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LEXOLOGY
Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the seventh edition of *Fund Management*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

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LEXOLOGY
Getting The Deal Through

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United Kingdom

Kate Habershon, Oliver Rochman, William Yonge, Steven Lightstone and Monika Rzesniowiecka

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FUND MANAGEMENT REGULATION

Regulatory framework and authorities

1 | How is fund management regulated in your jurisdiction? Which authorities have primary responsibility for regulating funds, fund managers and those marketing funds?

The Financial Conduct Authority (FCA) is generally responsible for regulating funds, fund managers and fund management-related activities (including fund marketing) in the UK. The UK regulatory framework for fund managers is largely set out in the Financial Services and Markets Act 2000 (FSMA), various statutory instruments made under FSMA and FCA rules.

Subject to a transition period that expired on 31 December 2020, the UK withdrew from the European Union (EU) and the European Communities Act 1972 (which incorporated subsisting EU law into domestic UK law) was repealed on 31 January 2020. At the end of the transition period, EU law that was operative in the UK at that time broadly became part of UK domestic law as a new category of retained EU law under the EU (Withdrawal) Act 2018.

Fund administration

2 | Is fund administration regulated in your jurisdiction?

Overall responsibility for the administration of a fund in the UK will normally amount to the regulated activity of 'establishing, operating or winding up a collective investment scheme'. Providing custody services relating to investments is generally also a regulated activity. Subject to certain exemptions, these regulated activities require FCA authorisation.

Authorisation

3 | What is the authorisation or licensing process for funds? What are the key requirements that apply to managers and operators of investment funds in your jurisdiction?

UK collective investment in transferable securities (UCITS) funds established as authorised unit trusts (AUTs), open-ended investment companies (OEICs) or authorised contractual schemes (ACSs) must be FCA-authorised. An application form for authorisation must be submitted to the FCA, along with:

- a draft prospectus;
- constitutional documents (and a solicitor's certificate confirming their compliance with applicable regulation); and
- a model portfolio.

The FCA has two months to consider a UCITS authorisation application.

Most UK closed-ended retail funds and non-retail open- and closed-ended funds do not require FCA authorisation. However, their UK manager would generally be subject to FCA authorisation or registration and self-managed funds that do not have a separate manager must generally be FCA-authorised.

Subject to certain exemptions and depending on the precise activities carried on, a manager or operator of an investment fund must generally be FCA-authorised to carry on in the UK the regulated activities of:

- managing an alternative investment fund (AIF) or a UCITS fund;
- discretionary portfolio management (eg, delegated portfolio management for a fund or managing a single investor's assets in a segregated account);
- advising on investments;
- establishing, operating or winding up a collective investment scheme (where operating generally involves being responsible for the scheme's property);
- arranging deals in investments (including intermediation activities relating to arranging an investor's investment in an investment fund); and
- agreeing to carry on any of the above regulated activities.

The FCA authorisation process can take six months or more for managers or operators of investment funds and self-managed funds, and the FCA requires as part of the process detailed information on the applicant's operation, management and ownership.

Territorial scope of regulation

4 | What is the territorial scope of fund regulation? Can an overseas manager perform management activities or provide services to clients in your jurisdiction without authorisation?

Unless an exemption applies, it is prohibited (and a criminal offence) under FSMA to carry on in the UK a regulated activity by way of business without authorisation, and any contract made in contravention of this prohibition is unenforceable against an investor. For the purpose of this prohibition, an investment manager would not be deemed to be carrying on in the UK the regulated activities of discretionary portfolio management or arranging deals in investments if the investment manager is based outside the UK when undertaking those activities. Further, an overseas investment manager could rely on an exclusion from requiring authorisation to carry on the regulated activity of entering into an agreement with a UK person to carry on for them discretionary portfolio management, if the overseas manager enters into the agreement other than from a permanent place of business maintained by it in the UK and any solicitation of the UK person complies with the UK financial promotion rules.

Acquisitions

5 Is the acquisition of a controlling or non-controlling stake in a fund manager in your jurisdiction subject to prior authorisation by the regulator?

A person who decides to acquire control over an FCA-authorised fund manager must obtain the FCA's approval before making the acquisition. For this purpose, 'control' broadly means holding at least 10 per cent of the shares or voting power in the manager or the manager's parent undertaking (or 20 per cent if the manager's FCA permission only covers managing AIFs) or holding shares or voting power as a result of which the holder is able to exercise significant influence over the management of the manager. Further, a person deciding to subsequently increase his or her holding in a fund manager (other than in a fund manager with FCA permission only to manage AIFs) to at least 20, 30 or 50 per cent of the shares or voting power in the manager must again obtain the FCA's prior approval.

Restrictions on compensation and profit sharing

6 Are there any regulatory restrictions on the structuring of the fund manager's compensation and profit-sharing arrangements?

Certain employees of UK fund managers may be subject to one of more of the five sets of remuneration rules.

Broadly, an investment manager that is a firm other than a manager of an AIF (AIFM) or a UCITS is likely to be governed by the FCA's BIPRU Remuneration Code, an AIFM is governed by the FCA's AIFMD Remuneration Code and a UCITS manager is governed by the FCA's UCITS Remuneration Code. More than one of these remuneration codes may in certain circumstances apply to a firm, although the requirements of each code are similar (but not identical). The rules must be applied in a way that is appropriate to the firm's size and internal organisation, and the nature, scope and complexity of its activities.

FCA-authorised investment managers with FCA permission to hold client money or assets, to deal on own account or to underwrite or place financial instruments are subject to the FCA's IFPRU Remuneration Code. For these firms, the ratio of variable to fixed remuneration must not exceed 1:1 (or 2:1 with shareholder approval) and all variable remuneration must be subject to clawback in case of subsequent poor performance.

Further, dual-regulated firms, such as banks that carry on asset management, are subject to the FCA's Dual-regulated firms Remuneration Code.

FUND MARKETING

Authorisation

7 Does the marketing of investment funds in your jurisdiction require authorisation?

A UK investment fund is classified as an undertaking for collective investment in transferable securities (UCITS) fund or an alternative investment fund (AIF), unless it is a 'fund of one' that does not amount to an AIF by virtue of it having only one investor. Broadly, the marketing of a UK UCITS fund in the UK requires Financial Conduct Authority (FCA) approval. An EEA UCITS now constitutes an AIF in the UK, although EEA UCITS and EEA AIFs that were marketed in the UK under the EEA passport regime immediately before the end of the Brexit transition period can continue to be marketed in the UK under the UK temporary permission regime if their managers notified the FCA by 30 December 2020. Broadly, the marketing in the UK of a UK AIF with a UK manager (AIFM) requires FCA approval, while the marketing of an AIF (regardless of whether it is UK-established) with a non-UK AIFM requires prior notification to the FCA under the UK national private placement rules. The arranging of investments in funds could also require FCA authorisation. Further, the marketing of AIFs, UCITS funds, funds of one and segregated accounts is subject to the UK financial promotion regime.

8 What marketing activities require authorisation?

Marketing activities in the UK relating to UCITS funds, AIFs and any other investment product or service are subject to the UK financial promotion regime. A financial promotion of a fund is an 'invitation or inducement' to invest in the fund and generally covers all types of marketing activity, including where solicited by the investor. Separately, there is a narrower concept of 'marketing' under the UK AIFM regulations that applies only to AIFMs. For this purpose, marketing is a 'direct or indirect offering or placement' by an AIFM at the AIFM's initiative or on behalf of the AIFM. The FCA interprets this as broadly catching only the distribution of final-form fund documents and similarly binding documents.

While the requirements of the new EU Directive and Regulation setting out new rules on the cross-border marketing and pre-marketing of AIFs and UCITS take effect in the EU in August 2021, it is not clear the extent to which the UK will adopt them.

