

Personal Finances & Funds

11 May 2020

1 Blue, HM Treasury

1 Horse Guards Road

London SW1A 2HQ

Submitted via email to: [overseasfundsregime@hmtreasury.gov.uk](mailto:overseasfundsregime@hmtreasury.gov.uk)

**RE: Overseas Fund Regime**

Dear Sir and Madam

BlackRock<sup>1</sup> is pleased to have the opportunity to respond to the consultation on the future of Overseas Funds regime, issued by HM Treasury.

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to comment on the issues raised by this consultation paper and will continue to contribute to the thinking of HM Treasury on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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<sup>1</sup> BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world. More about our activities can be found in our UK snapshot available [here](#).

## Executive summary

BlackRock welcomes the consultation and the proposals for an offshore fund regime to replace the section 264 (FSMA) regime for passporting UCITS as recognised schemes into the UK, as well as providing a route for retail funds in non-EU jurisdictions with equivalent rules to be recognised for distribution in the UK.

We believe there are three areas of focus in ensuring UK investors benefit from the proposed regime: (i) Equivalence assessments evaluating overall levels of consumer protection, (ii) ensuring that UK savers and investors continue to benefit from an open and competitive market, and (iii) clarity and speed of process to ensure continuity of access, innovation, and manageable burdens on regulatory authorities.

We believe it is critical that equivalence assessments are prioritised for jurisdictions in which UCITS funds are domiciled under the current section 264 passporting arrangements.

We recommend developing an outcomes-based assessment of the equivalence of a jurisdiction's legal and regulatory framework for ensuring consumer protection, in line with the principles set out by former FCA chief Andrew Bailey in his speech on 23<sup>rd</sup> April 2019.<sup>2</sup> We make a number of recommendations as to what elements could be taken into account to achieve this aim. We suggest supplementing these with an assessment of the scope of the relevant local regulator's supervisory framework and willingness to enter into supervisory cooperation arrangements with the FCA, if these are not already in place.

In particular, we recommend that the Overseas Funds Regime:

- Ensures that UK investors have access to a broad choice of investment products and strategies, particularly specialist funds with global platforms such as Money Market Funds (MMFs) and Exchange Traded Funds (ETFs) which are not currently domiciled in the UK. While the UK remains an important market for these types of specialist funds, it is not possible for promoters to achieve the same economies of scale prized by investors if these funds were solely offered in the UK.
- Provides greater certainty regarding the basis for access for applicants, once a jurisdiction or type of funds has been deemed to provide investors appropriate levels of investor protection.
- Promotes the UK as an open and interconnected international market and encourages the flow of capital to businesses and projects in need of long-term financial support.

In moving from the Temporary Permissions Regime (TPR) to the new recognition regime the industry needs clear timelines and achievable deadlines once a jurisdiction or fund type has been deemed to be equivalent.

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<sup>2</sup> <https://www.fca.org.uk/news/speeches/future-financial-conduct-regulation>

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Given the protections provided by the EU's Money Market Fund Regulation (MMFR) we do not believe that it is necessary to put in place a separate regime for Money Market Funds (MMFs) available solely to professional clients, and we would, instead, support a consistent, fast track approach for all UCITS MMFs.

Finally, enhancing financial outcomes for end-investors, preserving the benefits of a safe, competitive and innovative market for consumers, current and future, should be the overarching objective of the new framework. As such, we see no reason to make market access conditional on reciprocity or other factors not related to this objective.

## Responses to questions

### 1. Are there any other relevant factors HM Treasury should consider in the design of the equivalence regime for retail funds?

We believe there are three key areas of focus to ensuring UK investors benefit from the proposed regime: (i) equivalence assessments, (ii) ensuring that the UK retains a competitive regime and open market for the benefit of investors, and finally (iii) clarity and speed of process.

#### i. Equivalence assessments

We believe it is critical that equivalence assessments are prioritised for jurisdictions in which UCITS funds are domiciled under the current section 264 passporting arrangements. At this stage it is unclear whether HMT will be recommending equivalence at the level of the UCITS directive itself or whether supplementary assessments will be carried out at the level of individual jurisdictions. We set out below some suggestions on criteria to use when assessing equivalence, referring in particular to examples of national requirements in Ireland and Luxembourg.

