

# Distributing EU funds in the UK

Considerations for EU investment firms

June 2022



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# Introduction

As a transition measure the UK established the **Temporary Marketing Permissions Regime (“TMPR”)** to allow EU funds which were passporting into the UK when the Brexit transition period ended to continue to be sold in the UK when the UCITS and AIFMD passporting regimes ceased. Under the UK Financial Services Act, 2020 (the “UK FSA 2020”) the **TMPR will continue until the end of December 2025.**

The UK FSA 2020 introduced a new **Overseas Funds Regime (“OFR”)** which will replace the TMPR when it ends. Non-UK funds which are aimed at UK retail investors will be able to access the UK via the OFR. The OFR introduces two new equivalence regimes, one for retail investment funds and one for money market funds.

On 21 February 2022, the [Financial Services Act 2021 \(Commencement No 4\) Regulations 2022](#) (the Regulations) were published by the UK Government. The Regulations set 23 February 2022 as the date on which the OFR came into force. However, this does not mean that the OFR is now ready to be used. While the OFR is now in law, there are a number of steps that the UK Government and the FCA must undertake before the regime becomes operational.

Before the OFR can be used, HM Treasury (“HMT”) must assess and make a positive equivalence decision that another country’s regulatory regime for a specific type of investment fund is deemed equivalent. Once HMT has made a positive equivalence determination for a specific jurisdiction and fund type, the FCA will consider applications for recognition from individual firms in respect of individual funds.

Firms that have funds within the TMPR cannot apply to the FCA at their discretion: rather **they will be given a defined “landing slot”**, being a quarterly window in which they will be eligible to submit an application in respect of their funds. Given the number of funds involved, the FCA suggests that it will take around two years to work through the applications. The FCA allocated landing slots for AIFMs marketing AIFs under the UK TMPR. Any EU AIFM that wished to continue to market AIFs in the UK needed to submit a written notification to the FCA no later than 1 November 2021.

In the meantime **what can an EU Investment Firm do if it wishes to sell a new fund or sub-fund into the UK?** Currently the new fund or sub-fund which wishes to access to the UK retail market can only do it by applying under section 272 of **Financial Service and Market Act 2000 (FSMA)**. This process requires an in-depth assessment of all aspects of the individual fund, the operator, depositary, auditor, investment adviser and it is a long process. The UK Government is proposing some minor amendments to section 272 to make it more efficient for the industry and the FCA.

This process poses challenges for the EU investment firms as compliance with all the information and documentation required can be time consuming and costly.

Managers distributing funds in the UK will also need to navigate to the **UK Reporting Fund Regime**. An offshore fund that has **UK reporting fund status** is treated as if it were a UK fund for investor taxation purposes.

# Post-Brexit implications: EU fund distribution in the UK

Past regime	Current regime	Future regime
<ol style="list-style-type: none"> <li>1. European Investment Funds authorised under the EU's Undertaking for Collective Investment in Transferable Securities ("UCITS") and Alternative Investment Fund Managers Directive ("AIFMD") regimes were registered for sale in the UK using the passporting processes. This regime ceased when the Brexit transition period ended.</li> <li>2. Non-European investment funds applied to be Individually recognised overseas schemes under section 272 of FSMA for sale in the UK.</li> </ol>	<ol style="list-style-type: none"> <li>1. A Temporary Marketing Permissions Regime was established, allowing European Investment Funds authorised under the EU's Undertaking for Collective Investment in Transferable Securities ("UCITS") and Alternative Investment Fund Managers Directive ("AIFMD") to continue to be marketed until 2025.</li> <li>2. The funds which have not applied to TMPR or cannot access the TMPR must apply through the section 272 regime to get an individual recognition by FCA.</li> </ol>	<p>The TMPR will end, the only options for non - UK firms seeking to access UK retail investors are:</p> <ol style="list-style-type: none"> <li>1. Establishing a UK authorised fund;</li> <li>2. Using the OFR to distribute non-UK funds to UK retail investors; or</li> <li>3. Make use of the update section 272 regime where the OFR is not available.</li> </ol>

The FCA believes that the OFR process for individual fund applications would need to begin in December 2023.  
Are you registered for sale under the correct regime in the UK?

# Overview of the Overseas Fund Regime (OFR) in the UK

**1**

## Introduces two new equivalence regimes

- One for the **retail investment funds** and
- One for **money market funds**

**2**

## Outcomes-based equivalence

The regime is based on a broad principle of regulatory equivalence and adequate reciprocal supervisory cooperation between the FCA and the other country's regulatory authorities.

**3**

## Recognition process

Once equivalence is granted, individual funds wishing to market in the UK will need to register with or notify the FCA. The registration is to retail fund and MMF that are structured as retail funds, the notification is only to MMF wish to market to professional clients only.

**4**

## Obligations for retail funds marketing recognised

Funds recognised under the OFR will be subject to obligations such as: disclosure obligations and the payment of a regulatory fee.



# Overview of the Overseas Fund Regime (OFR) in the UK

Two conditions must be met before HM Treasury can grant equivalence to a country.

