion or advertising in the EU can be made by any person acting on behalf of the investment firm, however casual it may appear.

→ Thirdly, ESMA also reminds the market of the consequences of those providing or using services without proper authorisations (namely, the risk of administrative or criminal proceedings for service providers and loss of regulatory protection for investors).

This public statement by ESMA is a clear warning sign to firms who are conducting business into the EU in purported reliance on the reverse solicitation exemption from licensing under MiFID. Such firms need to look very closely at the manner in which they are conducting their activities to ensure that they truly amount to reverse solicitation in the narrowly-defined ESMA sense. Interestingly, some EU jurisdictions may have taken a more permissive view on reserve solicitation in the run up to Brexit that is not entirely consistent with ESMA's stance. Over time these jurisdictions may well need to realign their approach to ensure supervisory convergence across the EU with ESMA's position.

UK'S GREEN FINANCE AMBITIONS

With £1bn invested into ESG funds every month since April 2020 (Investment Association, December 2020) and heavyweight asset managers championing ESG practices, we are seeing what has been described as a 'tectonic shift' in the investment landscape, reflecting a genuine desire by managers to embrace ESG initiatives, actively driven by the investor community and set against a backdrop of proactive regulatory agendas.

Whilst referring to "interactions with related international initiatives, including those that derive from the EU's Sustainable Finance Action Plan" (HM Treasury's November 2020 Interim Report of the UK's Joint Government-Regulator TCFD Taskforce) the UK has made various strides in its own Green Finance ambitions. In particular, the FCA has extended and accelerated its plans to introduce mandatory climate-related financial disclosure requirements for listed issuers and large asset owners that are aligned to the Taskforce on Climate-related Financial Disclosures' (**TCFD**) recommendations. For asset managers, along with life insurers and FCA-regulated pension providers in the UK, the FCA intends to consult in the first half of 2021 on proposed new disclosure rules. The TCFD's Taskforce Roadmap expects 75% of UK-authorised asset managers to be covered by the regulatory/legislative requirements for TCFD reporting in 2022, increasing to 96% by 2023.

The UK government has also announced its own UK taxonomy for determining which activities can be defined as environmentally sustainable, and that this will take the scientific metrics in the EU taxonomy as its basis.

EU SUSTAINABLE FINANCE UPDATE

The Sustainable Finance Disclosure Regulation (**SFDR**) is an EU regulation that applies automatically in each member state from 10 March 2021. The UK did not onshore the SFDR; as a consequence it is only UK firms conducting business cross-border that need to consider their SFDR obligations come 10 March 2021. However, many firms may choose to opt into the rules on a voluntary basis – for competitive advantage, to meet investor demand, or to align policies in an EU/UK group.

On 2 February 2021, the European Supervisory Authorities (**ESAs**) produced their Final Report on the SFDR level 2 draft Regulatory Technical Standards (**RTS**). Subject to the Commission's endorsement, these implementing measures will apply from January 2022 (although the SFDR

10 March 2021 compliance date has not changed). In publishing their Final Report, the ESAs have taken on board many industry feedback points from the April 2020 consultative version of the RTS. We would highlight three points of interest, set out below.

→ The pro forma manager-level principle adverse impacts statement (set out in Annex I of the RTS and to published on a firm's website) has been simplified, to provide a minimum (and reduced) number of core universal mandatory indicators, a larger choice of opt-in indicators (subject to a materiality test) and to specifically reflect investments in sovereigns and real assets.

→ The draft RTS also include mandatory templates for pre-contractual product disclosures and periodic reports, along with details on the information to be published for the sustainability-related website disclosures. Alongside a narrative explanation of the asset allocation for fund investments, the manager has to publish details of minimum proportions of investments used to attain Article 8/9 objectives. For the remaining proportion of 'non-sustainable' investments, information on their purpose and any minimum environmental and social safeguards.

→ Product-level disclosures are to include a description of how any sustainable investments contribute to a sustainable investment objective and 'do no significant harm' to any others, with reference to both adverse impacts indicators and the extent of alignment with international guidelines ie OECD and UN. This obligation extends to any Article 8 products that commit to making one or more Article 9-type 'sustainable investments'.

Although the ESA's Final Report provide some welcome clarity, the ESA's have flagged various interpretative uncertainties of SFDR in their January 2021 letter to the Commission, and which are not covered in their Final Report (as issues that are likely to be considered to be outside the scope of their legislative empowerments). These include clarification of the application of SFDR to third country and small AIFMs using the NPPRs to access EU27 investors; around categorisation of Article 8 and Article 9 products; and how to maintain client confidentiality obligations if disclosure obligations apply at MiFID portfolio level.

