



Morgan Lewis

**ADVANCED TOPICS IN  
HEDGE FUND PRACTICES  
CONFERENCE**

**Manager and Investor Perspectives**

**NEW YORK**

Tuesday, June 13, 2023

# UK and Europe Funds Landscape

## Speakers



**Steven W. Stone**  
+1.202.739.5453  
[steven.stone@  
morganlewis.com](mailto:steven.stone@morganlewis.com)



**William Yonge**  
+44.20.3201.5646  
[william.yonge@  
morganlewis.com](mailto:william.yonge@morganlewis.com)

**Morgan Lewis**

# Agenda

## EU

- AIFMD review
- Proposed EU retail investment package
- SFDR (Sustainable Finance Disclosures Regulation)

## UK

- FCA regulatory focus for 23/24
- Consumer duty
- New FCA anti-greenwashing rule
- UK-EU memorandum of understanding

## US/EU/UK

- Payment for research

# AIFMD Review

## Key changes (final legislation likely H2/23, to apply in 2025)

### Delegation

- Increased emphasis on substance requirements for AIFMs and resources for monitoring and controlling delegates
- AIFMs must have at least two FTE, EU resident staff members
- ESMA to be notified (by home state regulator) of delegation by an AIFM to a third country firm of more portfolio or risk management functions than AIFM retains
- AIFMD delegation regime extended to delegation by AIFMs of non-AIF management activities – e.g. portfolio management and investment advice
- ESMA to report every two years to EU Commission on market practices relating to delegation to third country firms and carry out a peer review of supervisory practices in relation to delegation across the EU

### Loan Origination

'Originating' likely to be defined as the granting of loans by an AIF as original lender

- Originating loans to be a passportable activity of an AIF
- Loans to any AIF or UCITS, or a bank, insurer, investment firm, or other financial undertaking not to exceed 20% of AIF capital
- Specific risk-management procedures required for granting of loans, assessing credit risk, and monitoring credit portfolio
- Loans cannot be made by an AIF to its AIFM (or its staff), its depositary, or any delegate
- AIF must retain at least 5% of notional value of loans originated and sold on secondary market; 'originate-to-distribute' strategies look likely to be prohibited
- If notional value of originated loans exceeds 60% of net asset value, AIF must be closed-ended. This may be amended to allow redemptions in such circumstances if specified requirements are met
- Percentage restrictions apply on a continuing basis, so could be breached by fluctuations in capital/NAV

### Marketing/NPPRs

- NPPRs for non-EU AIFs remain but application becomes more restricted
- Country in which AIF (and its manager) is established must have entered into an OECD compliant tax information exchange agreement with member state in which AIF is to be marketed
- Country of AIF (and/or its manager) must not be on EU list of non-cooperative jurisdictions for tax purposes (BVI added February 2023)
- Country in which AIF (and its manager) is established must not be on EU list of high-risk countries for AML purposes (nb: Cayman Islands, Gibraltar, and UAE are currently listed)

# AIFMD Review

## Investor Disclosures

- Pre-contract (art 23) disclosures to investors to include:
  - a list of fees and charges to be borne by the AIFM
  - disclosure of liquidity management tools that may be used
- Periodic disclosure to investors of:
  - originated loan portfolios
  - all fees and charges directly or indirectly charged or allocated to the AIF or its investments (on a quarterly basis)
  - any parent/subsidiary or SPE established by the AIFM or affiliates in relation to the AIF's investments
- Applicable to non-EU AIFMs using NPPRs

## Depository Services

- Provision of depository services by EU credit institutions on a cross-border basis permitted pending a review by the Commission on the need for a depository passport
- Ability for a depository to use services of a central security depository without that use being regarded as a delegation

## AIFM Ancillary Services

- Permitted non-AIF management activities expanded to include benchmark administration and credit servicing

## Liquidity Risk Management

- List of liquidity management tools which AIFMs are permitted to use added to AIFMD
- Open-ended AIFs must be able to use at least one of redemption gates, notice periods, or redemption fees and may additionally use temporary suspension of redemptions (in exceptional cases)
- AIFM must notify its regulator when activating/deactivating gates, notice periods, or redemption fees
- ESMA is permitted to develop standards to specify characteristics of the listed liquidity management tools
- Power given to EU regulators to require AIFM (including non-EU AIFMs using NPPRs) to activate or deactivate a relevant liquidity management tool