First, HM Treasury must be satisfied that the regulatory regime of the country meets the required standard on an outcomes basis:

- With respect to retail funds, the regulatory regime must achieve at least equivalent investor protection to comparable UK authorised funds;
- With respect to MMFs, the regulatory regime must be at least equivalent to the regulations that apply to UK MMFs.

Second, HM Treasury must be satisfied that there are, or there will be, adequate supervisory cooperation arrangements between the FCA and the NCA in the other country, in order to grant equivalence.

- Could take other factors into consideration, such as potential impacts on UK financial stability, market integrity, competition, preventing financial crime including adherence to international standards on anti-money laundering, and international or domestic sanctions.
- Additional requirements may be required in the case of specific categories of funds.

- Before making an equivalence determination, HM Treasury will request advice from the FCA on the regulatory regime of the overseas country.
- Equivalence determinations will be given effect through a statutory instrument

Equivalence determination could be modified or withdrawn by HM Treasury if it becomes apparent that the required standard of equivalent outcomes is unlikely to be or is no longer met. HM Treasury and FCA will engage with the overseas NCA and finance ministry with a view to rectifying the situation or outlining next steps. If it has not been possible to remedy the situation within an appropriate amount of time, it may be necessary for HM Treasury to withdraw an equivalence determination. The fund operator will be required to inform investors of the withdrawal and the consequences for them and will be eligible to apply for recognition under section 272. Once equivalence is granted, individual fund wishing to market in the UK **will need to register with or notify the FCA.**

**Retail funds** from a country with an equivalence determination, and which fall within the specified category of funds, will need to register with the FCA to gain recognition. The FCA will ordinarily have 2 months, to either confirm a fund's recognition or provide reasons why the fund is not eligible.

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**The process for MMFs** gaining market access **will depend on whether they intend to market to retail or professional clients:**

- **MMFs that are structured as retail funds** (such as UCITS) and wish to market to both retail and professional clients must either:
  - be located in a country with equivalence determinations for both MMFs and retail funds, and register for recognition under the OFR.
  - be located in a country with an equivalence determination for MMFs, and be recognised under section 272 of FSMA.

# Overview of the Overseas Fund Regime (OFR) in the UK

Funds recognised under the OFR will be subject to obligations such as:

- **Financial Ombudsman Service:** the compulsory jurisdiction of the Financial Ombudsman Service could be applied to operators and depositories of funds recognised under the OFR.
- **Alternative Dispute Resolution (ADR):** alternatively, the UK government could ensure that a requirement for granting equivalence is that UK investors have access to an appropriate ADR facility in the overseas country.
- **Final Service Compensation Scheme (FSCS):** the UK government is considering whether the FSCS should be expanded to include funds recognised under the OFR.
- **Disclosure:** the PRIIPs Regulation will therefore be the legislative default for funds marketing into the UK via the OFR.

- **The provisions of investor facilities in the UK:**

- Provision of the fund prospectus;
- The provision of information on unit prices;
- The ability to receive and pass on orders to redeem units;
- Enabling investors to make a complaint about the operation of their fund products and for these complaints to be communicated to the fund operators; and
- A UK contact point for the FCA.

- **Regular reporting to the FCA.**

- **Payment of regulatory fees.** The FCA will be able to make rules to set registration and periodic fees.



# How will the OFR operate?

## Retail Investment Funds

### 1 Equivalence determination

- HM Treasury will be able to grant **equivalence** for retail funds to an overseas country.
- HM Treasury request advice from the FCA on the regulatory regime of the relevant overseas country.

### 2 Recognition of retail fund

- Individual funds submit a **registration** form and will have their recognition confirmed by the FCA.
- Fund will be required to comply with additional requirements if the deems it necessary.

### 3 Recognised fund

- Will be able market to UK retail and professional investors.
- The retail funds marketing and financial promotions obligations in UK will be applied to the fund recognised.

## Money Market Funds

### 1 Equivalence determination

- HM Treasury will be able to grant equivalence for MMfS to an overseas country.
- HM Treasury request advice from the FCA on the regulatory regime of the overseas country.

### 2 Recognition of fund

- **Retail MMFs** will be recognised under OFR if this is located in a country with equivalence determination for both regimes (MMF and retail fund). If the country's equivalence determination is just to MMF Regime, the Retail MMF must apply to section 272 regime of FSMA to be recognised.
- **Non-retail MMFs** will submit a notification form to the FCA under National Private Placement Regime (NPPR).

### 3 Recognised fund

- **Retail MMFs** will be able to market to UK retail and professional investor.
- **Non-Retail MMFs** will be able to market to professional investor.

# Funds falling outside of the OFR

## Section 272 of the FSMA

Overseas investment funds from a country that is not recognised as equivalent will instead need to apply to distribute in the UK under **Section 272 of the Financial Services and Market Act (“FSMA”)** in order to gain access to retail investors in the UK.

Apply both to a collective investment scheme and to a “part” of a collective investment scheme (i.e. to a sub-fund).

This requires an in-depth assessment of the individual fund (and maybe an assessment of the operator and depository as well) by the FCA to ensure that the fund affords adequate protection to UK investors and meets several other UK tests.



