SPRING FUNDS FIRST UPDATE

February 2019

www.bclplaw.com

BRYAN CAVE LEIGHTON PAISNER BCLP

Introduction

Welcome to our Funds First Update. Whilst a lot of focus at present is on Brexit and the uncertainties surrounding that process, there have been a great many other developments in the past few months that are of relevance to the fund management sector. What follows is an overview of some of the main developments and upcoming changes that we think will be of impact to fund managers, fund investors and to the funds sector as a whole.

This briefing is set out in four sections: an overview of the current market trends; a summary of some of the most recent regulatory developments; other key hot topics (including developments on tax and ESG); and a brief look at some of the other key developments that you should be looking out for in 2019 and 2020. For some of the topics covered we have highlighted action points.

If you are interested in developments across the broader financial services sector, please also see our 2019 Emerging Themes publication. Our theme this year is New Perspectives, recognising that many of our clients are having to look at their industry, and the world at large, from new angles. Our Emerging Themes publication covers a number of areas that are likely to be of particular interest to managers, including articles on running internal investigations; AML supervision; managing data breaches, and the FCA's continued focus on culture within firms.

We will shortly be sending invitations to our next Funds First Seminar. Please do get in touch with us (corporate.marketing@bclplaw.com) if you are not sure whether you are on our invitation list, or you have a colleague who would like to be added.

Please feel free to call any of the BCLP 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.

Real estate funds market overview and observations

The current level of available capital earmarked for global real estate investment is still at record highs (€72.4bn in 2019, according to the INREV investment intentions survey 2019) with investors continuing to access the asset class via allocations to funds, joint ventures and clubs as well as separate accounts and direct investment. We are seeing investors increase their allocations to favoured and well-established managers, resulting in fewer but larger fundraises with significant discretionary and non-discretionary co-investment allocations.

Other themes we are seeing include: a growing interest in long-dated funds or 'permanent capital vehicles' (with terms of 15 years or more); strategic investors continue to look for opportunities to invest into the GP or sponsor alongside the fund investment; ongoing

competition to place capital and source investment opportunities; and strong interest in the authorised funds space.

From a regional perspective, the growth in Asia Pacific (the only region to see an increase in fundraising in 2018 year-on-year, up by 62%) is expected to continue, reflecting the maturity of growth of opportunities across the region as well as attractive long-term return prospects.

In terms of strategies and fund styles, value add strategies continue to be favoured, typically with closed-ended fixed life structures. However, there is a general shift towards core at the expense of opportunistic funds. Hybrid open-ended structures for core funds are common.

The table below sets out our general observations on fund terms and recurring themes, based on recent fundraisings that we've been involved with.

Term or issue	Comment
Fund terms have not changed significantly in recent years	There is a common understanding and acceptance of market terms weighted in favour of investors
Fee breaks to large and first close investors are common	These often track through to other investors through most favoured nations provisions
Some investors are making smaller discretionary allocations to a fund supported by "soft" co-investment commitments	For those investors who have the capacity to process transactions quickly, co-investment gives the investor the option to increase its exposure to an investment whilst having greater control over the deployment of its capital. Managers can benefit from having a deeper pool of capital as well as strengthening relationships with investors.
What constitutes "marketing" under the Alternative Investment Fund Managers Directive (AIFMD) rules needs to be considered in each member state the sponsor intends to market into (particularly when using a sub-threshold Alternative Investment Fund Manager (AIFM))	For instance, the extent to which a sponsor can "passive market" on a reverse solicitation basis or conduct pre-marketing using draft documents varies from jurisdiction to jurisdiction. However, from 2021 a new definition of "pre-marketing" will apply (see below for more, at 'AIFMD - removing barriers to cross-border distribution of investment funds').
Any preferential treatment given by an AIFM to one or more investors must not result in an overall material disadvantage to other investors. Additionally, there is an overriding obligation to treat all investors fairly.	An AIFM must treat investors fairly, but need not treat them identically. For example, an AIFM can offer side letter provisions but cannot offer things like earlier redemption rights as that would give an investor an unfair advantage on requesting a redemption before other investors can exit. The requirements on side letters and preferential treatment do not oblige an AIFM to disclose all side letters to other investors in the absence of a request to do so in the underlying fund documentation.