Territorial scope and restrictions

9 What is the territorial scope of your regulation? May an overseas entity perform fund marketing activities in your jurisdiction without authorisation?

The UK financial promotion regime broadly covers both promotions made within the UK and, if they are capable of having an effect in the UK, promotions made from outside the UK. A promotion capable of having effect in the UK could include a promotion communicated to a website that is accessible in the UK. Communications 'directed' only at persons outside the UK are exempted. Making a financial promotion in the UK is broadly prohibited (and a criminal offence) unless it is made or approved by an FCA-authorised person or exempted, and any contract arising from a prohibited promotion is unenforceable against an investor. Exempted recipients of financial promotions made from within or outside the UK include, for instance, investment professionals (including UK and non-UK local authorities), high net worth companies, high-value trusts (including private sector pension funds constituted as trusts) and institutional investors and pension funds.

Authorised persons are also subject to restrictions and FCA rules on promoting unauthorised funds in the UK. While authorised persons can promote UCITS funds to the general public, they can only promote non-UCITS funds to certain categories of investors, such as professional investors and investors of a category similar to the categories of exempted recipients of financial promotions under the general restriction.

A notification must also first be submitted to the FCA in accordance with the UK national private placement rules by a UK AIFM to market a non-UK AIF in the UK and by a non-UK AIFM to market a UK or non-UK AIF in the UK.

10 If a local entity must be involved in the fund marketing process, how is this rule satisfied in practice?

There is no specific requirement for a local entity to be involved in marketing a fund in the UK. However, FCA-authorised firms are often used in practice to facilitate the marketing of AIFs to individual investors, since an FCA-authorised firm can market an AIF to individuals it has opted up to professional client status or certified as sophisticated or high net worth investors for the purpose of the financial promotion restriction.

Commission payments

11 | What restrictions are there on intermediaries earning commission payments in relation to their marketing activities in your jurisdiction?

If a UK authorised firm, such as an independent financial adviser, recommends a retail investment product (such as a UCITS) to a UK retail client, the firm can only be paid for its advice by fees agreed with the client and is prohibited from receiving payments (such as initial and ongoing commission) from the product provider (such as the fund manager). Further, a platform service provider through which a retail client buys or sells a retail investment product without a recommendation may not offer or pay any related commissions.

RETAIL FUNDS

Available vehicles

12 | What are the main legal vehicles used to set up a retail fund? How are they formed?

Under section 238 of the Financial Services and Markets Act 2000 (FSMA), before a fund which constitutes a collective investment scheme (CIS) may be promoted by a firm that is authorised under FSMA by either the Financial Conduct Authority (FCA) or the Prudential Regulation Authority (PRA) (each an authorised firm) to the general public (ie, on a retail basis) in the UK, it must qualify as any of the following legal vehicles:

- an FCA-authorised unit trust scheme (AUT);
- an FCA-authorised contractual scheme (either a co-ownership or a limited partnership scheme) (ACS); or
- an FCA-authorised open-ended investment company (OEIC) described by the FCA as an investment company with variable capital or ICVC.

Of the above vehicles only the OEIC is a body corporate and has separate legal personality.

In addition, a fund that is recognised by the FCA under section 272 of FSMA (Individually Recognised Overseas Schemes) may also be promoted to the general public. Such recognition does not turn on the nature of the legal vehicle deployed but on factors such as the adequacy of protection afforded to investors, the fund's constitution and management and the powers and duties of the operator – and if relevant its trustee or depositary.

A retail fund will typically be established in the UK as an open-ended undertaking for collective investment in transferable securities (UK UCITS) fund. A UK exchange-traded retail fund (a retail ETF) will usually be constituted as a UK UCITS fund listed on the London Stock Exchange (LSE). Alternatively, a manager may establish a closed-ended vehicle, typically to invest in assets in which a UCITS fund is not permitted to invest (eg, real estate), and adopt the investment trust model (see below). An investment trust is required to be listed on a stock exchange to allow investors to realise their shares on the stock market and to enable a public offering of the shares (if desired).

Open-ended retail funds

An 'open-ended' fund is one in respect of which the participants have a right to redeem or sell their interest in the fund at a price related to the net value of the assets held by the fund. Open-ended retail funds established in the UK are either UCITS funds or (more rarely) non-UCITS retail schemes (NURS). A NURS is a type of non-UCITS fund authorised by the FCA for distribution to retail investors in the UK, with wider investment and borrowing powers than a UCITS; in particular, a NURS can invest in real estate (land) and gold. In either case, the fund will be legally constituted in the UK as an OEIC, AUT or ACS. UK AUTs, OEICs and ACSs are all open-ended funds by definition, as they are required to confer on unitholders or shareholders the right to redeem their units or shares.

An OEIC is formed under the Open-Ended Investment Companies Regulations 2001 (not the Companies Act 2006) with an instrument of incorporation, at least one director and shareholders (investors). An OEIC must have an authorised corporate director (ACD), who must be an FCA-authorised person, who is responsible for managing the fund. Typically, the ACD is the OEIC's sole director. The legal ownership of an OEIC's portfolio will be vested in the depositary or its nominee. However, in contrast to AUTs and ACSs, the beneficial interest in the portfolio will be vested in the OEIC itself and not in its shareholders. An AUT is a trust and, as such, has no separate legal personality under English law. It is constituted by a trust deed made between the trustee and the fund manager. The trustee holds the assets (investments) on trust for the beneficiaries (investors), who are known as 'unitholders', since their beneficial interests are represented by 'units' under the trust. Unlike an OEIC or AUT, an ACS is a transparent vehicle constituted either as a co-ownership scheme or limited partnership. A co-ownership scheme is constituted by an agreement between the fund manager and the depositary (custodian), under which the investors' rights to the assets are similar to those of AUT unitholders.

Any of these vehicles, except an ACS constituted as a limited partnership, can be an umbrella fund, with underlying sub-funds. The property of a sub-fund may be used only to discharge the liabilities of that sub-fund. Each sub-fund of an umbrella is therefore individually ring-fenced.

Closed-ended retail funds

Closed-ended retail funds established in the UK are typically companies listed on the LSE's Main Market (called investment trusts, venture capital trusts or real estate investment trusts, each taking corporate form despite the name). An investment trust is typically a UK public company that meets the eligibility conditions in section 1158 of the Corporation Tax Act 2010 (CTA 2010), that satisfies certain other requirements on an ongoing basis, and that has been approved as an investment trust by Her Majesty's Revenue and Customs (HMRC). These vehicles do not constitute a CIS under FSMA and so are not subject to the restriction on promotion of CISs set out in section 238 of FSMA. The Main Market is the most liquid market in the UK (offering the widest investor base). Funds listed on the Main Market can accordingly be marketed to retail investors and also qualify for inclusion in institutional investors' mandates limited to investments listed on a regulated market, subject to local law regulation which will need to be checked. Shares in an investment trust must be admitted to trading on a regulated market, and the investment trust must comply with requirements including investment diversification in order to qualify for favourable tax treatment.

Some investment companies are traded on the LSE's Alternative Investment Market (AIM) or its Specialist Fund Segment (SFS). AIM is an exchange-regulated market, not a UK regulated market. As such, it is generally easier and quicker for a fund to make an initial offering of its shares on AIM rather than on the Main Market (and also follow-on offerings), provided the offering is limited to institutional investors, because compliance with the retained EU law version of the Prospectus Regulation 2017/1129/EU (UK Prospectus Regulation) is not then required. The Specialist Fund Segment is designed for specialist investment funds targeting only professional, professionally advised, institutional or knowledgeable investors. Compliance with the UK Prospectus Regulation is required. There are also special LSE regimes for venture capital trusts and real estate investment trusts.