We recommend developing an outcomes-based assessment of the equivalence of a jurisdiction's legal and regulatory framework for ensuring consumer protection supplemented by an assessment of the scope of its supervisory framework and willingness of the relevant local regulator to enter into supervisory cooperation arrangements with the FCA, if these are not already in place.

#### Legal and regulatory framework

Criteria	Example of typical framework for a retail funds (UCITS) located in the EU	Additional supervisory and industry frameworks
Product governance rules regarding fund design, assessment of target market and investor base and ongoing assessment of whether fund continues to meet investor needs.	MiFID rules on product governance and UCITS rules on fund oversight.	Target market information in FinDatEx EMT format
Consideration by fund governance structure of pricing policies		Local rules e.g. additional rules in CP86 in Ireland or Circular 18/698 in Luxembourg  For example, see CBI Guidance on regular review of pricing structures within funds

Criteria	Example of typical framework for a retail funds (UCITS) located in the EU	Additional supervisory and industry frameworks
Asset allocation rules notably around diversification and avoidance of concentration	Note UCITS rules on diversification and avoidance of concentration	Note any local jurisdictional comments
Rules on eligible assets, particularly in respect of maintaining appropriate fund liquidity	UCITS Directive and Eligible Assets Directive	Additional local guidelines - on use of unapproved securities
Specific rules for MMFs	Rules in MMFR	Additional MMFR reporting requirements
Comprehensive asset protection rules	UCITS V depositary liability rules	Note additional ESMA Guidelines on asset segregation and liability.
Independence within fund structures	See duties of management companies and need for conflict of interest policies	Note specific local practice in Ireland and Luxembourg
Rules on liquidity management	ESMA Guidelines on LST and LST for MMFs	Local regime for supervisory oversight – for example CBI and CSSF liquidity reporting frameworks
Availability of full suite of liquidity management tools by managers	Tools defined at local not national jurisdiction	Ability in relevant local jurisdiction to use swing pricing/ dual pricing or other anti-dilution measures, deferrals, gates and suspensions
Consumer disclosures on objectives, benchmark usage, and on costs and charges	ESMA Guidelines on disclosure of use of benchmarks and performance measures  Note ESMA Q&A on publication of costs and charges data	Note interaction with MiFID and PRIIPs on UCITS costs and charges by intermediaries on a pre and post-sale basis  Industry delivery mechanism using EMT/EPT templates

Criteria	Example of typical framework for a retail funds (UCITS) located in the EU	Additional supervisory and industry frameworks
Consumer redress (see detailed discussion below)		CBI investigation into closet indexing and requirements for benchmark disclosure
Consumer compensation (see discussion below)		

There is also an indication in the consultation that a separate assessment will be carried out of funds meeting the EU's Money Market Fund Regulation (MMFR), differentiating between whether the funds are sold to purely professional clients or also to retail clients. While MMFs are sold largely to an institutional audience, many clients for regulatory reasons or for the purposes of internal due diligence express a preference for MMFs to have recognised fund status. On this basis we recommend that there should be a single equivalence regime for MMFs and that no distinction should be drawn between the intended investor base of these types of funds. This would also be consistent with the MMFR which does not distinguish between investor type.

**ii. Ensuring that the UK retains a competitive regime and open market for the benefit of investors**

For many years UK investors have benefited from an open and competitive fund market for both domestic and overseas funds, particularly those from the EU. Recent domestic developments in UK asset management regulation from the asset management market study means that overseas funds will have to continue to innovate and/or offer specialist strategies to remain competitive with the offering from domestic UK funds. The UK asset management industry continues to be heavily engaged in the day to day management and distribution of overseas funds marketed in the UK. We believe that a competitive process also involves a speedy and straightforward recognition process for those fund types deemed to be equivalent, as described below. We also support calls for the grandfathering of funds already recognised under section 264 and the Temporary Permission Regime to provide certainty of outcome and continuity of provision to investors. In particular, we recommend that the OFR:

- Ensures that UK investors have access to a broad choice of investment products and strategies, particularly specialist funds with global platforms such as Money Market Funds (MMFs) and Exchange Traded Funds (ETFs) which are not currently domiciled in the UK. While the UK remains an important market for these types of specialist funds, it is not possible for promoters to achieve the same economies of scale prized by investors if these funds were solely offered in the UK.