PROPOSED CHANGES TO THE FINANCIAL PROMOTION REGIME – WHAT TO EXPECT

We await HM Treasury's response to its consultation paper proposing changes to the regulatory framework for authorised firms approving financial promotions of unauthorised firms, which closed on 26 October 2020.

The proposals would amend the financial promotions regime to create a new gateway which would require authorised persons to first obtain FCA consent before being able to approve financial promotions by an unauthorised firm. The consultation provides that the creation of a 'new gateway' would ensure that the FCA is able to determine that a firm's systems, governance and overall approach to the assessment of financial promotions are robust before it is able to start approving financial promotions. It would also enable the FCA to take a less 'reactive' approach to supervision in this area, as the FCA would be able to first assess whether the authorised firm is suitable and competent to provide such approval.

The proposals have potentially far-reaching consequences across the financial services industry, but particularly for those sectors which rely on the "regulatory umbrella" models (for example, host AIFM/ACD providers, investment advisors and corporate finance advisory firms etc.). The direct impact being that such firms will need to apply either for consent to remove the applicability of the general restriction or to amend their permissions (depending on which option is adopted). However, the consultation paper does not detail the proposed suitability assessment that the FCA would seek to adopt when assessing whether or not an authorised firm is suitable to approve the financial promotions of unauthorised persons. It is likely that this will involve the FCA looking more closely at authorised firms systems and controls to ensure that they reflect the standards set out in the FCA Handbook regarding the approval of financial promotions.

Clearly, there is a need to better police poor practices by firms approving financial promotions for third parties, but it remains to be seen whether the FCA actually needs additional powers, and whether those being suggested would simply act to stifle innovation and new entrants to the market. We note that the FCA and HM Treasury have been making various changes to the financial promotion regime recently (for example to include cryptoassets) and that this has left the Handbook quite fragmented and confusing between all the different specialist regimes (NMPIs, AIFMD, speculative illiquid securities etc). It may be that the FCA use the proposed changes, if implemented, as an opportunity to completely overhaul COBS 4 and the financial promotion regime.

DAC 6 AND THE UK'S NEW APPROACH

DAC 6 is a new regime, which went live on 1 July 2020 (but with a two year look-back) under which intermediaries and/or taxpayers must report to an EU tax authority information about cross-border arrangements that fall within one or more of a list of specified Hallmarks, with a view to the information being exchanged with other EU tax authorities. A "cross-border" arrangement is one which concerns either at least two EU member states, or at least one EU member state and a third country.

In an unanticipated development, changes were made to the UK implementation with effect from 31 December 2020 so that only cross border arrangements that meet Hallmark D are reportable in the UK. Hallmark D relates to avoidance of the common reporting standard reporting regime and opaque ownership structures. The tax main benefit test does not apply to Hallmark D.

We would note four points:

→ The UK change is significant as it removes all of the Hallmarks we would have expected to impact on 'normal' commercial arrangements motivated by reasons other than tax.

→ The change affects the look-back reporting as well as reporting for arrangements from 1 July 2020.

→ The UK government plans to replace DAC 6 with the OECD's model Mandatory Disclosure Rules (**MDR**) (we expect this transition to be no earlier than 2022), although the MDR is similar in scope to the EU's Hallmark D.

→ The reporting deadlines are unchanged (as set out below).

Funds transactions will still need to be assessed as to whether or not they fall within scope of Hallmark D for UK reporting. Arrangements with jurisdictions that have beneficial ownership registers, or a mechanism for authorities to obtain the information, are unlikely of themselves to fall within scope. However, establishing an investment or holding vehicle which results in a beneficial owner holding an interest below the reporting threshold (eg 25% or lower for the purposes of the UK PSC rules) deliberately to avoid a reporting or public disclosure requirement could fall within Hallmark D.

For transactions in respect of which EU reporting is relevant the full suite of DAC 6 Hallmarks continues to apply and, although in many cases we would expect UK guidance to be helpful, any differing local rules and interpretation must be taken into account.

The UK had already opted to delay initial reports by six months. Accordingly the following reporting deadlines still apply:

→ For arrangements where the first step in the implementation took place between 25 June 2018 and 30 June 2020 (the two year look-back) - reporting is due by 28 February 2021.

→ For arrangements where the trigger for reporting fell between 1 July 2020 and 31 December 2020 - reporting was due by 30 January 2021. Reporting could be triggered by any of: arrangements made available (or ready) for implementation, or where the first step in the implementation takes place, or a service provider provides aid, assistance or advice.

→ For arrangements where the trigger for reporting arises on or after 1 January 2021 - reporting is due within 30 days of the earliest trigger for reporting.