A final market development of interest is the launch of the International Property Securities Exchange (IPSX), which will allow companies to list individual assets and will be the first and only regulated exchange dedicated to commercial real estate. Open to both institutional and retail investors, it is designed to overcome some of the barriers to investment that can be off-putting for first time investors (for example, large lot sizes, the need for professional skills to understand operational costs, difficulties acquiring stock and costs to invest).

Regulatory updates

AIFMD – removing barriers to cross-border distribution of investment funds

There is potentially some good news in the world of AIFMD. As we have reported previously (see our June 2018 briefing Update on reducing barriers to the cross-border distribution of investment funds), the EU is consulting on new laws that seek to remove barriers to cross-border fund sales and will seek to level the playing field on pre-marketing regimes. These proposals are looking close to being finalised and are due to be adopted by the EU Council and Parliament later this year, to come into effect in 2021.

These proposals will introduce a new definition of 'pre-marketing'. At present, there is a patchwork of approaches across Europe and, whilst some jurisdictions allow managers to hold initial conversations with prospective investors without needing to register the fund, others will only allow even preparatory conversations to take place once the fund has been registered. If passed in the anticipated form, the new legislation will require all member states to permit AIFMs to carry out market-sounding activities with prospective professional investors pre-launch of a fund, provided that the fund documents are still in un-finalised form (once finalised, AIFMs are likely to be deemed to be carrying out 'marketing' activities and so need to have notified regulators of their activities in the normal manner under AIFMD). The proposed amendments will therefore force those more restrictive EEA countries to allow managers to have initial discussions with investors and test the market without needing to commit to obtaining a marketing passport or submitting Article 42 National Private Placement Regime (NPPR) notices. If the test marketing looks to be productive, only then will the manager need to fully commit to its marketing strategy and obtain the necessary passport or notification.

The legislative proposals also contain provisions relating to reverse-solicitation, marketing communications, retail investors, ceasing marketing and fees and charges that can be levied by national competent authorities (NCAs).

AIFMD review

On 10 January 2019 the European Commission (the Commission) published a report, produced by KPMG, on the operation of AIFMD. This forms part of the Commission's wider review of AIFMD (due to have started by July 2017) and which will culminate in a report (expected in the next year) to the European Parliament and Council. This evidence-based study provides a comprehensive account of industry's and regulators' experiences in applying AIFMD, its impact on Alternative Investment Funds (AIFs) and AIFMs in the EU and third countries, investors and other concerned parties, and the achievement of AIFMD's objectives. However, it cannot yet be considered a roadmap for hypothetical future revisions to the AIFMD regime, not least because the report found that "AIFMD has yet to prove itself" given the relatively short time since in came fully into effect. Indeed, one of the report's conclusions is that, although there are various areas where rules should be improved, clarified, rationalised or enhanced, the asset management industry continues to be impacted by a swathe of new rules and by regulatory uncertainty. Adding to that already considerable burden would not be welcome and could cause yet more disruption and costs for investors, the industry and regulators.

The findings of the report are not, of themselves, perhaps surprising – the general themes are that AIFMD is broadly working as intended but that: (i) it suffers from uneven interpretation and implementation across the EU; and (ii) many of the disclosure requirements are excessive and duplicative. What will be interesting is to see how the Commission responds to these findings as and when the AIFMD II process is launched and whether this study re-opens some of the more thorny issues. Given that AIFMD seeks to apply a one-size-fits-all approach to the very wide range of types of AIFs that exist around the EU and elsewhere, there are bound to be some differences between member states. However, much of the report's criticism is levelled at particular and nuanced areas of uneven implementation and lack of harmonisation. We wait to see the extent to which these divergences are allowed to continue.

See our briefing Effectiveness and Efficiency of AIFMD Under Scrutiny for the principal points of interest arising from the report, both positive and constructive.

SMCR – new prescribed responsibilities for authorised fund managers from September 2019; and 9 December 2019 extension

By now all fund managers should be aware that they will need to undertake some significant changes to their governance arrangements in 2019. This is because the FCA's Senior Managers and Certification Regime (SMCR) is to be expanded to encompass fund managers (and other types of FCA-authorised and solo-regulated firms).