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- Provides greater certainty regarding the basis for access for applicants, once a jurisdiction or type of fund has been deemed to provide investors from appropriate levels of investor protection.
- Promotes the UK as an open and interconnected international market and encourages the flow of capital to businesses and projects in need of long-term financial support.

### **iii. Speed and effectiveness of process**

In moving from the TPR to the new recognition regime the industry needs clear timelines and achievable deadlines once a jurisdiction or fund type has been deemed to be equivalent.

We recommend that HMT prioritises funds in jurisdictions recognised under Section 264 FSMA to ensure continuity for existing investors in offshore funds, or better still offers a grandfathering process. For jurisdictions or fund type that will not be recognised on day one, UK investors will be disadvantaged by not being able to access new funds as they await OFR equivalence assessment or individual recognitions under FSMA Section 272.

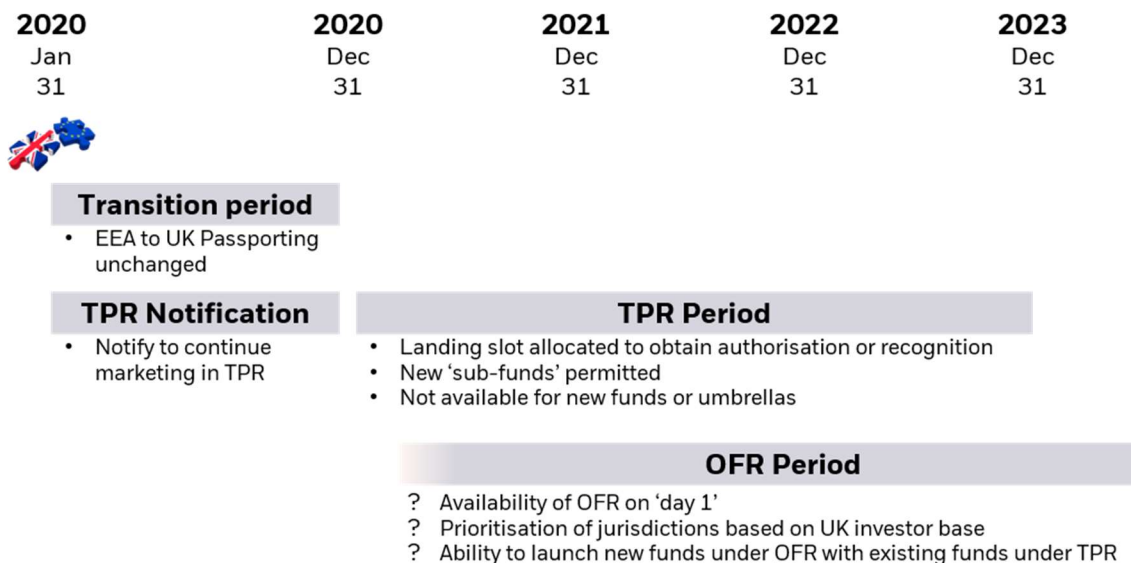
We also highlight that the listing of ETFs in the UK is dependent on obtaining a decision of recognition. As such we recommend a predictable process for recognition of ETFs so that subsequent steps such as listing can be conducted as smoothly as possible.

We also recommend a transparent process for the frequency at which issues of equivalence are assessed and a process for curing any deficiencies, either at the level of the jurisdiction and/or at the level of the manager.

When considering the timing of the introduction of the regime there are a number of questions which need consideration. There are also issues around timing and the interaction of the various steps needed for the regime to be in place:

- Timeframe for agreeing enabling legislation for the new regime and the scope of the equivalence process.
- Timeframe the FCA needs to conduct its equivalence assessments and time for HMT to assent to these and an indication of which jurisdictions will be prioritised over others, determined by what is in consumers' best interest.
- Timeframe for FCA to consult on its new forms and application process for recognition.
- Confirmation of when landing slots for application for recognition will be awarded and an assessment of the time needed to ensure the FCA can assess recognition applications of existing funds notified under the TPR to ensure continuity of treatment for investors.
- Confirmation of whether this process can be accommodated within the current timeframe of the TPR.
- Confirmation of when new umbrellas have to start using the new recognition process and cease using the TPR, and whether there will be an overlap here between grandfathering existing fund structures (including new funds of an existing umbrella) under the TPR and the launch of new umbrellas to avoid any gap in authorisation.

