EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (OVERSEAS FUNDS REGIME) (EQUIVALENCE) (EUROPEAN ECONOMIC AREA) REGULATIONS 2024

2024 No. 635

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Bim Afolami MP, Economic Secretary to the Treasury at HM Treasury, confirms that this Explanatory Memorandum meets the required standard.

2.2 Daniel Rusbridge, Deputy Director for Personal Finances and Funds at HM Treasury, confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Matilda Embling at HM Treasury (email: matilda.embling@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 The legislation establishes that, for the purposes of section 271A of the Financial Services and Markets Act 2000 (2000 c. 8) ("FSMA 2000"), HM Treasury is approving each European Economic Area ("EEA") State (this includes the 27 Member States of the European Union, and Norway, Iceland, and Liechtenstein).

4.2 The effect of this determination is to enable Undertakings for Collective Investment in Transferable Securities (UCITS) funds authorised in any EEA state, except those UCITS that are authorised as Money Market Funds (MMFs), to market to any UK client, subject to those funds being recognised to do so by the FCA.

4.3 HM Treasury is content to make this determination because it is satisfied that each EEA State meets the tests set out in sections 271B and 271C of FSMA 2000.

4.4 In relation to the test in section 271B, HM Treasury has determined that the law and practice of each EEA State in relation to the protection afforded to investors or potential investors of EEA UCITS funds (that are not MMFs) is equivalent to the UK's law and practice under which comparable authorised schemes are authorised and supervised.

4.5 In relation to the test in section 271C, HM Treasury is satisfied that adequate cooperation exists, between the Financial Conduct Authority (FCA) and the relevant regulatory authorities in each EEA State.

Where does the legislation extend to, and apply?

4.6 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.

4.7 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

5.1 The Overseas Funds Regime is an equivalence regime, legislated for as part of the Financial Services Act 2021 (2021 c. 22) ("FS Act 2021"). The Overseas Funds Regime (OFR) is the collective term given to Section 271A-271S of the Financial Services and Markets Act 2000.

5.2 The OFR was created to provide a more streamlined route for overseas funds to market into the UK compared to the existing route for recognition of overseas funds, provided by section 272 of FSMA 2000. The section 272 route requires the FCA to conduct an in-depth assessment of each individual applicant fund, before that fund can be granted recognition. The existing section 272 route is explained in further detail in paragraphs 5.18-5.20.

5.3 The OFR enables HM Treasury to grant equivalence in relation to specified categories of funds from a particular jurisdiction, where HMT is satisfied that the tests in section 271B and 271C are met. HMT is making an equivalence decision, under the OFR, in respect of each of the 30 EEA States, in relation to UCITS authorised in any of those States, except those which are also MMFs. Funds which fall within this scope can then apply to the FCA to become recognised schemes, allowing them to be promoted to all categories of client in the UK.

Marketing of EEA UCITS in the UK

5.4 UCITS are a category of fund that use capital raised from clients of the fund to invest in transferable securities, and other kinds of liquid assets, with the goal of producing profits for those clients.

5.5 Currently, around 75% of funds able to market to UK retail clients are UCITS authorised in the EEA States and are currently able to market to UK clients via the Temporary Marketing Permissions Regime ("TMPR"). However, this is a temporary regime, which the Government intends to expire at the end of 2026 (following an extension through legislation intended to be laid shortly). Unlike the TMPR, the OFR does not impose time limits on the market access it provides.

5.6 When the UK was a member of the EU, UCITS from any EEA State were able to market to UK clients under the UCITS passporting regime, which was in effect for all EEA states. Following the UK's exit, however, it was critical to develop a route to market access that ensured UK consumers still had access to a wide variety of UCITS. If EEA-authorised UCITS had not been given an alternative route to market, it is very likely the number of funds available for UK consumers to access would decline significantly.

5.7 Although the majority of UCITS available to UK clients are authorised in the EEA States (primarily in Ireland and Luxembourg) the portfolio management of many of these funds - the day-to-day oversight of the investment decisions taken by the fund - primarily occurs in the UK. This model has produced considerable value for the UK economy. The UK's asset management sector contributes around 1% of UK GDP

annually and is the second largest asset management sector in the world, behind only that of the United States.