But prior to the main implementation, from 30 September 2019 all managers of authorised funds (so encompassing ACDs, authorised unit trust managers and authorised contractual scheme managers) (AFMs) will be required to appoint independent directors. These rules will apply to AFMs regardless of their size. AFMs will be required to appoint independent directors to make up at least 25% of their board (and, where there are fewer than eight directors, there must be at least two independent directors). These rules, which seek to implement an element of the FCA's Asset Management Market Study (AMMS, and discussed further below), set out detailed provisions for whether a person is independent. A director is unlikely to be considered independent if there is a monetary link with the AFM's group, or where they have a close relative in a senior position in the AFM or a firm in its group. There is no obligation for the AFM's chair to be independent; it is the AFM's decision. The FCA will be monitoring this proposal and will consider introducing higher thresholds for independence in due course, if necessary. Independent directors can act on more than one board (including on AFM group companies) but will be restricted to terms of up to 5 years which can be renewed once up to a 10 year maximum service period.

Action point: AFMs should already be identifying potential candidates for independent directorship roles. They should also consider whether any consents are required in order to make those appointments (whether under the firm's ownership arrangements or the fund documents) and factor that into their timetables.

From 9 December 2019 the FCA's SMCR will apply to all FSMA-authorised firms (replacing the existing approved persons regime), as well as to branches of non-UK firms with permission to carry out regulated activities in the UK. Prior to 9 December firms will need to identify, and train, their new Senior Managers and Certification Staff and undertake other steps depending on their classification as Limited Scope, Core or Enhanced firm. As part of the extended SMCR regime, AFMs (in addition to the independent director representation) will need to have a senior manager (usually the Chairman) with the prescribed responsibility for the assessment of value and acting in investors' best interests. See our briefing SMCR for FCA-solo regulated firms - How to survive implementation for more.

Action point: Although it may still seem like a while away, managers should ensure that their SMCR implementation plans and teams are in place. Involving all areas of the business (including HR, compliance, legal as well as the managers themselves) is crucial, as is getting buy-in from senior management. BCLP has assisted many firms and senior managers who are already subject to the regime – please do get in touch if you would like to discuss your plans.

Brexit – the Temporary Permissions Regime and positive news on regulatory co-operation agreements

Whilst there is considerable uncertainty (at the time of writing) on how and when we will see an outcome of the Brexit process, there is some clarity at least on breathing space for the funds industry.

Incoming firms. For EU27 firms and funds providing services or marketing funds into the UK, a Temporary Permissions Regime (TPR) has been established. It will apply only if no transitional period is agreed and if there is a no deal Brexit: in which case it will apply to EEA firms and funds (AIFs and UCITS) passporting into the UK on exit day who have signed up to the TPR. EEA firms and funds that sign-up to the TPR will be able to continue operating as they had up to the point of Brexit and will be granted a temporary FCA licence to undertake the regulated activity (usually covered by its passport) in the UK as if they were authorised in the UK. It is intended that the TPR will last for a maximum of 3 years, however the period will vary from firm to firm as firms will be invited to apply for full authorisation in cohorts during that period. In order to benefit from the TPR, relevant EEA firms and investment funds will need to

notify the FCA (or PRA, if dual-authorised) of their intention to do so. The notification window is 7 January to 28 March 2019; any firms and funds that have not notified in time will not benefit from the TPR and therefore default to accessing the EEA market using the Article 42 NPPR.

Action point: EU27 firms passporting into the UK (or marketing funds into the UK under UCITS or AIFMD passporting rights) should sign-up to the TPRs as soon as possible. Signing up now will not impact any existing passports in the event that Brexit is delayed or the Withdrawal Agreement signed; whereas missing the window will mean the firm or fund will need to stop all activities immediately following Brexit until they obtain a fresh licence or make a new Article 42 notification.

UK firms. After a slow start, there is at last also some relief for UK firms providing services into the EU27. The expectation had been that no reciprocal access arrangements would be given by EU27 member states, and that UK firms wanting to access the EU27 market would be relying on their contingency plans. However, a couple of recent announcements have changed this. The Dutch Ministry of Finance has provided for an equivalent to the UK's TPR (discussed above), allowing UK-based investment firms to temporarily (until January 2021) continue to service professional clients in the Netherlands in case of a no-deal Brexit. The CSSF is formulating similar legislation, which would allow UK-based authorised AIFMs managing Luxembourg AIFs on exit day to continue to exercise their activities in Luxembourg by means of the free provision or services or a branch. It seems likely from recent press reports that some other NCAs may follow suit.