Most investment companies listed or traded on the LSE are classified as alternative investment funds (AIFs) under the Alternative Investment Fund Managers Regulations 2013, with the exception of those real estate investment trusts which have a commercial, not an investment, purpose.

Laws and regulations

13 What are the key laws and other sets of rules that govern retail funds?

The establishment and operation of open-ended retail funds in the UK are governed by the FSMA, various statutory instruments made under FSMA and the FCA Handbook (in particular, the FCA's Collective Investment Schemes Sourcebook (COLL)). In addition, the retained EU law version of the Packaged Retail and Insurance-based Investment Products Regulation 1286/2014/EU (UK PRIIPs Regulation) applies to all investment funds that are available to retail investors (each a PRIIP) except UK and EEA UCITS funds that are exempted until 31 December 2021. This exemption was maintained in the UK PRIIPs Regulation for all UCITS, including EEA UCITS, so that both UK and EEA funds can continue to adhere to the existing disclosure framework for UCITS until the exemption ends, and so that investors in UK and EEA UCITS can continue to receive the same disclosures for similar investment products. The UK PRIIPs Regulation requires a standardised pre-contractual key information document for each fund. If and when that Regulation applies to UCITS, this would replace the equivalent key investor information document currently required by virtue of the UCITS Directive. Specialised rules apply to UK UCITS funds that are money market funds (MMFs) under the retained EU law version of the Money Markets Fund Regulation 2017/1131/EU (UK MMFR), including liquidity management procedures and a prohibition on external financial support (such as a guarantee). Notably, the EU Packaged Retail and Insurance-based Investment Products Regulation 1286/2014/EU continues to apply to UK firms that manufacture, sell or advise on PRIIPs to retail investors in the EU.

Authorisation

14 Must retail funds be authorised or licensed to be established or marketed in your jurisdiction?

Open-ended retail funds

To be marketed in the UK, open-ended retail funds must either be authorised by the FCA (if established in the UK) or, in the case of EEA UCITS, be temporarily permitted by the FCA to be marketed in the UK for a limited period of time following the end of the Brexit transition period on 31 December 2020 under the temporary marketing permission regime (TMPR) or, in the case of a fund managed outside the UK, be recognised by the FCA under section 272 of FSMA. Any entity established as an open-ended retail fund in the UK must be authorised by the FCA.

Following the end of the Brexit transition period, there is no longer any specific recognition by the FCA of EEA UCITS for sale to retail investors in the UK under the since repealed section 264 of FSMA. Certain EEA UCITS which are not able to rely on the TMPR may apply to the FCA for recognition, as discussed below.

Certain open-ended retail funds considered comparable to FCA-authorised funds can be recognised by the FCA for retail sale in the UK under section 272 of FSMA. This procedure is rarely used and is potentially onerous and lengthy except in relation to certain funds established in Guernsey, the Isle of Man or Jersey and following almost identical rules to FCA-authorised funds. As referenced below, HM Treasury is looking to make the procedure more efficient.

From 1 January 2021, EEA UCITS, subject to the TMPR, need to find an alternative to passporting, to allow their sale to the retail market in the UK, although the requirement to do this will be deferred for up to three years until 31 December 2023 (and the UK government is legislating to extend that period by two years) for funds that signed up with the FCA to the TMPR by the deadline of 31 December 2020. There is a concern that the existing non-passporting fund recognition procedure is not fit for purpose with regard to the probable high volume of applications from EEA UCITS, and this has led to the proposal by HM Treasury of a new regime, the Overseas Funds Regime (OFR). OFR is intended to provide a post-Brexit legislative framework for overseas funds being marketed in the UK that will act as a more appropriate basis than section 272 for recognising overseas retail funds, including EEA UCITS, and MMFs. On 11 March 2020, HM Treasury published a consultation paper on the new OFR and a similar new regime for recognition of MMFs. The paper proposed a more streamlined regime for non-UK funds to apply for recognised status and permission to market to the retail public in the UK. Under the OFR, it was proposed that two conditions are met before equivalence is granted. First, for retail funds other than MMFs the regulatory regime applicable to them must achieve equivalent investor protection to comparable UK authorised funds; and for an MMF, the regulatory regime applicable to it must be at least equivalent to the regulations that apply to UK MMFs; in each case this is determined by HM Treasury with advice from the FCA. Second, there must be 'adequate supervisory cooperation arrangements' between the FCA and the local regulator in the relevant jurisdiction. In addition, non-UK retail funds may, under the OFR, be subject to additional requirements as a condition of being recognised in the UK. Section 272 will remain available for individual funds that are not eligible to be recognised through the regime because they are not within the scope of an equivalence determination for retail investment funds.

In order to address concerns around the need for a smooth transition for EEA UCITS from the TMPR to the OFR, the government has made changes to the TMPR. In particular, the government will legislate to extend the TMPR from three to five years, to allow enough time for HM Treasury to complete any equivalence assessments and for funds in the TMPR to apply for recognition, either through the OFR or section 272 as appropriate.

Furthermore, a power has been given to the FCA to create 'landing slots' for funds that are leaving the TMPR and applying for permanent recognition under the OFR. The two-month time limit for the FCA to consider applications under the OFR has also been disapplied for funds leaving the TMPR.

HM Treasury confirmed that under OFR, operators of funds recognised thereunder will not be deemed authorised persons, similar to the approach taken for funds recognised under section 272. This means that financial promotions for funds recognised under the OFR will need either to be approved by a UK authorised firm or fall within an exemption from section 21 of FSMA in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

Closed-ended retail funds

Closed-ended retail funds listed on the LSE's Main Market or traded on its SFS are not authorised as funds by the FCA, although the actual listing on the Main Market will require approval by the FCA in its capacity as the UK 'listing authority', and Main and Specialist Fund Segment prospectuses will require its approval under the UK Prospectus Regulation and FCA Handbook. Closed-ended funds traded on AIM are also not FCA-authorised, but will still be subject to the AIM rules. In addition, an AIM prospectus will require approval by the FCA if the shares are to be offered to retail investors. Any fund traded on AIM must appoint an independent adviser to act as a nominated adviser (NOMAD), whose function will be to confirm to the LSE the fund's compliance with the AIM rules.

Marketing

15 Who can market retail funds? To whom can they be marketed?

Open-ended retail funds authorised or recognised by the FCA, and closed-ended retail funds listed on the LSE's Main Market or traded on its SFS, can be marketed to any type of investor in the UK (although, in practice, a fund traded on the SFS will not make a retail offering, because the LSE will admit to that market only funds targeted at professional, professionally advised, institutional or knowledgeable investors). The SFS appeals to a variety of different types of investment managers, including those managing large hedge funds, private equity funds, and certain emerging market and specialist property funds, seeking admission to a public market in London. As the SFS is a regulated market, securities admitted to the market are eligible for most investor mandates providing a pool of liquidity for issuers admitted to the market. A fund traded on AIM is also, in practice, rarely offered to retail investors in the UK (any retail offering would require compliance with the UK Prospectus Regulation, and AIM-traded funds typically seek to avoid that expense). However, UK retail investors can and do acquire shares in AIM-traded funds on the secondary (as distinct from primary) market.

An entity marketing a retail fund in the UK must be an authorised firm if:

- it carries on a regulated activity by way of business in the course of marketing the fund, such as giving investment advice or arranging deals in investments; and
- it carries on that activity in the UK, subject to the overseas person exclusion.

In practice, a professional UK fund distributor, such as an independent financial adviser (IFA), is normally an authorised firm either because it gives investment advice to clients or because its distribution activities, such as taking clients' investment orders and transmitting their investment subscription monies, constitute the regulated activity of 'arranging deals' in investments.

Managers and operators

16 | Are there any special requirements that apply to managers or operators of retail funds?