OTHER THINGS TO LOOK OUT FOR IN 2021

Illiquid assets and open-ended funds

In quick succession to the FCA's Policy Statement PS19/24 that came into effect on 30 September 2020 the FCA published a Consultation paper CP20/15: Liquidity mismatch in authorised open-ended property funds. This would introduce a notice-period model so that risks of suspension can be reduced by better aligning redemption terms with the liquidity of assets – by avoiding offering daily dealing where this may not be sustainable without loss of value.

Although the proposed changes impact NURS, they will be of interest to all types of property funds, including other authorised funds such as QIS, and those working in the unregulated open-ended funds space, where there is a potential knock-on effect. Indeed, the FCA invites wider views on whether the introduction of notice periods for other types of funds would be welcomed; as well as views on what rule changes could be considered to facilitate the development of an efficient secondary market.

The FCA wants to tackle the unfairness risk created by liquidity mismatch, and draws attention to two key points on this. Firstly, that in stressed market conditions investors that redeem ahead of others may gain at other investors' expense ('first mover advantage'), by either receiving a better price for their units, or avoiding being temporarily trapped in a suspended fund. Secondly, that the rule changes could potentially improve investment returns by allowing increased property exposure/reduced 'cash drag' as managers would not need to retain cash buffers for long periods in order to meet unanticipated high levels of redemption requests.

The Consultation closed on 3 November 2020 with a policy statement and final rules expected to follow in early 2021. The industry will want to continue to engage with the proposals, as well as being alive to further developments in this area, for instance from the FCA and Bank of England, alongside any developments in industry initiatives such as those emanating from HM Treasury's UK funds review.

Vision for the Future of Financial Services in the UK

On 21 October 2020, the UK's Financial Services Bill was introduced to Parliament (the **Bill**). We would highlight three areas of particular interest in the Bill that effectively empower the UK's regulators to make more detailed rules in various subject matters. The Bill is the foundation of the UK's financial services industry post-Brexit, the vision for this which was set out by Chancellor Rishi Sunak on 9 November 2020 and included the anticipated consultation on reforming the UK's regime for investment funds that was published at the end of January and the focus on Green Finance (both as set out above).

→ First, establishing the UK's new prudential framework for investment firms (based largely on the EU's Investment Firms Directive and Regulation). Following the consultative process, an FCA policy statement and near-final rules are expected in summer 2021.

→ Secondly, making changes to the EU-derived PRIPPs rules as applicable for the UK framework. These include clarifying the scope of the UK PRIIPs Regulation; to clarify what information on performance should be provided in the KID; and to further extend the UCITS exemption for up to 5 years.

→ Thirdly, establishing the framework for the UK's approach to the MiFIR third country access regime. In the meantime the impact on EU firms is mitigated by the UK's Temporary Permissions Regimes, the financial services contracts regime and for firms not operating through a branch in the UK, under the general exemptions and exclusions on the financial promotion restriction under UK FSMA.

Continued focus on culture and conduct

Culture and conduct remains a significant cross-sector priority by the regulators, including for asset managers. We highlight two points:

→ First, continued focus on non-financial misconduct. The regulators are clear that tolerating non-financial misconduct (such as sexual harassment, bullying and discrimination at work) is indicative of poor culture within firms and that active steps should be being taken from the top-down to address all incidences of such conduct. In terms of the Senior Managers & Certification Regime, issues of non-financial misconduct may amount to a breach of the Individual Conduct Rules (going to integrity) and are relevant to a firm's assessment of fitness and propriety for Senior Management Function and Certified Function staff. As such, these issues are considered regulatory issues, not just HR/employment issues, and amongst other things firms must consider regulatory notifications and the impact on regulatory references.

→ Secondly, healthy cultures demonstrate strong governance. This was a key message from Marc Teasdale, FCA Director of Wholesale Supervision, in his speech entitled "A regulatory perspective: the drivers of culture and the role of purpose and governance" delivered in the autumn at The Investment Association, Culture in Investment Management Forum. The speech focused on corporate purpose as a fundamental driver of culture and being critical to achieving good customer outcomes, and underlined the role of governance in supporting purpose. A proper focus on diversity and inclusion was highlighted as essential.

UKLP reform: progress still awaited

Following the December 2018 government response to its consultation (which closed in July 2018) on the reform of limited partnership law (the major elements of which, along with our comments, are set out in our briefing Welcome Government response to UK limited partnership law reform consultation) we still await draft legislation and further detail in some areas. Of particular interest will be the procedure introduced for striking off UKLPs from the Companies House register, along with transitional provisions for existing UKLPs relating to the new mandatory requirement for UKLPs to retain a demonstrable link with the UK. Progress was expected in 2020.