Many cross-border activities of third country firms, specifically delegation and marketing, require regulatory co-operation agreements to be put in place. In the absence of these co-operation agreements, UK managers would not be permitted to act as delegated portfolio managers of EU AIFs (a key plank of many contingency plans) or register for marketing into EU27 member states under the Article 42 NPPRs. On 1 February 2019, there was a very welcome announcement from the FCA, that it had agreed two Memoranda of Understanding (MoU) with ESMA and EU regulators to allow co-operation and exchange of information in the event the UK leaves the EU without a withdrawal agreement and implementation period (and which ESMA confirmed in a separate press release).

Action point: Check back against your contingency plans to assess whether these developments change your approach. Note that the MoUs need to be in place on an individual jurisdiction by jurisdiction basis, so also check whether particular member states where you are performing marketing are expected to sign-up to them in time.

Liquidity risk issues 1: the FCA consultation on regulatory approach to UK open-ended funds

The FCA consultation and feedback paper (CP18/27) on illiquid assets and open-ended funds recently ended, on 25 January 2019. Final rules and guidance are expected this year, to take effect in 2020 (and which will supplement liquidity provisions in AIFMD). The focus of the proposed changes is on the Non-UCITS Retail Scheme (NURS) ie those authorised open-ended funds available to the retail market and that can invest substantially in illiquid assets; although the consultation considers whether or not some of the suggested remedies should also apply to Qualified Investor Schemes. Whilst the FCA has concluded that a major overhaul of the regulatory framework in this area is not needed, it did identify various improvements that should be made in the use of suspensions, other liquidity management tools, contingency planning, oversight arrangements and disclosure to retail clients. This is certainly topical, especially as the FCA is currently monitoring outflows by retail investors in the context of recent stock market falls and Brexit uncertainty.

Some of the proposals have raised concerns in the industry, including a new rule that an AFM of a NURS holding immovable such as property must suspend the issue, cancellation, sale and redemption of units when there is 'material uncertainty' about the valuation of at least 20% of the scheme property. The critique is on the basis that the existing regulatory toolkit works well (for instance, around fair price adjustments), and that a mandatory suspension rule could cause knock-on liquidity issues, being the reverse of what is intended. Another concern is that the proposal places disproportionate discretion and responsibility for any suspension on the valuer (where this should rest with the authorised fund manager).

Action point: Notwithstanding that these measures are not expected to take effect until next year, as the Brexit discussions play out (and broader economic situations develop), it would be prudent to monitor the developments, so that once the outcomes are known you can be ready to apply the new measures early and to minimise the risk of having your systems and controls challenged in the event of market disruption.

Interestingly, the European Commission's 10 January 2019 report on the operation of AIFMD (see above for more on this), produced by KPMG, found that AIFMD provisions "are effective and created a uniform standard in AIFMs risk and liquidity management. This enables NCAs to assess whether AIFMs have appropriate risk management controls and manage major risks. They also provide assurance for investors that the liquidity profile of an AIF is aligned with their redemption rights." Nonetheless, as we discuss in the next item, ESMA has since issued draft guidelines looking at liquidity stress testing across both AIFs and UCITs.

Liquidity risk issues 2: the EU and the US contexts

ESMA published a consultation on 4 February 2019 on draft guidelines on liquidity stress tests (LST) of investment funds applicable to AIFs and UCITS. ESMA has produced 14 (principles-based) draft Guidelines for managers to fulfil when executing LST on their funds. Broadly, these Guidelines set out that LST should: be tailored towards the individual fund; reflect the most applicable risks to a fund; include sufficiently extreme or unfavourable (yet plausible) test scenarios; sufficiently model how a manager is likely to act in times of stressed market condition; and be embedded into the fund's risk management framework. The consultation also makes the point that LST is not an exercise to be taken in isolation; it necessarily relies on being integrated into the overall liquidity risk management process of an investment fund. NCAs and financial market participants must make "every effort" to comply with the Guidelines.