The EEA Equivalence Assessment

5.8 Given the importance of EEA-authorised funds to UK investors, it was decided that the first jurisdictions to be assessed for equivalence under the OFR should be the EEA States.

5.9 HMT has conducted an assessment of the law and practice of each EEA State in relation to UCITS, in order to draw a conclusion as to whether the equivalent protection test (set out in paragraph 4.4 above) was met by the EEA States.

5.10 This assessment was conducted on an outcomes basis, in line with HMT's standard approach to examining other jurisdictions for equivalence, as set out in HMT's Guidance Document on the UK's Equivalence Framework.[1]

5.11 The FCA provided technical advice to support HMT's outcomes-based assessment of the law and practice in each EEA State, and on the existence of adequate cooperation arrangements between the FCA and relevant regulatory authorities in each EEA State.

5.12 Based on this assessment, HMT has concluded that the regulatory regime of each EEA State in relation to UCITS (that are not MMFs) provides a level of consumer protection that is equivalent to that provided by the regulatory regime of the UK.

5.13 Furthermore, based on advice from the FCA, HMT is also satisfied that adequate cooperation arrangements exist or will exist between the FCA and the relevant regulatory authorities in each EEA state.

Money Market Funds

5.14 The equivalence decision provided for by this instrument will not apply to UCITS authorised in the EEA as MMFs. MMFs are a specific kind of fund which invest in lower risk, short-term money market instruments.

5.15 It is possible for a UCITS fund to exist as a standalone scheme, or as an umbrella scheme with a number of sub-funds. A standalone scheme is a scheme (i.e. a UCITS fund) with one or no sub-funds. An umbrella scheme is where parts of the overall property of the scheme is separated into different sub-funds. Sub-funds are separate pools of assets which may have distinct investment aims from other sub-funds under the same umbrella. Participants in a particular sub-fund are able to exchange their rights in one sub-fund for rights within another sub-fund within the same umbrella scheme.

5.16 For the purposes of this decision, standalone schemes that are authorised in the EEA States as MMFs will not be in scope of this decision. Similarly, where an umbrella scheme has sub-funds that are authorised as MMFs, those sub-funds will not be in scope of this decision.

What was the previous policy, how is this different?

5.17 Currently, the vast majority of EEA-authorised UCITS that are able to market to UK clients are marketing through the TMPR. A fund being able to market under the OFR is different in two key respects from the TMPR:

[1] Guidance Document for the UK's Equivalence Framework for Financial Services; www.gov.uk/government/publications/guidance-document-for-the-uks-equivalence-framework-for-financial-services

- The TMPR is a temporary regime, that is due to expire at the end of 2025 (although this is planned to be extended to 2026 as part of forthcoming legislation). Once this period expires, EEA funds will no longer be able to use this route to market to UK clients. The equivalence decision for the EEA States under the OFR, in contrast, has no such time limit.
- Not all UCITS authorised in the EEA are eligible to use the TMPR. Only standalone and umbrella UCITS funds that were marketing to UK clients under the UCITS passport and who applied to the FCA to continue to do so before 31st December 2020, have been able to use the TMPR. Many new UCITS that have gained authorisation in the EEA States since this point, even though they are subject to the same regulatory requirements as UCITS that were eligible for the TMPR, have been unable to market to UK clients (unless they opt to apply for recognition under section 272 FSMA 2000). The OFR equivalence decision enables all EEA UCITS (excluding UCITS that are MMFs) to market into the UK via a more streamlined route, subject to FCA recognition of a particular fund.

5.18 The UK does have an alternative system to enable the recognition of funds from any overseas jurisdiction, including the EEA States, provided for by section 272. This process allows individual funds to apply to the FCA to become recognised.

5.19 However, the Section 272 process is very resource intensive, both for the applying fund, which has to provide a high volume of detailed information, and the FCA who need to review this information. As a result, the approvals process under section 272 can take up to a year to complete, and entail significant administrative costs.