## Annex IV Reporting

- Expanded by removal of limitations on information which is to be reported
- All markets, instruments, and exposures of AIF to be reported rather than principal markets and exposures and main instruments
- Applicable to non-EU AIFMs using NPPRs

# Proposed EU Retail Investment Package

- Takes form of a proposal for a directive that amends AIFMD and MiFID II, amongst other directives, published in May 2023
- Whilst focussed on retail customer promotion, not limited to that

## **MiFID II:**

- Many changes proposed, applicable to EU-based and authorised MiFID investment firms
- Eases restrictions for investors to qualify as “professional” by:
  - Reduction of the wealth criterion from EUR 500,000 to EUR 250,000
  - Adding a new criterion relating to relevant education or training giving a choice of two out of four (rather than three) criteria

# Proposed EU Retail Investment Package

## **MiFID II (continued):**

- Proposed ban on investment firms, when providing reception and transmission of orders or execution of orders to or on behalf of retail clients, from either paying or receiving any monetary inducement or providing or receiving any non-monetary benefit, in connection with such services to or from any third party responsible for the creation, development, design, or issuance of any financial instrument on which the firm provides such services

# Proposed EU Retail Investment Package

**Ban only applies where the distributor providing such services does so for execution only and where no independent advice relationship exists**

**This development is noteworthy for EU so-called “manufacturers” of investment products that are provided to retail via execution only distribution chains**



# Proposed EU Retail Investment Package

## AIFMD

From a non-EU AIFM perspective, limited change proposed, for example, an additional item for Annex IV reporting to cover “information on the costs borne by investors and performance of the AIF”

# SFDR (Sustainable Finance Disclosures Regulation)

**Brief update on take-up by  
US AIFMS**

# UK FCA Regulatory Focus 23/24

## Financial Services and Markets Bill reforms

These relate to the implementation of the outcome of the government's Future Financial Framework review—the aim of which is to consider how the financial services regulatory framework should adapt following the UK's exit from the EU. The FCA anticipates a very significant programme of work.

## Consumer Duty

The Consumer Duty applies at the end of July 2023 and requires FCA-regulated firms to “act to deliver good outcomes for retail customers”.

## Strengthening the UK's position in global wholesale markets

As part of this focus, the FCA is expecting to receive proposals for changes involving MiFID/MiFR, Prospectus Regulation—including a new public offer regime, Securitisation Regulation, and Short Selling Regulation—and to bring forward proposals on asset management regulation following its discussion paper on updating and improving the UK regime for asset management published in February 2023.

## Reducing and preventing financial crime

# UK FCA Consumer Duty

- An FCA-regulated firm must deliver good outcomes for retail customers
- Four key focus areas supported by detailed rules:
  - products and services are designed to meet retail customer needs/characteristics and objectives
  - products and services provide fair value
  - consumer understanding is supported to enable effective decision-making
  - appropriate consumer support is given to meet the needs of retail customers
- Non-retail financial instruments exclusion:
  - exclusion applies to a financial instrument for which there is a minimum denomination or a minimum investment of £50,000—activities carried on in relation to such an instrument is not retail market business and the consumer duty does not apply.
  - accordingly, activities in relation to funds with minimum £50,000 investment threshold continue to be non-retail business and fall outside scope

# New FCA “Anti-Greenwashing” Rule

Proposed as part of FCA’s ongoing consideration of, broadly, its answer to EU SFDR, known as Sustainability Disclosure Requirements and Investment Labels (SDR)

Unlike the bulk of the proposals, the new rule is scheduled to apply from the date of publication of the final rules which is likely H2/23, with application of those other rules being phased in over 2024 – 2026

# New FCA “Anti-Greenwashing” Rule

New rule to be included in the ESG sourcebook of the FCA Handbook of Rules reads:

*“a firm (whether it is undertaking sustainability in-scope business or not, including firms that approve financial promotions for unauthorised persons) must ensure that any reference to the sustainability characteristics of a product or service is:  
(1) consistent with the sustainability profile of the product and service; and  
(2) clear, fair and not misleading.”*

