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Insights

FUNDS FIRST AUTUMN LEGAL AND REGULATORY UPDATE FOR REAL ESTATE FUNDS

27 September 2021

SUMMARY

At our recent Funds First webinar we shared some technical and market issues and updates on a selection of key developments of impact for real estate funds. Our discussion covered the Long Term Asset Fund (LTAF) , the Qualified Asset Holding Company (QAHC) regime, various regulatory changes that impact on the sector (including the FCA's proposed new duty of care framework and the new CBDF pre-marketing rules) and the proposed TCFD-based disclosure rules for UK asset managers contained in the draft new ESG Sourcebook. This briefing sets out some of the highlights of the issues discussed, which we hope will also be of interest to those who could not attend the webinar itself.

Please do not hesitate to get in touch with 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.

LONG TERM ASSET FUND (LTAF) - PROPOSED NEW OPEN-ENDED FCA-AUTHORISED FUND

- The LTAF is designed for inherently more complex and less liquid investments than have to date been deemed suitable for the retail market (and have been typically made available via closed-ended fund structures aimed at professional investors). The LTAF is based on the Qualified Investor Scheme (QIS) regime, albeit with enhanced investor protections.
- The FCA proposes a principles-based approach to the LTAF, giving managers (that will have to be full-scope UK AIFMs) more flexibility, with broad discretion to both access illiquid investments via collective investment vehicles as well as to manage liquidity. Initially open to QIS investors (professional clients and sophisticated investors) and DC pension schemes, with the expectation that the LTAF distribution regime will be expanded to include a broader retail client base in due course.

- Although there is a strong focus on investor protection, including reporting and valuation requirements, the FCA rules on mandatory suspension of dealings where there is material uncertainty about the valuation of at least 20% of scheme property, (that applied, amongst others, from September 2020 under the FCA Policy Statement PS19/24 on illiquid assets and open-ended funds), will, helpfully, not apply to LTAFs.

- There has been widespread industry support for the LTAF. However, concerns have been raised around the limited initial target market; the fact that distribution infrastructure is geared towards daily dealt funds and the proposed overly onerous reporting requirements. We will have to wait and see if the Chancellor's pledge to have the first LTAF launched in 2021 is met.

- Subject to feedback to the Consultation, the FCA plans to publish a final policy statement and final handbook rules later in 2021. For more see our briefing FCA consults on a new category of UK authorised open-ended fund to invest in illiquid assets: the Long Term Asset Fund (LTAF)

QUALIFYING ASSET HOLDING COMPANY (QAHC) REGIME

- The QAHC regime is intended to rival other fund holding regimes, with the hope of attracting more asset holding company structures to the UK and to capitalise on the strength of the UK investment management sector.

- A company has to meet a number of conditions in order to be eligible for the QAHC regime, for example it must be UK tax resident and be owned as to at least 70% by "Category A" investors. Whilst a REIT is a "Category A" investor, a QAHC cannot itself be a UK REIT or a member of a group UK REIT, which is disappointing given the importance of the REIT in the UK as a structure for holding property.

- A company that elects into the QAHC regime benefits from a number of changes to the UK corporation tax treatment of its investment in specified assets (including overseas (but not UK) real estate), which constitute its "QAHC ring fence business". The regime intends to make ownership of relevant assets broadly tax neutral by, for example, providing limited exemptions from UK corporation tax and permitting the use of profit participating loans.

- From a real estate perspective, the fact that UK real estate is excluded from the QAHC regime is disappointing but the ability to hold overseas real estate is a positive development. The interaction between the REIT and QAHC regimes under the current draft legislation could be improved and it is hoped that the ongoing consultation process between HMRC and industry will prove successful in dovetailing those regimes before April 2022 when the QAHC legislation is due to be enacted.

- For more see our briefing Promoting UK funds – Can the new qualifying asset holding company compete with Luxembourg? You may also be interested in our briefing First phase of UK REIT reform is confirmed

REGULATORY UPDATE

We picked out several themes to illustrate how regulatory change impacts on our sector. We would highlight a few items, as set out below.