The manager and trustee of a UK UCITS fund or a UK NURS, established as an AUT, must be persons who are independent of each other. Subject to the temporary permissions regime (TPR), each must be a body corporate incorporated in the UK whose affairs are administered in the UK and be an authorised firm permitted, in the case of a manager of a UK UCITS, to act as a manager of a UK UCITS, or, in the case of a manager of a NURS, to act as a manager of an AIF; and, in the case of a trustee, to act as a trustee of a UK UCITS or an AIF, as the case may be. The TPR does allow for AUTs to continue for a limited time to have as their manager or trustee an EEA firm participating in the TPR.

The manager of a UK UCITS fund established as an OEIC will usually be the ACD of the OEIC which, subject to the TPR, must be a body corporate incorporated in the UK and an authorised firm permitted to carry on the regulated activity of managing a UK UCITS. The depositary of an OEIC must also be a body corporate incorporated in the UK, an authorised firm permitted to carry on the regulated activity of acting as a depositary of a UK UCITS and be independent of the OEIC and its ACD. The TPR does allow for OEICs to continue for a limited time to have as their manager or depositary an EEA firm participating in the TPR.

The manager of a closed-ended retail fund must be an authorised firm, typically one permitted to carry on the regulated activity of managing an AIF. Alternatively, the fund itself can be authorised by the FCA as a self-managed AIF, if it has no external alternative investment fund manager (AIFM).

Under product governance rules introduced in 2018 by the FCA in the course of implementing Markets in Financial Instruments Directive II (MiFID II) and set out in chapter 3 of the FCA's Product Intervention and Product Governance Sourcebook (PROD), a firm 'manufacturing' a new fund (ie, creating, developing, issuing or designing a new fund) must identify the fund's 'target market' of 'end (ultimate) clients', ensure its distribution strategy is compatible with that market and take reasonable steps to ensure the fund is in fact distributed to that market. Typically, it will be the manager or operator of a fund that will manufacture it for these purposes, although this will not necessarily preclude a primary distributor from also being a manufacturer. Although the rules apply to non-retail funds as well as retail funds, they will, in practice, have a greater impact on retail funds, simply because the end clients and distributors will be more numerous and identifying the target market and monitoring distributors will therefore be more challenging.

Managers of an ACS, AUT or OEIC (authorised fund managers or AFMs) are required to act in the best interests of the authorised funds they manage and those who invest in those funds, under rules in the FCA's Conduct of Business Sourcebook (COBS), COLL and Principles for Businesses (the Principles). While PROD rules apply to AFMs as guidance rather than rules, the FCA does expect AFMs to carefully consider them when meeting their obligations to ensure they comply with the FCA Principles and other relevant rules. Notably, acting in line with PROD will enable AFMs to comply with some of these other requirements. As well as the guidance in PROD, the FCA states that AFMs should also consider the guidance in the Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD). RPPD sets out the FCA's view on what various rules require of providers and distributors in certain circumstances to treat customers fairly. Compliance with these product governance rules is a particular continuing focus of the FCA.

Investment and borrowing restrictions

17 | What are the investment and borrowing restrictions on retail funds?

The investment and borrowing powers for UK UCITS funds (except MMFs) are set out in the FCA's COLL Sourcebook implementing the UCITS Directive. A UK UCITS fund (except an MMF) can invest its portfolio in the following assets:

- transferable securities and money market instruments traded on an EEA or UK regulated market or on an 'eligible market' (broadly, a non-UK market listed in the UCITS fund's prospectus satisfying specified criteria). Transferable securities consist of shares, debt securities and other traded securities, such as depositary receipts;
- certain other money market instruments issued by a regulated body;
- other transferable securities and money market instruments (unlisted securities) (subject to the investment spread limit below);
- cash and near cash (including bank deposits and Treasury bills);
- units in other UCITS funds and regulated collective investment schemes, subject to conditions; and
- derivatives and forward transactions.

A UK UCITS fund (except an MMF) is subject to investment spread and concentration requirements, including:

- up to 5 per cent of its assets can be invested in transferable securities or money market instruments issued by a single body (unless the fund tracks an index, when a higher limit may apply – see below). The 5 per cent limit can be raised to 10 per cent for 40 per cent of the portfolio;
- up to 10 per cent of its assets can be invested in unlisted securities;
- up to 20 per cent of its assets can be invested in cash deposits with a single body;
- exposure to a single over-the-counter derivatives counterparty cannot exceed 5 per cent of its assets, except where the counterparty is an approved bank, where the exposure can be up to 10 per cent;

- up to 20 per cent of its assets can be invested in transferable securities and money market instruments issued by the same group (or, exceptionally, up to 35 per cent in transferable shares or debt securities issued by a single body, if the fund tracks an index);
- up to 20 per cent of its assets can be invested in units of (broadly) any one regulated collective investment scheme (eg, another UCITS fund) and up to 30 per cent in (broadly) all other regulated collective investment schemes;
- up to 35 per cent of its assets can be invested in government or public securities issued by a single body – or 100 per cent, subject to conditions, including:
  - no more than 30 per cent can be invested in a single issue; and
  - the securities must comprise at least six different issues;
- the fund cannot hold more than 10 per cent of the debt securities issued by a single body;
- the fund cannot hold more than 25 per cent of the units or shares issued by a single regulated collective investment scheme; and
- the fund cannot hold more than 10 per cent of the money market instruments issued by a single body.

A UK UCITS fund (except an MMF) can borrow up to 10 per cent of its assets on a temporary basis. It follows that, in practice, a UK UCITS fund cannot borrow for investment purposes, and so can do so only to cover redemptions of units or shares by selling investors or, if it is an MMF, not at all.

A UK UCITS fund that is an MMF must comply instead with the UK MMFR's specialised investment eligibility, spread, concentration and portfolio rules. The applicable investment portfolio rules will depend on the type of MMF and whether it is 'short-term' or 'standard'.

A UK NURS is subject to less restrictive investment spread limits than a UK UCITS fund, so that it can invest, for example:

- up to 100 per cent of its assets in real property (land);
- up to 10 per cent of its assets in transferable securities issued by a single body;
- up to 10 per cent of its assets in gold;
- up to 20 per cent of its assets in unlisted transferable securities; and
- up to 35 per cent of its assets in other collective investment schemes (including non-UK non-UCITS funds whose investment and borrowing powers are equivalent to, or more restricted than, NURSs, and other non-UCITS funds, provided that the combined value of unlisted transferable securities and those other non-UCITS funds does not exceed 20 per cent of its assets).

In addition, a UK NURS authorised as a 'fund of alternative investment funds' can invest in a range of AIFs.

A UK NURS can borrow up to 10 per cent of its assets on a permanent basis and, if it tracks an index, can invest up to 20 per cent of its assets in transferable shares or debt securities issued by a single body (or, exceptionally, up to 35 per cent).

Closed-ended retail funds

Closed-ended retail funds listed on the LSE's Main Market are not subject to restrictions on investment or borrowing, although, as a condition of listing, they must have a published investment policy covering asset allocation, risk diversification, gearing and maximum exposures. In practice, a fund will have to draw up its own set of investment restrictions and require shareholder approval to amend them.

A UK closed-ended retail fund listed on the LSE's Main Market must satisfy certain investment conditions in order to qualify for favourable tax treatment. For example, the business of the company must consist of investing its funds in shares, land or other assets with the aim of spreading investment risk and giving members of the company the benefit of the results of the management of its funds.

Tax treatment

18 | What is the tax treatment of retail funds? Are exemptions available?