Note: this rule will apply to all types of FCA-regulated firms and is not limited to communications with retail clients (unlike the proposed SDR naming and marketing rules, which will apply in retail context only)

# UK-EU MoU on Framework for Financial Services Regulatory Cooperation

Shared objective to preserve financial stability, market integrity, and the protection of investors and consumers

## **Provides for:**

- Bilateral exchanges of views and analysis relating to regulatory developments and other issues of common interest
- Transparency and appropriate dialogue in the process of adoption, suspension, and withdrawal of equivalence decisions
- Bilateral exchanges of views and analysis re market developments and financial stability issues
- Enhanced cooperation and coordination including in international bodies as appropriate

# UK-EU MoU on Framework for Financial Services Regulatory Cooperation



**Establishes a Joint EU-UK  
Financial Regulatory Forum  
to facilitate regulatory  
cooperation**



**MoU makes clear that EU  
and UK remain free to  
implement measures each  
considers appropriate**



**MoU has no immediate  
impact on equivalence or  
mutual passporting/market  
access**



# EU and UK Changes to MiFID II Research Payment Rules

## EU

On 1 March 2021, the European Commission's MiFID II Quick Fix (the Quick Fix) entered into force, as part of the EU's Capital Markets Recovery Package to support recovery from the pandemic

The Quick Fix allows re-bundling of payments for research and execution services with respect to small and mid-capitalisation issuers, provided the following conditions are met:

- The research concerns listed/unlisted companies with a market capitalisation below EUR 1bn for the three years preceding the provision of research (this includes companies established for less than three years);
- An agreement is first entered into between the investment firm and research provider identifying the part of any combined charges for execution services and research; and
- The investment firm informs its clients about the joint payments for execution services and research made to the third-party research provider

# EU and UK Changes to MiFID II Research Payment Rules

## UK

In November 2021, the FCA released a policy statement on its consultation on changes to UK MiFID II's conduct and organisational requirements, setting out its intention to introduce new exemptions from UK MiFID II inducement rules

The exemptions, published in the FCA's Conduct of Business Sourcebook, came into force on 1 March 2022 and are listed below:

- research on listed/unlisted companies with a market capitalisation below GBP 200m (SMEs), provided that it is offered on a re-bundled basis or for free
  - FCA chose a threshold of GBP 200m over the EU's EUR 1 bn as it believed that a wider scope would "reintroduce material bundling of fees and unacceptably high inducement risk in the UK market"

# US/EU/UK Payment for Research

Third-party research that is received by a firm providing investment services or ancillary services to clients where it relates to fixed income currencies and commodities (FICC) instruments (the exemption for FICC research does not include macroeconomic research)

Research providers who do not provide execution services and are not part of a group that includes a firm offering execution or brokerage services

Corporate access services for listed/unlisted SMEs

Openly available written research does not fall within the scope of UK MiFID II inducement rules

# US/EU/UK Payment for Research

**In April 2023 UK government announced review of investment research in context of the competitiveness of UK capital markets**

**Hints at appetite to revisit the current rules on unbundling**

**Clashes of SEC rules and UK/EU rules**

- Expiration 3 July 2023 of SIFMA No-Action Letter allowing US brokers to accept P&L and RPA payments for research
  - UK and EU separately launched re-evaluations of MiFID II inducement restrictions
  - US Congress considering legislation
  - Scramble for investment managers and brokers to create transition plans

# US/EU/UK Payment for Research

## Potential UK solutions to clash with US

Could FCA confirm that where UK managers face US broker dealers who provide research, they could be permitted to pay via a traditional client commission agreement or CSA?

Could FCA confirm that market color falls outside the definition of "research" and constitutes a minor nonmonetary benefit and so be exempt from MIFID II inducement rules?