The Guidelines aim to enhance managers' on-going fund liquidity risk management, as well as to help mitigate the potential impact of crystallised liquidity risk in funds. They also seek to promote supervisory convergence by providing a set of minimum standards by which NCAs should assess managers' LST programmes. One of the Guidelines (on verification procedures regarding LST) applies to depositaries.

There are explanatory considerations to assist managers/depositaries' compliance with the Guidelines, including for funds investing in less liquid assets (for example, LST could therefore help a manager to establish a governance framework seeking to support fair outcomes for all investors by helping model a fair method of liquidating assets).

All AIFs are within scope, and the Guidelines will therefore also apply to leveraged closed-ended AIFs (on the basis that liquidity risk may materialise independently of redemptions). The consultation closes on 1 April 2019 and ESMA plans to publish its feedback in Q2, with its final report in Summer 2019.

Action point: Consider how these Guidelines will apply to your business and the funds that you manage or advise and engage with the consultation process. Whilst the UK may be outside the EU by the time the Guidelines are brought into force, we should anticipate that the UK will adopt similar standards.

Also of interest will be the FCA's December 2018 discussion paper on the suitability of the UK authorised fund regime for investing in patient capital (which includes a range of illiquid investments intended to deliver long-term returns, including infrastructure, real estate and private equity/debt). In particular, whether investors and fund managers have appropriate access to patient capital and if the right level of investor protection is in place.

Liquidity risk issues have also moved up the agenda in the US: in December 2018 the SEC revised the Investment Company Act 1940 to require US open end mutual funds to adopt and implement a written liquidity risk management program that is reasonably designed to assess and manage "Liquidity Risk." "Liquidity Risk" is the risk that the fund could not meet shareholder redemption requests without significant dilution of remaining fund shareholders. Under the new rule, mutual fund advisers are required to classify the fund's investments into liquidity categories (ranging from assets that are readily liquid to those that are restricted and/or thinly traded) and to determine a minimum percentage of the fund's assets that will be held in highly liquid investments. Mutual funds have always been required to file public reports

that disclose their portfolio holdings as of each quarter-end (on a delayed basis). Under the new rule, a mutual fund will also be required to file a report with the SEC if more than 15% of its net assets are determined to be illiquid and/or restricted.

FCA's Asset Management Market Study - implementation of the reform package

The FCA is in the process of implementing a comprehensive remedies package on asset management following its AMMS, a journey which commenced in November 2015. On 4 February 2019 the FCA published its Policy Statement (PS19/4) in response to the Consultation Paper (CP18/9) on further remedies. We have picked out three key points of interest below.

- Guidance to help authorised fund managers (AFMs) make objectives more meaningful and useful to consumers. The FCA recognises a tension between having objectives that are specific enough for investors and flexible enough for managers to adjust in response or anticipation of changing market conditions – and which it expects AFMs to manage. As part of this initiative the Investment Association has produced supplementary 'fund communication guidance'. Key messages are around simple, clear and consistent language, instead of technical terms and jargon; KIIDs/KIDs disclosures going beyond the prospectus if necessary (eg where the manager strategy is to make specific use of an investment power such as derivatives); and setting out non-financial objectives (such as ESG) and how these will be measured and reported on. AFMs are expected to take the guidance into consideration when writing and reviewing fund documentation (in particular any key information documents and marketing material such as fund factsheets) from the date of publication (18 February 2019).
- The FCA is proposing 3 new categories of benchmark ('constraint,' 'target' or 'comparator') and AFMs will have to explain why and how they are using particular benchmarks, or other means used to assess their fund's performance. The point being that more consistent use of and disclosures on benchmarks will improve information investors receive. Existing funds will need to adhere to the new rules from 7 August 2019; for new funds, compliance is from 7 May 2019.
- From 7 August 2019, performance fees disclosed in a prospectus must be calculated on the basis of the fund's performance after all other charges have been deducted.

Our April 2018 briefing sets out some background, key points of interest from the AMMS comprehensive remedies package, along with our comments on their impact on AFMs. The requirement for AFMs to appoint independent directors discussed above also derives from the AMMS.