Open-ended retail funds

Subject to special rules applying to tax-elected funds, property authorised investment funds (PAIFs) and Funds Invested in Non-Reporting Offshore Funds (FINROFs), AUTs and OEICs are treated as investments companies within the scope of corporation tax in the UK on profits, and may benefit from reliefs under tax treaties with other jurisdictions. They are generally exempt from UK tax on capital gains on the disposal of investments. They are taxable at a special rate of corporation tax (currently 20 per cent) on net income, subject to certain exemptions, including for most dividends received. Deductions may be available, for amounts distributed by funds primarily invested in debt securities including MMFs (bond funds) as interest distributions, subject to certain restrictions.

UK-resident individual fund investors will be subject to income tax on dividend distributions made, or if the fund adds value to accumulation units or applies the funds to reinvestment units, subject to a £2,000 annual dividend allowance. These dividend distributions are generally tax exempt for UK corporation taxpayers, such as companies, to the extent they are sourced from underlying dividend receipts; to the extent they are sourced from non-dividend income of the fund, UK corporation taxpaying investors are taxable on the distribution, but the distribution carries a tax credit that should offset the corporation tax. No withholding of tax on payment of the distributions is required.

UK-resident individual investors in bond funds will have their interest distributions generally treated as interest for income tax purposes, subject to an annual personal savings allowance under certain circumstances. UK corporation taxpayers generally need to treat interest distributions as loan relationship credits subject to corporation tax. No withholding of tax on payment of interest distributions is required.

UK-resident individual fund investors are generally subject to capital gains tax on gains realised that exceed their annual exempt amount on the disposal of units or shares in an AUT or an OEIC (excluding a FINROF). Payments of certain fund investment-related bonuses or trail commissions, for example from investment advisers, may be paid after deduction of UK tax (at 20 per cent). Non-UK resident individual fund investors are generally not directly subject to UK withholding tax (excluding investors in PAIFs receiving property income dividends), nor subject to UK capital gains tax, unless the fund (including a PAIF or FINROF) has a significant direct or indirect investment (broadly 75 per cent by gross asset value) in UK real estate.

With respect to income returns, UK-resident individual ACS investors will be treated broadly as if they had invested directly in the underlying assets, and this is also the case with respect to capital gains if the ACS is structured as a partnership. If the ACS is structured as a co-ownership scheme, it is not treated as transparent for capital gains tax from the perspective of the investor, so capital gains derived by the ACS are in effect disregarded, and UK-resident investors are taxable on any gains when they dispose of their interest in the ACS.

Closed-ended retail funds

UK investment trusts that satisfy relevant qualifying conditions (including the shares being traded on a regulated exchange, the business consisting of investing in shares, land and certain other assets to spread investment risk and most of its income being distributed annually) are exempt from tax on capital gains, but otherwise are generally subject to UK corporation tax, currently at 19 per cent. Most dividends received by an investment trust should generally be exempt from UK tax. Individual investors in a UK investment trust are generally taxed in the same way as individual shareholders in other UK companies. Investment trusts that receive interest income may elect to treat distributions of interest effectively as if they were payments of interest, and in this case the payment should be deductible for the investment trust, but taxable as interest income for the investors.

Asset protection

19 | Must the portfolio of assets of a retail fund be held by a separate local custodian? What regulations are in place to protect the fund's assets?

Open-ended retail funds must appoint an independent entity to hold their assets. This must be a trustee, for an AUT, or a depositary, for an OEIC or ACS. A trustee must be independent from the manager and established in the UK; the TPR does allow for AUTs to continue for a limited time to have as their trustee an EEA firm participating in the TPR. A depositary must likewise be established in the UK; the TPR does allow for OEICs and ACSs to continue for a limited time to have as their depositary an EEA firm participating in the TPR. Trustees and depositaries must be authorised by the FCA, since their activities as such constitute regulated activities. They will be subject to the FCA's rules on custody of assets in its Client Assets Sourcebook (CASS), which are intended to ensure that custodians observe professional standards of care and diligence, including in the appointment of sub-custodians. Depositaries of UCITS funds, and trustees, in the case of AUTs, are subject to strict liability for the loss of assets held in custody, similar to AIF depositaries.

Most closed-ended retail funds marketed in the UK are AIFs. Pursuant to the Alternative Investment Fund Managers Directive (AIFMD) under the FCA's Investment Funds Sourcebook, a UK AIFM must appoint a depositary for an AIF established in the UK. Closed-ended retail funds not required under the AIFMD to appoint a depositary, because the fund or the AIFM is established outside the EEA and UK (or the fund is managed by a sub-threshold AIFM), will, in practice, appoint a custodian, where they hold assets, such as listed securities, requiring a custodian for trade settlement purposes.

Governance

20 | What are the main governance requirements for a retail fund formed in your jurisdiction?

The registration and organisational governance requirements for UK UCITS funds established as AUTs, OEICs or ACSs are largely the same. Each must be authorised by the FCA. Application is accordingly made to the FCA with:

- a draft prospectus;
- a draft instrument of incorporation, in the case of an OEIC;
- a trust deed, in the case of an AUT, or limited partnership agreement or co-ownership deed, in the case of an ACS;
- a model portfolio;
- an application form; and
- a solicitor's certificate confirming that the constitutional documents comply with the applicable regulations.

The FCA has two months in which to consider a UCITS application.
Since 30 September 2019, FCA rules, forming part of the Asset Management Market Study, have required the manager of a UK UCITS fund or NURS to conduct an annual value assessment. This is required to discuss whether the payments out of the fund are justified 'in the context of the overall value delivered' to the fund's investors. This has to be tested against a minimum of seven prescribed criteria. The results must then be set out in the fund's annual report with an explanation of actual or proposed remedies if they show no justification. From the same date, FCA rules have required that at least a quarter, and no fewer than two, of the members of the governing body (eg, the board) of the manager of a UK UCITS or NURS are independent individuals (ie, in practice, independent of the fund manager). Tenure of such independent non-executive directors, often referred to as iNEDs, will be limited to 10 years, with reappointment allowed five years later. In part, these new FCA rules are designed to address FCA concerns about 'closet trackers' (ie, actively managed retail funds that in fact deliver a return not unlike that of passively managed funds that follow the performance of specified benchmarks, and that usually carry much lower fees).

Most UK closed-ended retail funds, as distinct from their managers, are outside FCA regulation, although the manager, or the fund itself if (unusually) self-managed, will be subject to FCA regulation. A listed or exchange-traded closed-ended retail fund is subject to the governance requirements of the rules of the exchange on which it is listed or traded. In particular, the FCA's Listing Rules, applying to the LSE's Main Market, require that the majority of the fund's board of directors are independent of the investment manager.

Reporting

21 | What are the periodic reporting requirements for retail funds?

For UK open-ended retail funds, reports must be made available on request to investors and to the public generally, free of charge, annually and half-yearly. The reports must include certain prescribed information, including the accounts and, in the annual report, a report from the auditor and the trustee or depositary.

Closed-ended retail funds listed on the LSE's Main Market, or traded on its SFS or AIM, must also publish a report twice a year, with a long report annually.

UK open-ended and closed-ended retail funds must effectively report any interest distributions to the UK tax authority (HMRC), and a UK PAIF must also report property income dividends to HMRC (and withhold tax from property income dividends). Special reporting rules may apply to a fund that has a significant direct or indirect investment (broadly 75 per cent by gross asset value) in UK land (real estate).

UK open-ended and closed-ended retail funds are generally required to report prescribed account holder information to HMRC (for onward automatic exchange with the Internal Revenue Service (in relation to the US Foreign Account Tax Compliance Act)) and taxation authorities in the EU and other Organisation for Economic Co-operation and Development (OECD) participating jurisdictions (in relation to the OECD common reporting standards).

Issue, transfer and redemption of interests

22 | Can the manager or operator place any restrictions on the issue, transfer and redemption of interests in retail funds?