5.20 There are a high number of UCITS (over 8000) authorised in the EEA States that are currently marketing to UK clients via the TMPR. HM Treasury anticipates there are also a high number of funds that are ineligible for the TMPR but who would potentially seek to market into the UK if a suitable marketing route became available. If no alternative routes for these funds to market to UK retail clients became available other than section 272, the large number of applications to the FCA from UCITS under section 272 would create very high costs, and time commitments, for the applying funds and the FCA. An equivalence determination for the EEA States under the OFR provides such an alternative route.

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument provides that each EEA State has been determined as equivalent for the purpose of section 271A of FSMA 2000, with regards to UCITS that are not authorised as MMFs. Those UCITS may be comprised of stand-alone schemes or as umbrella schemes.

6.2 This will allow EEA UCITS (that are not authorised as MMFs) to apply to the FCA for recognition to market to all UK investors under Section 271A(c) FSMA 2000. This will provide a more long-term marketing route compared to temporary marketing permissions, and will provide for a lighter-touch recognition process than is currently in place under the marketing route provided by section 272 of FSMA 2000.

6.3 This is the first use of this provision since it was created, in the FS Act 2021.

Why was this approach taken to change the law?

6.4 This is the only possible approach to make the necessary changes. Without making an equivalence decision for the EEA States, UCITS funds authorised in those states will

be unable to use the OFR to market to UK clients. Such funds would then be reliant on the process established by Section 272 of FSMA 2000 once the TMPR comes to an end.

7. Consultation

Summary of consultation outcome and methodology

7.1 HM Treasury has not undertaken a consultation on this instrument.

7.2 HM Treasury has already conducted a consultation on the introduction of the OFR itself, prior to its creation through the FS Act 2021. As part of this consultation, respondents emphasised the importance of the OFR ensuring continuity for EEA-authorised UCITS marketing into the UK via the TMPR. The equivalence decision in this instrument provides this continuity.

7.3 HM Treasury has also engaged with, and received advice from, the FCA in relation to the equivalence decision that will be enabled by this instrument.

8. Applicable Guidance

8.1 Further guidance is not being issued in relation to this instrument.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because, in line with Better Regulation guidance, HM Treasury considers that the net impact of this will result in an Equivalent Annual Net Direct Cost to businesses of less than £5 million a year. Due to this limited impact, a de minimis impact assessment has been carried out. A copy of this assessment is published alongside this Explanatory Memorandum on the legislation.gov.uk website.

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies because this instrument only applies directly to UCITS authorised in the EEA States.

9.3 The legislation does not impact small or micro businesses.

9.4 There is no, or no significant, impact on the public sector because the only organisations that will be directly impacted by this legislation are UCITS authorised in EEA States. The FCA will be required to process the recognition applications of each UCITS seeking to market into the UK. However, the impact on the FCA of processing these applications will be considerably lower than in a scenario where EEA-authorised UCITS need to continue to rely on section 272 of FSMA 2000 to be able to market into the UK. Furthermore, the direct impact to the FCA of considering applications for recognition will depend on the FCA's own requirements for the recognition process which will be subject to the FCA's own cost benefit analysis.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is that there is a Memorandum of Understanding between HM Treasury, the Bank of England, the Prudential Regulation

Authority and the FCA2 which states that HM Treasury may review the equivalence determination periodically or at any time, or in response to changes to the applicable framework. This does not prejudice HM Treasury's ability to revoke the equivalence determination at any time.

10.2 Each regulator may also recommend to HM Treasury that a review of the equivalence determination is undertaken in response to material changes in the applicable framework. Furthermore, each regulator may request a review of the equivalence determination if they have concerns arising from their statutory objectives.

10.3 The instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015 Bim Afolami MP, the Economic Secretary to the Treasury, has made the following statement: "It would be disproportionate to include a statutory review clause in this legislation as it does not introduce new ongoing regulatory burdens on businesses."

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2000 (Overseas Funds Regime) (Equivalence) (European Economic Area) Regulations 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").

2 https://assets.publishing.service.gov.uk/media/5da72160ed915d42a2f38d0a/equivalence_mou_october_2019_web.pdf