BREXIT AND THE IMPACT OF MARKETING LISTED FUNDS INTO THE EU

After the paralysis we saw in 2020 caused by the Covid-19 pandemic and by the uncertainty around a possible no-deal Brexit, there are signs now for cautious optimism.

London Stock Exchange-traded investment funds have got off to a flying start in 2021. Already, we have had ‘Intention to Float’ notices from the Great Point ENT and the Next Energy Renewables Investment Trust. Additionally, the Cordiant fund published its Prospectus and Triple Point announced the forthcoming digital Infrastructure fund initial public offering (IPO). There is no question that, despite the secondary raises in 2020, there is a build-up of investable cash looking for an interesting home.

The confirmation of any kind of Brexit deal as well as the good news about the vaccine roll out, has perhaps contributed to the current activity in the market. The Brexit deal is light on detail relating to financial services but there are a few areas which give us some certainty.

Historically, London Stock Exchange-traded funds have been insulated from what goes on in Europe. Most investors in Investment Trusts and Real Estate Investment Trusts (REITs) are based in the UK. Those investing from overseas tend to be in jurisdictions, such as Ireland, Holland or the Nordics, which all have straightforward National Private Placement Regimes (NPPR) under the Alternative Investment Fund Managers Directive (AIFMD), so there has been no need for any UK Investment Trust to apply for the full AIFMD marketing passport. In many cases, where the Manager is not already established as an Alternative Investment Fund Manager (AIFM) in the UK, they appoint a non-European Economic Area (EEA) AIFM, for example in Guernsey (e.g. JTC Global AIFM Solutions Limited). This avoids the requirement to have a full passport and the additional requirements that brings, for instance the appointment of a Depositary.

In January 2021, the UK became a third country so any UK AIFM is now outside the EEA. One would think that this means that there is no requirement for a Depositary to be appointed to a UK Investment Trust and that a Guernsey AIFM may no longer be required. This sounds simple but does not necessarily reflect the reality. AIFMD rules have been transposed into UK law so any UK AIF that has a UK AIFM will still need a Depositary but will not have passport access to the EU.

A number of UK AIFMs redeemed EU shareholders out of their funds before the end of December 2020 because they did not have the required processes in place to follow the NPPR. They saw it as an onerous task to register every fund under NPPR once their entitlement to market under the passporting regime fell away. There is still no equivalence declaration between the EU and the UK so it is quite possible that UK AIFMs may find it difficult to market into the EU for some time. Indeed, some of the UK’s planned legislative changes might make getting an equivalence ruling difficult. Guernsey has had the requisite equivalence declarations in place for years, therefore, it may still prove to be the most straightforward option to appoint an outsourced Guernsey AIFM Management Company in order to avoid the full passport requirements.

The European Commission is questioning whether NPPRs in some EU jurisdictions cause an uneven playing field. The question is whether this should remain or be replaced by some kind of passport for managers and funds based in selected third countries which meet regulatory standards imposed by the EU.

New pre-marketing rules also come into force in August 2021. A new piece of legislation highlights a new definition of pre-marketing: “The provision of information or investment strategies or ideas.” This is not very specific or helpful. Managers will have to “adequately document” all their pre-marketing in any given EU member state.

Additionally, for a period of 18 months after having carried out any pre-marketing, there will be a restriction on reverse solicitation. Finally, there is no obligation for EU member states to allow any pre-marketing by any AIFM that is not “full scope”, which includes any non-EEA AIFMs such as UK or Guernsey AIFMs.

Fortunately, many UK Investment Trusts do not need access to most EU member states, so these changes to legislation will not have a great impact on the listed funds market. For new managers, I suspect the tried and tested route of appointing a third-party AIFM in Guernsey will still prove the simplest and most attractive route. For those managers already established as an AIFM in the UK, they will be able to simplify their future structures if they are prepared to carry out the NPPR notifications and individual reports. Alternatively, they may choose to appoint a third-party non-EEA AIFM.

Another change to be considered is the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs) in the UK. HM Treasury published a policy statement in July 2020 on the proposed approach to bringing forward amendments to onshore PRIIPs regulation. The Key Information Document (KID) has been widely criticised as being misleading and unhelpful for investors in UK Investment Trusts. In particular, the backward looking performance forecasts are irrelevant, especially for a new Investment Trust. Any change can only be an improvement. However, unfortunately, it seems that the KID will be with us in some form for the foreseeable future, albeit in a more usable format. The caveat to this is that UK AIFMs who do wish to market into the EU might need to produce two versions of their KID: one for the UK market and one for the EU market. London Stock Exchange-listed funds often do not market into the wider EU but this may cause a problem if, for instance, they wish to attract investors from Ireland.

Both the UK and the EU are intending to make a number of legislative changes in 2021. These will cover not only AIFMD and PRIIPs but areas such as Environmental, Social and Governance (ESG) and General Data Protection Regulation (GDPR).

For now the relative certainty of any kind of Brexit agreement seems to have helped to restart the market for listed funds and I am optimistic about the prospects for 2021. However, we will need to keep a watching brief on these pending changes so that we can adapt and sustain the recovery in the market.

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