We set out below a simplified schematic setting out possible timelines for this process.



**2. Should the OFR allow for funds which make use of the management company passport under the EU UCITS Directive? Do similar arrangements, which allow the management company to be located in a separate country from the fund, exist outside of the EU?**

Our UCITS funds do not currently use this facility but we would encourage use of this arrangement to be included in the equivalence assessment of the UCITS regime.

We are not aware of any similar arrangements outside the EU.

**3. In your view, what additional requirements should be applied to funds accessing the UK via the OFR from the EU? Are there any aspects of the UK regime that would not be suitable to apply? Please explain your answer.**

As noted below, additional disclosure on the availability of compensation and resolution schemes may be recommended in an additional statement to UK investors.

The UK's consumer protection regime has very specific requirements on year end reporting using the SORP and on assessment of value reports. EU funds will report using local GAAP requirements which may also include the use of IFRS. We see no reason why local reporting requirements in major fund jurisdictions should not be treated as equivalent.

We recognise the need for UK retail investors to benefit from comparable levels of consumer protection whether they invest in a UK authorised fund or a recognised fund.

To achieve this, as set out in our response to Question 1, we suggest that there is a comprehensive assessment of the key elements of consumer protection in participating jurisdictions. We therefore suggest that on this basis, the direct application of the UK's assessment of value (AoV) requirements is not required provided the overall assessment of consumer protection achieves an equivalent outcome. There are a number of practical complications in the application of the AoV, given the worldwide distribution models of offshore funds with multiple share classes designed to accommodate the needs of widely



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differing groups of investors and national distribution models, which would make direct application impracticable. As noted in our response to Question 1 we suggest an alternative way of ensuring similar outcomes would be an assessment of whether the local jurisdiction has rules on selection on performance and reference benchmarks, full disclosure of costs and charges, including fund level transaction costs, performance reporting and regular review of the pricing of share classes sold to UK investors.

We also note that the UK's box profits regime is likely to be inapplicable given the prevalence of single priced schemes over dual-priced schemes in the UK.

#### **4. Do you consider that any other special provision should be made for the equivalence regime for MMFs?**

We note that the MMFR in the EU applies an additional set of comprehensive requirements to managers of MMFs in the EU over and above the UCITS Directive. Provided the fund complies with the requirements of the MMFR we do not believe that additional provisions are required.

#### **5. Do you agree with the proposed approach of relying on self-certification from funds that they are eligible for recognition?**

We support this approach. We also recommend a two-tier approach, one for the first time an umbrella is recognised and simplified approach to register underlying sub-funds to facilitate speed to market. Jurisdiction by jurisdiction we recommend specifying which retail investor fund types have achieved equivalence (e.g. UCITS or retail funds in other partner jurisdictions) given that apart from the investment objective all other elements of the fund are set out at the level of the umbrella.

#### **6. Do you agree that, where necessary, the FCA should require information from funds to ensure that they are satisfied that the funds comply with any additional requirements?**

As much as possible we recommend that the FCA set out up front in a standardised form the additional information it may require to avoid unnecessary delays in the recognition process.

#### **7. Are there any other circumstances, apart from those already listed in paragraph 4.14, in which funds should be refused recognition?**

We are not aware of other circumstances.

#### **8. Do you agree that MMFs targeting solely professional clients should only notify under the NPPR?**

As noted above, we do not believe that it is necessary to put in place a separate regime for MMFs available solely to professional clients, and we would, instead, support a consistent, fast track approach for all UCITS MMFs.