Hot topics

New non-resident capital gains tax rules (NRCGT)

From April 2019, a non-UK resident person will be subject to tax (corporation tax for a corporate investor and capital gains tax otherwise) on a gain on a disposal of directly held UK land (a direct disposal) or interests in "UK property rich" entities (an indirect disposal). An "indirect disposal" of property occurs when the entity being disposed of is "UK property rich". This will apply where 75% or more of the gross asset value of the entity being disposed of derives from UK land; and a non-resident has held a 25% or greater interest in the entity at any point in the 2 years ending on the date of disposal.

The new legislation (now final, as the Finance Act 2019 has been enacted) specifies that where an investment has an "appropriate connection" with a "collective investment vehicle" (CIV), there is no 25% ownership threshold ie if the UK property richness condition is satisfied, any disposal of that investment is potentially a taxable indirect disposal of the UK property. A CIV is defined to include collective investment schemes (eg a PAIF, an AUT, a JPUT, an FCP, a fund in the form of a limited partnership), alternative investment funds, UK REITs and foreign REIT equivalents.

There are 2 elections:

- the transparency election, for certain offshore "UK property rich" CIVs (including JPUTs) that can elect for transparency for the purposes of UK tax on capital gains; and

→ the exemption election – funds, that meet certain conditions, can elect for special tax treatment. This means gains by a fund (or within its structure) will not be taxable but investors will be taxed on disposal of their interest in the fund in line with their tax statuses i.e. when they receive value whether by a sale of units or distribution of gains.

Action point: As a result of the Government's extensive engagement with the industry, the legislation broadly preserves the status quo for indirect investment in UK real estate, in particular the efficiency of JPUTs that meet certain qualifying conditions and make appropriate elections. That said, in anticipation of these changes, many fund managers and investors in UK real estate are having to re-visit their fund structures and holdings, consider possible exemptions/alternatives as well as understanding practical considerations in order to implement chosen plans. See our November 2018 briefing for more.

Growing importance of ESG/SRI

ESG (environmental, social and governance) and SRI (sustainable, responsible and impact investment) are of increasing importance in the funds market, particularly as it is now possible to see hard evidence that a fund manager's approach to ESG/SRI can have a real impact on the value of underlying investments held by a fund. We expect a shift towards ESG/SRI policies being incorporated into fund objectives, rather than separately dealt with in individual side letters, and towards ESG risks being identified and monitored on individual investments as well as at portfolio-level.

A growing number of asset managers and investors (and their service providers) are signatories to the Principles for Responsible Investing (PRI), which are supported by the UN. This involves a manager's commitment to: factor in ESG issues when making investment decisions; seek disclosures from ESG entities in which they invest; and report on ESG activities and their progress towards improvement. IOSCO encourages issuers to consider the materiality of ESG matters to their business and to assess risks and opportunities in light of their business strategy and risk assessment methodology. When ESG matters are considered to be material, issuers should disclose the impact or potential impact on their financial performance and value creation.

Other recent initiatives in this area are ESMA's proposals to integrate ESG in asset management and advisory processes; the launch of the PRI Impact Investing Map (a business tool to help identify 'mainstream impact investing companies'); and the Investment Association consultation on sustainability and responsible investment (which closes on 1 March 2019). One of the views the IA seeks is around development of an industry-endorsed set of standard definitions for commonly used terms and a review of reporting frameworks used by asset managers to disclose how they embed ESG considerations into their investment process, and the impact that their investments have had on wider sustainability indicators.

Action point: Consider how ESG principles relate to your asset class (for instance real assets and energy funds may focus on environmental impact; emerging markets funds on social and corporate governance matters and jurisdictional-specific impacts). It may be more efficient to develop ESG obligations (eg LP reporting standards and format) as part of a standalone policy which is then incorporated into fund documents, rather than reacting to various ESG requests from different investors.

Other anticipated developments to look out for in 2019/2020

UKLP reform – draft legislation

Following the December 2018 Government response to its consultation (which closed in July 2018) on the reform of limited partnership law (the key elements of which, along with our comments, are set out in our December 2018 briefing Welcome Government response to UK limited partnership law reform consultation) we 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. A reform of Irish limited partnership law is also underway; it will be interesting to see if this emerges as a competitor fund vehicle to the UK private fund limited partnership.

Overseas Entities Bill – final legislation

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.