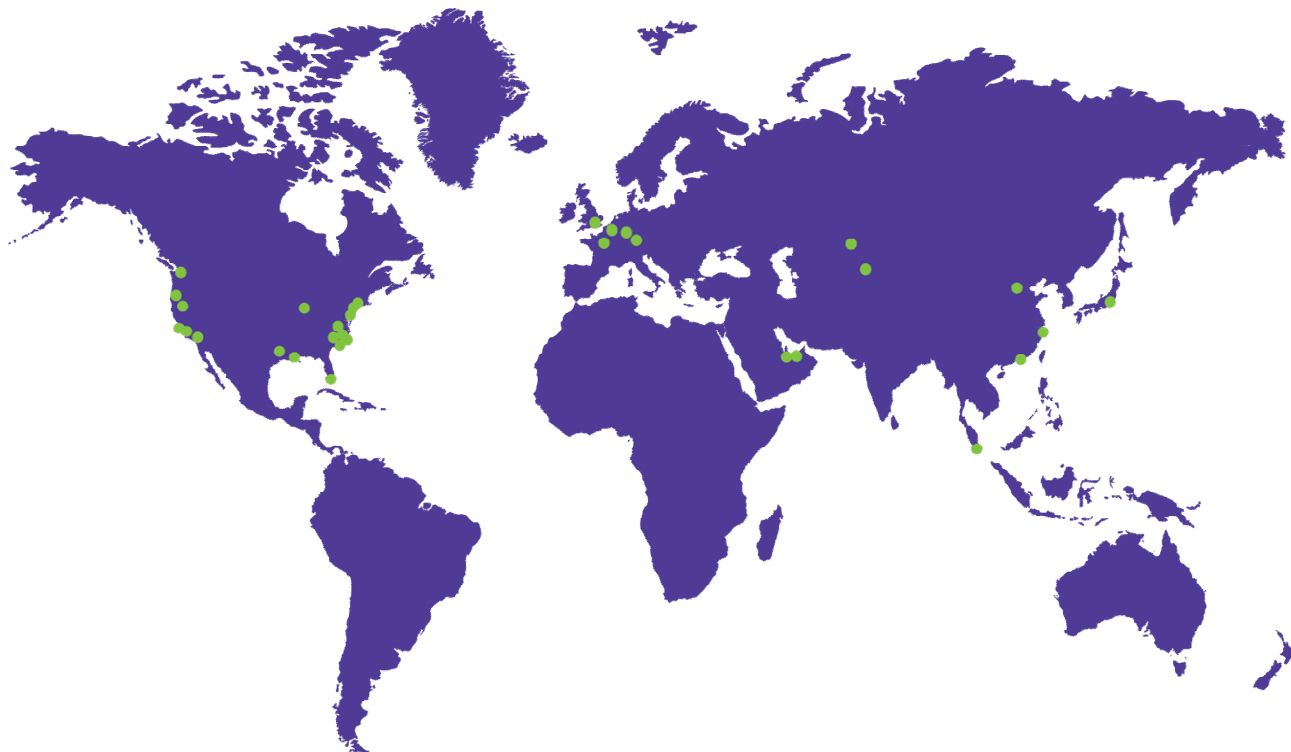
Could FCA exercise regulatory forbearance?

## Our Global Reach

Africa  
Asia Pacific  
Europe  
Latin America  
Middle East  
North America

## Our Locations

Abu Dhabi  
Almaty  
Astana  
Beijing  
Boston  
Brussels  
Century City  
Chicago  
Dallas  
Dubai  
Frankfurt  
Hartford  
Hong Kong  
Houston  
London  
Los Angeles  
Miami  
Munich  
New York  
Orange County  
Paris  
Philadelphia  
Pittsburgh  
Princeton  
San Francisco  
Seattle  
Shanghai  
Silicon Valley  
Singapore  
Tokyo  
Washington, DC  
Wilmington



**Morgan Lewis**

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP.  
In Hong Kong, Morgan, Lewis & Bockius is a separate Hong Kong general partnership registered with The Law Society of Hong Kong.

# THANK YOU

© 2023 Morgan Lewis

Morgan, Lewis & Bockius LLP, a Pennsylvania limited liability partnership

Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP.

In Hong Kong, Morgan, Lewis & Bockius is a separate Hong Kong general partnership registered with The Law Society of Hong Kong.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship.

Prior results do not guarantee similar outcomes. Attorney Advertising.

**Morgan Lewis**