UK open-ended retail funds must offer to issue and redeem (buy back) shares or units to or from investors on every dealing day. There must be at least two dealing days in each month, at least a fortnight apart. Retail funds can limit the number of shares or units in issue, provided this complies with the fund prospectus. Retail funds with a daily dealing day may defer redemptions to the next dealing day, if redemption requests for a particular day exceed 10 per cent of the fund's value, or some other reasonable proportion stated in the prospectus, subject to certain conditions. Dealing in open-ended retail funds may also be temporarily suspended under exceptional circumstances and where justified in the interests of unitholders or shareholders. This must be immediately notified to the FCA. Recently, many UK open-ended real estate funds suspended usual dealings as a result of difficulties in valuing fund assets because of the covid-19 crisis. In addition, specialised rules apply to the suspension of redemptions by UK UCITS funds that are MMFs under the UK MMFR's liquidity management procedures. A UK NURS can impose limited redemption arrangements (to limit redemptions for up to every six months) if it is a property fund, has an investment objective providing for a specified level of return (capital protection) or is a fund of alternative investment funds.

Shares in UK-listed or exchange-traded closed-ended retail funds are dealt in on-exchange. It will usually be a condition of listing or admission to trading, and of admission of the shares to a trade settlement system, that there are no restrictions on share transfer, although limited restrictions (such as on transfers to US persons) can be permitted. A UK closed-ended retail fund can repurchase its shares out of distributable profits, a method sometimes used to reduce a discount of the trading price to the fund's net asset (net investment) value.

NON-RETAIL POOLED FUNDS

Available vehicles

23 What are the main legal vehicles used to set up a non-retail fund? How are they formed?

As there are no UK non-retail tax-exempt fund vehicles (other than unauthorised unit trusts that are open only to UK tax-exempt unitholders), non-retail funds (other than limited partnerships) are normally established in offshore jurisdictions outside the UK.

Non-retail closed-ended funds (such as private equity funds) are normally established as English or non-UK (offshore) limited partnerships, and non-retail open-ended funds (such as hedge funds) are normally established as offshore open-ended companies or trusts. Scottish limited partnerships, which have separate legal personality, are sometimes used as non-retail fund vehicles (such as for private equity carried interest schemes) as they better protect limited partners from liability, while still being tax-transparent). The Cayman Islands and Ireland are commonly used offshore jurisdictions for non-retail investment companies and the Cayman Islands, Guernsey and Jersey are commonly used offshore jurisdictions for non-retail limited partnerships. Further, Guernsey or Jersey are typically used for forming non-retail exchange-listed closed-ended vehicles.

Laws and regulations

24 What are the key laws and other sets of rules that govern non-retail funds?

Non-retail funds are governed by the law of their jurisdiction of formation. Provided that they are only offered to professional investors, offshore jurisdictions generally impose relatively light requirements on these vehicles' establishment and operation.

UK-based managers of non-retail funds are subject to UK law that implemented the EU Alternative Investment Fund Managers Directive (AIFMD), as they carry on the regulated activity of managing an alternative investment fund (AIF), unless they carry on portfolio management as a delegate of another manager, in which case they would instead be subject to UK law that implemented the EU Markets in Financial Instruments Directive II (MiFID II)). The AIFMD requirements (such as the requirement to appoint a depositary) apply directly to the alternative investment fund manager (AIFM) in relation to an AIF, and so indirectly apply to the AIF. Further, certain types of non-retail UK AIFs may qualify as a venture capital fund or social entrepreneurship fund under UK law applying to AIFMs.

Authorised unit trusts (AUTs), open-ended investment companies (OEICs) and authorised contractual schemes (ACSs) can be established in the UK as qualified investor schemes (QISs), which are a type of scheme authorised by the Financial Conduct Authority (FCA) that have limited investment restrictions and are available only to professional and sophisticated retail investors. Due to this restriction, few QISs have been established in practice. They constitute AIFs (and so are subject to UK law implementing the AIFMD), but must also comply with additional requirements (such as the genuine diversity of ownership condition) to qualify for the tax treatment for an AUT or OEIC.

A UK AIF that is a money market fund is also subject to the requirements under the EU Money Markets Fund Regulation 2017, as retained and amended in UK law, such as rules on liquidity management procedures, a prohibition on external financial support and specialised investment eligibility, spread, concentration and portfolio rules. The applicable investment portfolio rules depend on the type of money market fund and whether it is 'standard' or 'short-term'.

Authorisation

25 Must non-retail funds be authorised or licensed to be established or marketed in your jurisdiction?

The UK manager of a non-retail UK or non-UK fund (AIFM) must usually be authorised under the Financial Services and Markets Act 2000 (FSMA) to carry on a regulated activity such as managing an alternative investment fund (AIF) or discretionary portfolio management. UK AIFMs are subject to the UK rules implementing the AIFMD for all purposes, unless they qualify as sub-threshold' AIFMs (see below). The fund itself cannot be authorised or licensed, except if it qualifies as a long-term investment fund (LTIF), which must be authorised under the EU LTIF Regulation, as retained and amended in UK law. LTIFs must mainly be invested in small companies and can only allow investors limited redemption rights. They can be marketed in the UK to non-retail investors and (subject to conditions) retail investors.

Sub-threshold AIFMs are broadly AIFMs whose aggregate assets under management across the entire portfolios of their AIFs do not exceed €100 million or, if the AIFs are all unleveraged and provide no redemption rights for the first five years, €500 million. While sub-threshold AIFMs are subject to only a limited AIFMD regime, most must still be authorised under FSMA and comply with FCA rules.

As to marketing in the UK to professional (ie, non-retail) investors:

- a UK AIF managed by an above-threshold UK AIFM can be marketed in the UK, subject to approval by the FCA and compliance with the AIFMD and the general UK financial promotion regime;
- a non-UK AIF managed by an above-threshold UK AIFM can be marketed in the UK, following notification to the FCA and subject to compliance with the AIFMD and the general UK financial promotion regime;
- a UK or non-UK AIF managed by a non-UK AIFM (including a sub-threshold non-UK AIFM) can be marketed in the UK, following notification to the FCA and subject to compliance with the AIFMD and the general UK financial promotion regime; and
- an AIF managed by a sub-threshold UK AIFM can be marketed in the UK, subject to compliance with the general UK financial promotion regime.

Marketing

26 Who can market non-retail funds? To whom can they be marketed?

Subject to certain conditions, non-retail funds can broadly be marketed in the UK by UK or non-UK AIFMs to professional investors (ie, professional clients within the meaning of MiFID II, including individuals and local authorities satisfying the conditions to be treated as professional clients). It can often be difficult in practice for individuals and local authorities to satisfy these conditions. Separately, the UK financial promotion requirements allow non-retail funds to be marketed to certain other types of institutional and individual investors (such as local authorities and certified sophisticated investors), subject to conditions on the promotion's content.

Subject to certain exemptions, a person marketing a non-retail fund in the UK must generally be FCA-authorised if it carries on in the UK a regulated activity in the course of marketing the fund, such as arranging deals in investments in the fund or giving investment advice to investors on investing in the fund.

UK intermediaries (such as those advising managers on their UK marketing strategy or finding prospective UK investors) are typically FCA-authorised in practice.

Ownership restrictions

27 Do investor-protection rules restrict ownership in non-retail funds to certain classes of investor?

There are no UK investor-protection rules that restrict ownership of non-retail funds to certain classes of investor, although there are rules that restrict the marketing in the UK of non-retail funds to certain types of investors. Further, certain types of investors (such as UK pension funds) are subject to restrictions on the types of investment they can make (such as for risk management or prudential reasons). FCA-authorised persons must in addition ensure that any investment recommended to a retail or non-retail client is suitable for the client and that any 'complex' financial products, including non-retail funds, sold on an execution-only basis to retail clients (ie, without advice) are appropriate for the client.