The UK Government proposes to make some minor amendments to section 272 to make it more efficient for the industry and the FCA.

# Application under Section 272 (current process)

## Step 1: Fund Operator

- The fund operator makes an application under [form 272](#) (template).
- The application requires detailed and rigorous analysis of all aspects of the fund and the level of investor protection provided by the regime under which the fund operates.

## Step 2: FCA

The FCA will consider, among other things, whether the following requirements are satisfied:

- Adequate protection (i.e. a similar level of protection to that provided under the Act) for investors.
- The arrangements for the fund's constitution and management, and the powers and duties of the operator and of any trustee or depositary, are also "adequate".
- The FCA has 6 months in which to determine a completed application.

The [additional informations and documents](#) which will be required by the FCA include:

- Fund Incorporation and commercialization documents.
- Details of the arrangements for the marketing of units in the UK.
- An operator of a recognised scheme must ensure the prospectus:
  - contains a statement that "Complaints about the operation of the scheme may be made to the FCA."; and
  - states whether or not investors in the scheme would be covered by the compensation scheme, and if so, it must state how they are covered and who they would need to contact for further information.
- Key information document in accordance with the PRIIPs regulation.
- Annual certificate of compliance.

# Tax considerations

## UK reporting fund status regime

### Overview of regime

An offshore fund that has **UK reporting fund status** is treated as if it were a UK fund for investor taxation purposes.

Investors suffer tax on the income returns of the fund annually (whether distributed or not) but benefit from **capital gains treatment** on any gains realised on exit from the fund (and receive a tax credit for any annual income tax paid).

In contrast, any **gains realised** by an investor when exiting a non-reporting offshore fund are treated as **'income'** and are taxable at income tax rates (which are currently considerably **higher** than capital gains tax rates).

A fund must meet **equivalence** and genuine diversity of ownership (**GDO**) conditions to automatically access the UK "white list" of investment transactions.

If a fund does not meet these conditions then they can undertake a **trading vs investment analysis** to determine whether it would be considered trading or investing for UK tax purposes. UK reporting fund status is generally beneficial where the fund can access the "white list" or is considered investing for UK tax purposes.

In order to avail of the preferential capital gains tax rates on exit, funds must comply with upfront application and annual reporting requirements.

### Entry to the regime

An **upfront application** to HMRC is mandatory to enter the regime.

Each share class that wishes to enter the UK reporting regime must make an application before the **later of the financial year end** or **three months** from the share class launch date.

### Annual Reporting Obligations

Funds with UK reporting fund status meet certain **annual conditions** by reporting their 'income' returns to UK investors and HMRC.

An offshore fund that has UK Reporting Fund status will be required to **report its income annually** to both HMRC and its investors in order for UK participants to avail of preferential capital gains tax treatment upon ultimate disposal of their holding.

Any **excess reportable income** of a share class needs to be calculated and disclosed by the fund within six months of the year end

The investor is then **liable to income tax** on this reportable amount by multiplying the ERI per unit by their holding. This figure will then be included on their personal tax return.

# Tax considerations

## Other tax considerations

### Permanent Establishment Risk

It will be important to ensure that an offshore fund is not brought within the UK tax net by virtue of being considered **tax resident** in the UK and/or being deemed to carry on a trade in the UK (a so called permanent establishment). The UK permanent establishment risk is heightened where a UK investment manager carries out discretionary investment management on behalf of a non-UK fund.

### IME Exemption

There is a UK Investment Management **Exemption** ("IME") available which keeps trading profits outside the UK tax net where an independent UK agent carries out investment management services. To fall within the UK IME a number of conditions would need to be met which would need to be considered.

### UK non-resident CGT exemption

Since 6 April 2019, a **new capital gain regime** applicable to non-resident funds investing in UK rich property rich entities (e.g. UK REITs) came into force. Offshore funds may now be subject to UK corporate taxation (notification procedure and annual tax return filing) on disposal of a UK property rich entity.

Certain exemptions may be available under UK tax law or double tax treaties between the country of residence of the offshore fund and the UK, however this would depend on the facts and circumstances on a case by case basis and would need to be considered.



# How PwC can help



- Navigating on the significant changes to the process, provisions, and mechanics of cross-border funds marketing by overseas funds to UK investors.
- Obtaining Recognition Status for overseas funds by the Financial Conduct Authority (FCA) for marketing in the UK.
- Our experienced tax team can assist with all aspects of the UK reporting fund status regime; from the initial trading versus investing eligibility analysis and upfront application requirements, to preparing the annual reportable income figures for sharing with HMRC and investors.
- As market leaders in providing UK investor tax reporting services, we have experience in dealing with all complex matters which can arise in the context of the UK reporting fund status regime and have close working relationships with key personnel in local HM Revenue authorities, thus allowing us to determine their views on technical matters.
- We have extensive experience in the funds industry and, over the past years, we have built a diversified team of technology experts and tax advisors to implement solutions for our clients with the best technologies adapted to your practice and challenges, be it in the UK reporting fund status regime or any other considerations you may have in distributing your products in the UK.

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