Overseas investors who own, or are proposing to acquire, UK property, will want to plan ahead for registration, by identifying both UK property holdings to which the new regime may apply and the registrable beneficial owners. Ensuring that the large number of international owners of UK high value (often residential) property are both aware of these new rules, and complete the registrations, may take some time. The loss of personal confidentiality is also likely to be unwelcome.

See our August 2018 briefing Overseas entities – new public beneficial ownership register for more.

Transparency initiatives under 5MLD and Sanctions and Anti-Money Laundering Act – implementation of EU member states and British overseas territories

Transparency of beneficial ownership is becoming a familiar theme. The UK is an early implementer in this field, having already established public PSC registers for UK companies, UK LLPs, certain Scottish partnerships and Societates Europaea. Businesses with EU operations are having to handle potential conflicts with new compliance requirements: on the one hand, personal data privacy obligations and protection policies under the GDPR, alongside increased disclosure of personal information for the purposes of beneficial ownership register requirements on the other.

The amendments to the Fourth Anti-Money Laundering Directive (4MLD) by 5MLD came into force on 9 July 2018 and in terms of beneficial ownership registers, allow broader access, more rigour and potential for enforcement. Three main points to note (and which are expected to continue to apply in the UK post-Brexit):

→ EU member states are to have public registers of beneficial ownership information for corporates/other legal entities by January 2020. This is of less relevance in the UK as the PSC regime already provides for public registers.

→ EU member states are to allow additional access to beneficial ownership registers for trusts and 'similar legal arrangements' (by March 2020): (i) on the basis of 'legitimate interest' (this will be for member states to define); and (ii) public access upon written request relating to a trust/arrangement that holds a direct or indirect controlling interest in a corporate/other legal entity that is not incorporated in the EU. We have not yet seen the UK implementing regulations on this.

→ Registers are to be interconnected via the European Central Platform (and information is to remain available for between 5 and 10 years from the date that the corporate/other legal entity is struck off the register, or after grounds for registered a trust cease to exist) by March 2021.

The Sanctions and Anti-Money Laundering Act requires British overseas territories to have public registers of beneficial ownership information for corporates. The deadline for compliance has been deferred by 2 years until 31 December 2023. The relevant jurisdictions within scope are Anguilla, Bermuda, Gibraltar, the BVI, the Cayman Islands, the Turks and Caicos Islands (note that the Crown Dependencies, ie the Channel Islands and the Isle of Man, are not caught by this legislation).

Review of PRIPPs – by 31 December 2019

In July 2018 the FCA consulted on the PRIIPs Regulation and its feedback statement is expected early this year. This Call for Input covered questions around scope and the content of KIDs. On 8 February 2019 the European Supervisory Authorities (ESAs) reported that they are not proposing substantive amendments to the PRIIPs Regulation; and will focus efforts on further reviews. However, the ESAs flagged the risk that retail investors are given inappropriate expectations about possible returns and recommend that PRIIP manufacturers provide a warning in the KID to ensure that retail investors are fully aware of the limitations of the figures provided in the performance scenarios.

FCA review of investment research (MiFID II)

One area of MiFID II that had a significant impact (in particular for corporate finance firms and fund managers) is in relation to commission sharing arrangements to pay for investment research. Fund managers may only receive investment research from brokers in limited circumstances. Currently, fund managers are only permitted to receive investment research from their brokers where either:

(a) the manager pays for the advice from its own resources; or

(b) the payment is made from a separate research payment account established by the fund manager funded by a specific research charge paid by the client. There are also then certain disclosure and ongoing compliance obligations that apply.

ESMA has confirmed that fund managers are permitted to increase their fees if they decide to pay for research under option (a). If a firm chooses to establish a separate research account under option (b), it must set the budget and agree the charge with the client – it cannot be done by reference to the volume or value of trades. There has been criticism that the costs and administrative burden of operating under option (b) are in reality prohibitive. This is contrary to the FCA's current thinking, as expressed in Andrew Bailey's 25 February 2019 speech.

In addition to work on investment research, the FCA has confirmed that it is expecting to publish some conclusions from its broader MiFID II supervisory work. This will include publishing conclusions on costs and charges disclosures in Q1. The FCA has said that it will then continue to carry out work on product governance and research unbundling throughout 2019.