Financial Services Bill: New process for the recognition of overseas retail funds after Brexit transition period

November 2020
New equivalence regimes for foreign investment retail funds

On 21 October 2020, the Her Majesty’s Treasury (HM Treasury) introduced the Financial Services Bill to the House of Commons (lower house of the UK Parliament). Amongst other things, the Financial Services Bill (hereinafter “the Bill”) introduces new equivalence regimes for foreign investment retail funds and money market funds. These equivalence regimes will simplify the process for overseas investment funds to be marketed in the UK, after the Brexit transition period, which is due to end on 31 December 2020. These new regimes will be known collectively as the Overseas Funds Regime (OFR).

NB: Retail investment funds that are not covered by the OFR will still be able to apply for recognition on an individual basis under section 272 of the of the Financial Services and Markets Act 2000 (FSMA).

Equivalence for retail funds and Market Entry

The Bill seeks to amend the FSMA by inserting new provisions on recognition under the OFR. The OFR will apply to both EEA and non-EEA jurisdictions. HM Treasury will firstly have the power to grant equivalence, by issuing a country-specific regulation, approving a jurisdiction and specifying the category of funds, subject to certain conditions. Secondly, foreign funds, which are eligible to benefit from an equivalence, will be able to apply to the Financial Conduct Authority (FCA) for recognition. Once recognised by the FCA, they will be able to be marketed to UK retail investors. HM Treasury will grant equivalence for retail funds to an overseas country if it judges that

- The law and practice of the jurisdiction provide at least equivalent protection to investors or potential investors as that afforded to investors or potential investors in comparable UK schemes; and
- There are adequate arrangements for cooperation between the FCA and the financial regulator of the jurisdiction.

HM Treasury will also have the power to impose additional requirements on funds recognised under the OFR if it deems it necessary to ensure a greater level of comparability and consistency with the regulation of schemes in the UK. The additional requirements will be specific to the equivalence determination for a particular country or territory. In addition, the FCA will be able to make or amend its rules to give effect to any additional requirements.

The FCA will have the power to determine the manner and form in which applications for recognition under the OFR are to be made by foreign funds. Foreign funds will have to include in their application the address of their UK facilities agent.

The FCA will be able to request additional information from the foreign fund in relation to its application for recognition. If the FCA is satisfied that the fund complies with all the relevant requirements in the FSMA, it must issue a written notice granting recognition under the OFR within two months of the FCA receiving a complete application, containing all the information it requires.

NB: The two-month time limit for approval will not apply to funds that are in the TPR and applying for recognition under the OFR during their allocated landing slot.

An overseas fund that can no longer benefit from the OFR because the equivalence from which it could benefit has been modified or withdrawn by HM Treasury would instead have to apply for recognition under section 272 to be able to continue being marketed in the UK.

Recognition of retail funds

1. Equivalence determination

HM Treasury will be able to grant equivalence to retail funds to an overseas country if it meets the “equivalent investor test” and if there are adequate arrangements for cooperation between the FCA and the financial regulator of the country.

2. Recognition of retail funds

Individual retail funds from that country must apply to the FCA to have their recognition confirmed.

Amendments to section 272 of the FSMA

Section 272 of the FSMA will remain available for foreign funds that cannot benefit from recognition under the OFR. This could either be because the fund is domiciled in a country or territory that has not been granted equivalence by HM Treasury for retail funds or because it not a specific category of funds that has been described in such an equivalence determination.

The Bill will make amendments to section 272, namely:

- The OFR will be the default recognition route and if it is not available for the applicant fund, it will be able to apply for recognition under section 272;
- The Bill clarifies that recognition under section 272 applies at sub-fund level in case of an umbrella.

In addition, it will no longer be required to provide the FCA with written notice of all changes to funds recognised under section 272; only material changes will have to be notified to the FCA (e.g. changes to the name or address of the operator or depositary or UK facilities agent of the scheme).

Next steps

The Bill will be subject to the usual processes of legislative scrutiny in both Houses of the UK Parliament (the House of Commons and the House of Lords). Once both Houses of Parliament have agreed, it will move forwards to receive Royal Assent at which point the Bill will become law. The timing will be subject to the UK Parliament’s schedule.

Furthermore, the Bill provides a general legal framework but the operational details of the processes described above will have to be elaborated by the FCA.

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