Managers and operators

28 Are there any special requirements that apply to managers or operators of non-retail funds?

UK AIFMs are subject to requirements under the FCA's rules on (among other things) risk and liquidity management, valuation, financial resources, delegation, appointing a fund depositary, investor disclosure, regulatory reporting and anti-asset stripping. These rules generally reflect the requirements under the EU AIFMD. The manager of a non-retail fund must additionally comply with any applicable local rules of the jurisdiction in which the fund is established.

Tax treatment

29 What is the tax treatment of non-retail funds? Are any exemptions available?

Funds structured as partnerships are generally not treated as taxable entities for UK tax purposes, but instead the investors are treated as having invested directly in the underlying partnership assets.

Funds structured as offshore companies are taxable entities, but generally would not be subject to tax in the UK unless they derive certain UK source income (such as certain interest and some real estate related income or gains), or if they are treated as trading in the UK for UK tax purposes. An asset manager transacting in the UK on behalf of an offshore company potentially results in the company being treated as trading in the UK, but typically the manager should qualify for the UK's investment manager, provided the manager is sufficiently independent from the fund.

UK non-resident fund investors are generally not subject to UK capital gains tax nor UK corporation tax on chargeable gains, unless the offshore fund has a significant direct or indirect investment (broadly 75 per cent by gross asset value) in UK land (real estate), in which case a special regime applies.

Offshore corporate funds (and some contractual funds, but not offshore partnerships) may fall within the UK offshore funds rules, under which UK-resident investors will generally be subject to income tax on disposals of interests in the fund, although some exemptions apply – particularly if the fund invests primarily in unlisted trading companies. If, however the fund elects to, and continues to qualify as, a reporting fund (which requires approval from HM Revenue and Customs (HMRC)), UK resident investors will be subject to income tax on income as it accrues (whether or not it is distributed), but should still qualify for capital gains tax on disposals of interests. Special rules can apply to prevent double counting in relation to the taxation of holdings in a reporting fund, and special rules can also treat distributions from bond funds broadly as if they were interest for tax purposes and require UK corporation taxpayers to pay tax on bond fund holdings on an annual fair value basis.

Asset protection

30 Must the portfolio of assets of a non-retail fund be held by a separate local custodian? What regulations are in place to protect the fund's assets?

Under UK law that implemented the AIFMD, a UK manager of a UK AIF must appoint a depositary to hold the AIF's assets as its custodian and perform certain other oversight duties, such as monitoring the AIF's asset valuation process and cash accounts. The depositary is strictly liable for the loss of any of the AIF's assets by itself, as custodian, or by a sub-custodian of any of the AIF's assets, unless it can prove that the loss resulted from an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts by it to the contrary. Depositaries carrying on business in the UK are also subject to the FCA's Client Assets Sourcebook (CASS) rules on custody of assets that are intended to ensure that custodians adhere to professional standards of care and diligence, including in the context of appointing sub-custodians.

A UK manager of a non-UK AIF that is not marketed in the UK is not required to appoint a depositary. A UK manager of a non-UK AIF that is marketed in the UK must appoint one or more entities to perform only the custody and monitoring ('depositary-lite') functions and the strict liability rule does not apply.

Governance

31 What are the main governance requirements for a non-retail fund formed in your jurisdiction?

The UK AIFM of a non-retail UK AIF must normally be authorised by the FCA to carry on the regulated activity of managing an AIF. A UK full-scope AIFM must apply for FCA approval to market in the UK a UK AIF and must provide the FCA with the AIF's details and a copy of its prospectus. The FCA then has 20 working days in which to grant or refuse approval for marketing the AIF.

A full-scope UK AIFM must notify the FCA before marketing a non-UK AIF in the UK and provide certain information to the FCA. The AIFM can market the AIF immediately after submitting the notification, although AIFMs in practice wait for the FCA's acknowledgement of the notification, which usually takes a day or so.

While a UK AIF is not itself subject to organisational rules, its AIFM is subject to organisational rules and must periodically disclose to investors information on the AIF.

Reporting

32 What are the periodic reporting requirements for non-retail funds?

A full-scope UK AIFM must, for each UK AIF it manages and for each UK or non-UK AIF it markets in the UK:

- make available an annual report that contains the AIF's financial statements and certain disclosures, such as the total remuneration (split into fixed and variable amounts) paid by the AIFM to its staff, and the total remuneration paid to its senior management and staff members whose actions materially impact the AIF's risk profile;

- disclose certain information on the AIF (such as changes in its risk profile, liquidity or leverage) to its investors on a periodic basis; and
- regularly report to the FCA (Annex IV reporting) on, among other things, the AIF's risk profile, asset categories and principal exposures.

SEPARATELY MANAGED ACCOUNTS

Structure

33 | How are separately managed accounts typically structured in your jurisdiction?

A separately managed account is typically structured in the UK by the client appointing an investment manager with full discretion to conduct acquisitions and dispositions of investments in the client's account. A discretionary mandate is contractually agreed by the parties in the form of an investment management agreement that contains specific investment guidelines, including any investment objectives and restrictions of the client. Investments in the account are usually held by a custodian appointed under a custody agreement.

Key legal issues

34 | What are the key legal issues to be determined when structuring a separately managed account?

The terms of a separately managed UK account (including the rights and obligations of the investor and manager) are typically set out in an investment management agreement between the investor and manager. The parties will often engage in detailed negotiations prior to entering into the agreement. An investor will seek to negotiate terms that relate in particular to:

- the manager's fees (including any performance fee);
- the manager's required standard of care (such as reasonable care and the avoidance of negligence, or only the avoidance of gross negligence);
- reporting arrangements;
- any limitation on the manager's liability (such as to the value of the assets under management);
- any indemnity provided by the manager to the client (such as for losses where the manager breaches its standard of care) or by the client to the manager (such as for losses where the manager acts within its authority); and
- the term (duration) and termination of the agreement (including circumstances giving rise to removal of the manager).

Financial Conduct Authority (FCA) rules relating to, for example, client categorisation, record-keeping, best execution, outsourcing, aggregation and allocation of client orders, conflicts of interest and risk management, will apply to the manager.

Regulation

35 | Is the management or marketing of separately managed accounts regulated in your jurisdiction?

The management of a separately managed account in the UK will comprise the regulated activity of the discretionary management of investments and, subject to certain exemptions, require FCA authorisation.

A separately managed UK account would unlikely constitute an alternative investment fund or a collective investment scheme. Marketing a separately managed account to UK investors would be subject to the general UK financial promotion regime. Subject to certain exemptions, a non-authorised person can broadly market a separately managed account in the UK only to certain categories of investors, such as professional investors, local authorities, high-value trusts (for example private sector pension funds), high net worth companies, certified high net worth individuals and certified sophisticated investors. Subject to adhering to FCA rules on suitability and investor communication (such as the requirement for any communication to be fair, clear and not misleading), authorised persons can broadly market a separately managed account to any UK investor.

GENERAL

Proposed reforms

36 | Are there proposals for further regulation of funds, fund managers or marketers of funds in your jurisdiction?

Following the UK government's announcement in spring 2020 that it would carry out a review of the UK funds regime, in January 2021 it published a call for input on this review. The review covers the UK's approach to funds taxation and regulation, and opportunities for reform. Its main objective is to identify options to make the UK more attractive for establishing, managing and administering funds and to support a broader range of investments that are better suited to investors' needs. Stakeholders were invited to provide comments by 20 April 2021 on which reforms should be taken forward and how those reforms should be prioritised. The government is now assessing responses and will consult on any specific proposals for reform.

While certain measures relating to the cross-border distribution and pre-marketing of alternative investment funds (AIFs) and undertakings for collective investment in transferable securities (UCITS) are to take effect in the EEA in August 2021, these measures have not been adopted in the UK.