- The FCA's proposed new duty of care framework will include a broad new principle requiring firms to act either in the best interests, or to deliver good outcomes to, their retail clients. The FCA expects the rules to apply "to firms that are involved in the manufacture or supply of products and services to retail clients, even if they do not have a direct relationship with the end customer". Firms therefore will have to look through the distribution chain to consider whether their products could ultimately be held by retail clients – if so, they are likely to be caught by the new regime, once implemented. See our briefing FCA proposes new Consumer Duty – TCF with bigger teeth?

- We await feedback from the European Commission (expected later this year, along with its review of ELTIFs) following its October 2020 consultation on a review of AIFMD. The review covered 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. Reportedly the Commission is seeking to amend AIFMD itself rather than simply fine-tune the Level 2 measures (which was the approach industry has advocated – the point being significant changes at this point would be unnecessary and could potentially create disruption, undue costs and inefficiencies). Expected target areas include delegation, liquidity management, depositary passports, valuations and marketing. UK AIFMs will not be directly impacted by any changes, 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.

- From 2 August 2021 the new 'pre-marketing' rules under the EU Cross Border Distribution Framework have applied. Although the new provisions apply to EU AIFMs, there is a reference to the harmonised rules not disadvantaging EU AIFMs over non-EU AIFMs. It appears that jurisdictions are taking different approaches in this regard– for example, Luxembourg and Germany have extended the rules to third country managers. Therefore UK (along with other non-EU) AIFMs engaging in pre-marketing activities in Luxembourg or Germany should also comply with similar conditions as those imposed on EU AIFMs pre-marketing AIF in those countries. See our Spring Funds First update for more.

- HM Treasury is proposing changes to the regulatory framework for authorised firms approving financial promotions of unauthorised firms. The proposal does not affect the way authorised firms communicate their own financial promotions, approve their own promotions for communication by unauthorised persons, or approve the promotions of unauthorised persons within the same corporate group. The key impact is that authorised firms will only be able to approve financial promotions for unauthorised persons where they have had the requirement to not approve financial promotions varied or cancelled. What is likely to impact the industry more is if the FCA or HM Treasury look to do a wider review of the promotions regime, or if specific changes to perceived higher risk products inadvertently impact the sale of funds to HNWI and other clearly sophisticated investors who cannot nonetheless meet the test for MiFID professional client status.

SUSTAINABLE FINANCE LEGISLATION FOR UK FUND MANAGERS

In the webinar we discussed the proposed TCFD-based disclosure rules for UK asset managers contained in the draft new ESG Sourcebook (as set out in the FCA consultation CP21/17) as well as how the EU's Sustainable Finance Disclosure Regulation (SFDR) and Taxonomy Regulation are likely to impact on UK asset managers with EU operations. We would flag three issues from this discussion.

- Although the FCA proposals are based on a similar approach to that of SFDR (ie mandatory manager-level and product level disclosures) they are distinct and have to be considered and applied on a parallel basis. For example, UK firms can cross-refer their climate-related financial disclosures, but to TCFD-compliant reports only, and not to SFDR disclosures (or other models). Also, for divergences between core metrics for TCFD and SFDR calculations at product level, UK firms will have to report using both formulae.

- UK AIFMs of unauthorised and unlisted AIFs (as well as portfolio managers and investment advisers within scope) do not have to make their TCFD product report public. Instead, they will have to make it available annually on request from 1 July 2023/24 for a client that needs that information for its (or its clients) own climate-related financial disclosure obligations.

- The FCA consultation needs to be considered in the context of various other UK- specific sustainability initiatives, in particular: the FCA Guiding Principles on ESG and sustainable investment funds; the FCA's focus on investor stewardship and the proposal to implement integrated Sustainability Disclosures Requirements.

- For more see our briefing Climate-related disclosures for the UK asset management industry: the FCA consults on TCFD-compliant measures

View the recording of our Autumn Funds First Webinar >

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