Overseas Entities Bill: progress still awaited

Following a government consultation (along with draft legislation, published in July 2018) we are expecting a final draft of the Overseas Entities Bill, which is due to go live in 2021. The draft legislation provides that non-UK entities that are legal persons (so including non-UK companies and LLPs, and non-UK partnerships that have or elect to have legal personality) will have to identify and provide information on those with significant influence or control over them, before they can be registered as legal owners of UK real estate or register legal charges at the Land Registry. As per the 'persons with significant control' (PSC) rules, failure to comply is a criminal offence. An overseas entity that is within scope and that cannot provide beneficial ownership information must provide information about its managing officers.

REAL ESTATE FUNDS MARKET OVERVIEW AND OBSERVATIONS

Despite market uncertainty in the face of a global pandemic, weaker economic outlook and geopolitical risks, real estate as an asset class has continued to gain favour since the financial crisis and investor appetite appears unabated, with target allocations by institutional investors reported to be 10.6% in 2020 (Hodes Weill 2020 Institutional Real Estate Allocations Monitor). Unsurprisingly, however, the pace of year-over-year growth has moderated over the last 2 years. €64.6bn of capital is earmarked for European real estate investment in 2021, according to the INREV investment intentions survey 2021 (again, albeit a slight reduction from the €88.5bn in 2020). The historic low correlation of private equity real estate with traditional equity markets, means that an investment in a private real estate fund has continued appeal – it could help diversify an investor's portfolio, reduce overall portfolio risk and increase returns.

Investors continue to access the asset class via allocations to funds, joint ventures and clubs as well as separate accounts and direct investment. INREV identified recent shifts in trends in its 2021 survey: funds being the most likely route that investors will access European markets; investors shifting down the risk curve towards core (with a local and multi-sector bias) at the expense of value add strategies, and anticipated growth in real estate debt. The INREV survey finds that the UK has been displaced by Germany and France as the top European investment destination, signalling one of the disruptive consequences of Brexit. Top of the preferred sectors charts sits a Majestic logistics site (buoyed by the double whammy of Brexit and the pandemic), whilst data centres, life sciences and the living sectors continue to attract significant interest as safe longer term investment. In the meantime, retail's woes have been well documented as it has slipped down the list of preferred sectors, and we are now seeing opportunities for repurposing retail assets at appealing price points.

We would expect there to be a shift back towards new opportunistic specialised strategies in real estate, correlated with an anticipated increase in market distress and dislocation. This may also lead to an increase in new manager relationships (and a change from the theme over the past few years of investors favouring well-established managers).

The theme of embedding ESG credentials continues to accelerate as investors weigh both positive societal and environmental impacts with financial returns. ESG developments provide an exciting opportunity for asset managers across all asset classes and sectors – whose actions in terms of strategy, governance, practices and engagement with stakeholders, can unlock investment opportunities and have tangible effects on economic prosperity, as well as health and wellbeing that impact their partners, tenants and build the foundations of tomorrow's world.

CONTACT US

Kieran Saunders
Partner
Funds & Investment Management
T: +44 (0) 20 3400 4749
kieran.saunders@bclplaw.com

Antony Grossman
Partner
Funds & Investment Management
T: +44 (0) 20 3400 4320
antony.grossman@bclplaw.com

Kate Binedell
Partner
Funds & Investment Management
T: +44 (0) 20 3400 4276
kate.binedell@bclplaw.com

Matthew Baker
Partner
Funds & Investment Management
T: +44 (0) 20 3400 4902
matthew.baker@bclplaw.com

Simon Pollock
Partner
Funds & Investment Management
T: +44 (0) 20 3400 4710
simon.pollock@bclplaw.com

Louisa Cobbe
Partner
Funds & Investment Management
T: +44 (0) 20 3400 3247
louisa.cobbe@bclplaw.com

Nileena Premchand
Senior Associate
Funds & Investment Management
T: +44 (0) 20 3400 3575
nileena.premchand@bclplaw.com

Matthew Poole
Partner
Tax Advice & Controversy
T: +44 (0) 20 3400 2382
matthew.poole@bclplaw.com

Chris Ormond
Associate Director - KDL
Funds & Investment Management
T: +44 (0) 20 3400 2370
chris.ormond@bclplaw.com

Anne Powell
Principal KDL
Tax Advice & Controversy
T: +44 (0) 20 3400 2162
anne.powell@bclplaw.com

Victoria Duxbury
Associate Director, KDL
Real Estate
T: +44 (0) 20 3400 3190
victoria.duxbury@bclplaw.com

Samantha Paul
Principal KDL
Disputes and Investigations
T: +44 (0) 20 3400 3194
samantha.paul@bclplaw.com

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When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

London
Governor's House, 5 Laurence Pountney Hill
London EC4R 0BR England