Further, while the new capital requirements under the EU Investment Firms Regulation (IFR) and EU Investment Firms Directive (IFD), which take effect for EEA investment firms on 26 June 2021, will not apply in the UK, the FCA is proposing to introduce by January 2022 a new UK investment firm prudential regime for investment firms that is based on the IFR and IFD.

Public listing

37 | Outline any specific requirements for stock-exchange listing of retail and non-retail funds.

Most closed-ended funds listed on the London Stock Exchange (LSE)'s Main Market will qualify as AIFs, but their listed status will allow them to be marketed to retail investors. Those funds are typically listed in the premium segment and the specialist fund segment of the LSE's Main Market and less commonly on the Alternative Investment Market (AIM). Many open-ended UCITS exchange-traded funds are also listed on the LSE's Main Market.

Overseas vehicles

38 | Is it possible to redomicile an overseas vehicle in your jurisdiction?

An overseas fund cannot be redomiciled into the UK by means of transferring its place of incorporation and registered office or a cross-border merger. However, a scheme of arrangement can be put in place, subject to the local law governing the overseas fund, whereby an overseas fund is liquidated and investors receive interests instead in a UK fund.

Foreign investment

39 | Are there any special rules relating to the ability of foreign investors to invest in funds established or managed in your jurisdiction or domestic investors to invest in funds established or managed abroad?

Other than restrictions on fund marketing, there are no special rules in this regard. However, the UK government has proposed draft legislation, the National Security and Investment Bill, that reforms the UK's foreign investment rules, introducing mandatory and voluntary notification requirements on grounds of national security for transactions involving an acquisition of shares or voting rights above certain thresholds in a sensitive sector (eg, defence, energy, communications or transport). The new legislation is expected to come into force in late 2021 and certain requirements are intended to apply retrospectively.

Funds investing in derivatives

40 | Are there any special requirements in your jurisdiction relating to funds investing in derivatives?

The EU European Market Infrastructure Regulation 2012 (EMIR) regulates over-the-counter (OTC) derivatives trading in the EEA and UK. In relation to over-the-counter derivatives trades in the EEA or UK by UK funds, EMIR imposes the following obligations:

- trade reporting to a registered EEA trade repository. A fund manager may delegate this obligation – for example, to the counterparty to the trade;
- clearing of certain trades by an authorised EEA or UK central counterparty (CCP) or a recognised non-EEA and UK CCP, if the fund is a UCITS or an AIF established in the UK or EEA, or managed by a regulated EEA or UK AIFM and the counterparty is (broadly) a financial professional or, if not, meets specified financial criteria. Classes of OTC derivatives that are subject to central clearing are those that have been identified for this purpose by the European Securities and Markets Authority; and
- risk mitigation in relation to trades not subject to the clearing obligation, including variation margin requirements, if the fund and counterparty are as above, trade confirmation and reconciliation, agreed dispute resolution procedures and portfolio compression. Additional initial margin requirements are still being phased in and some buy-side firms may have to post initial margins for the first time from 1 September 2021 where they have an average aggregate notional amount of uncleared derivatives of over €50 billion, calculated on a group level, including UK and non-UK group members. This is a date that, subject to final confirmation from EU legislative authorities, has been put back by one year as a result of the covid-19 pandemic.

UPDATE AND TRENDS

Recent developments

41 | Are there any other current developments or emerging trends in your jurisdiction that should be noted? Please include reference to world-wide regulatory concerns, such as restrictions on foreign ownership in strategic industries, high-frequency trading, commodity position limits, capital adequacy for investment firms and 'shadow banking'.

Fund liquidity continues to be a key focus of UK regulators and, as part of their joint review of liquidity mismatch in open-ended funds, the Financial Conduct Authority (FCA) and Bank of England (BoE) published in March 2021 the results of their survey on liquidity management practices for UK-authorised open-ended funds, which illustrate the divergences in funds' approach to liquidity management. The results indicate that while authorised open-ended funds have a large number of liquidity management tools at their disposal, they use swing pricing more frequently than other tools. Further, following the FCA's consultation on measures seeking to reduce liquidity mismatch in authorised open-ended property funds, which closed in November 2020, the FCA looks likely to publish a policy statement at some point in 2021. Under the proposed new rules, investors would have to notify fund managers in advance of their intention to redeem their investment in authorised open-ended property funds.

In a similar vein, the UK government has committed to launching by the end of 2021 a new UK-authorised open-ended fund vehicle, the long-term asset fund (LTAF), which is aimed at allowing investors, especially defined contribution pension schemes, to invest more confidently in illiquid assets (such as infrastructure and venture capital).

Sustainability also continues to receive growing regulatory attention. Environmental, social and governance (ESG) factors are the focus of a recent package of EU legislative initiatives, including the new EU Sustainable Finance Disclosure Regulation (SFDR), which has required, from 10 March 2021, EU fund managers to make sustainability-related investor disclosures, consider how their investment decision-making processes incorporate sustainability risks and integrate ESG considerations into their controls and risk management processes. While the UK is not implementing the SFDR, the UK government has announced that it will introduce disclosure rules aligning with the recommendations of the Task Force on Climate-related Financial Disclosures, and that the UK will implement a taxonomy for environmentally sustainable activities that will be based on scientific metrics in the EU taxonomy. The FCA has said that it recognises the benefits of internationally aligned approaches.

Further, the transition from London Inter-bank Offered Rate (LIBOR) to the Sterling Overnight Indexed Average (SONIA) and other alternative reference rates at the end of 2021 has been identified by the FCA as one of the main challenges the financial services sector faces this year. The FCA announced in March 2021 that panel bank submissions for all sterling, euro, Swiss franc and Japanese yen LIBOR settings will cease after 31 December 2021, with US dollar LIBOR setting following suit after 30 June 2021. A report published in July 2020 by the Investment Association showed that significant progress has been made by the fund management industry in transitioning away from LIBOR.

While uncertainty relating to the post-Brexit cross-border framework for financial services also remains, the UK and the EU announced in March 2021 that they had concluded technical negotiations on the text of a memorandum of understanding that formalises voluntary regulatory cooperation between them in financial services. From a domestic law perspective, UK rules based on EU laws that affect funds and fund managers have changed very little following the end of the Brexit transition period on 31 December 2020 and will continue to broadly follow those EU laws in the immediate future.

A wide consultation of the UK funds regime was initiated in January 2021, and this includes a number of tax issues that may have an impact on the attractiveness of the UK as a funds jurisdiction. The consultation process will also cover the VAT treatment of fund management fees.

Coronavirus

42 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

The FCA offered various relief measures to fund managers in light of the pandemic, such as by delaying annual and half-yearly reporting deadlines and by easing its regulatory approach in several key areas – including in relation to best execution, call recording, best execution reporting, certain requirements under the senior managers and certification regime and professional qualifications and examinations. While many of these relief measures have now ended, as the FCA considers that businesses have had time to adjust to the changed environment, certain of the measures remain in place.

For instance, the FCA confirmed in February 2021 a two-month extension to the deadline for submitting annual report and accounts due up to 31 July 2021, where the impacts of the pandemic have made it impractical to finalise audited financial statements. Further, the FCA confirmed in March 2021 an extension to the end of 2021 for temporary relief from requirements for submitting quarterly execution quality reports and making investor notifications upon a 10 per cent depreciation of portfolio value. Fund managers should continue to consult the FCA's dedicated resources webpage on the pandemic.

The FCA has said that while the industry has responded well to the pandemic, there is now a need to move towards focusing on longer-term impacts, such as operational resilience, financial resilience and acting with integrity. It has said that the pandemic and Brexit have reinforced the need for outcome-based regulation and that the FCA now has the opportunity to look at its rulebook, focusing more on promoting outcomes that serve the public interest than on tick-box compliance.

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