We note that many MMFs have multiple share classes, some of which are restricted to professional clients and others which are more widely available. While MMFs are principally sold to professional clients the following exceptions should be taken into account:

- i Funds are made available on a number of platforms for the clients of private wealth managers. A professional-client only option would still leave open the question of the whether distributors (portfolio managers or advisors) as well as the manager of the fund itself would be required to look through to the end customer to ascertain whether they have retail client status or not. A single MMF recognition regime would avoid the need for firms to put in place look through controls and processes.
- ii MMFs are also invested in by a number of DC pensions subject to the permitted links rules and as such it is preferable for these funds to have “recognised” status to ensure ongoing eligibility. The relevant rules for recognition on the eligibility of a recognised fund for permitted links can be found in the FCA Handbook COBS 21.3.1.
- iii UK authorised funds often invest cash received pending investment in MMFs to obtain the segregated account protection. This process is simplified if the fund is recognised. The relevant rules on eligible investment (including of a recognised fund) of an authorised fund can be found in the FCA COLL Sourcebook 5.2.13.
- iv Certain local authority clients can still be classified as retail investors (i.e. they have not opted up to professional client status).
- v Some clients such as public authorities may be designated as retail clients for regulatory purposes.

**9. Do you agree that MMFs eligible to be recognised under an equivalence determination for retail funds should follow the registration procedure for retail investment funds set out in paragraphs 4.6-4.14?**

As noted above we believe that MMFs will wish to avail themselves of recognised fund status and we recommend a simplified process to achieve this.

**10. Do you agree with the circumstances in which the FCA would be able to suspend or revoke the recognition (or access to the market as an MMF) of a fund? Are there any other valid reasons for suspending or revoking a fund’s recognition?**

We understand that the HMT will have the ability to modify or withdraw an equivalence determination, for example if there have been material changes to the regulatory regime in either the UK or the overseas country. The HMT has noted that it will in the first instance attempt to engage in a dialogue in order to attempt to reconcile these changes in the context of outcomes-based equivalence. However, if this fails, then the fund’s recognition would be revoked by the FCA. We understand that in this situation the existing UK investors could continue to hold and top-up their investments; however, no new UK investors would be able to invest. This uncertainty is troublesome, and we are concerned that it will mean that the regime is vulnerable to political agendas.

Our key concern is that often investors have their own policies or regulations that dictate what type of products they can invest in, or how they must treat that investment. For example, a pension scheme might only be permitted to invest in UK authorised or recognised products. Would an investor therefore have to sell its investment if the fund is no longer recognised. Alternatively, an insurance company may have to give an investment different capital treatment depending on whether it is authorised/recognised or not. We are concerned that

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this uncertainty surrounding the funds long-term recognition will mean that investors cannot be confident about investing if the position on the authorisation of the investment can change and is outside of their control.

We have a few other areas of concern where we would appreciate further clarity:

- How much notice would the fund receive from the FCA that its recognition is to be revoked due to the HMT modifying, or withdrawing an equivalence decision.
- For open-ended funds, if existing UK investors had requested that any of their distributions be re-invested for further shares in the fund, would that still be permitted?
- ETFs admitted to trading on LSE are required to maintain FCA recognition (via 264 currently) –We note that maintaining a secondary market listing is paramount to the distribution of ETFs in the UK and, therefore, a loss of recognition would be a significant problem for distribution and listing of ETFs to UK investors.

**11. Do you agree with the actions proposed to inform investors that a fund's recognition (or access to the market as an MMF) has been suspended or revoked? Are there any other factors that the government should consider?**

We are not aware of any other factors the government should consider.

**12. In your view, should the compulsory jurisdiction of the FOS be extended to cover funds recognised under the OFR, or should the OFR rely on investors having access to an ADR service in the fund's country? What are the advantages and disadvantages of each approach?**

We believe that most complaints are related to the provision of services by a UK intermediary such as advisor, platform or discretionary manager and should already be covered by the FOS. If the government is minded to ask funds to appoint a UK regulated entity as the fund's local representative, then this entity could be the recipient of UK investor complaints and subject to the jurisdiction of the FOS.

**13. How common is it, under the passporting framework, for complaints from UK investors to be escalated to ADR services in the country where the fund is domiciled? What is the nature of these complaints?**

In our experience this is a rare occurrence as most complaints are routed through a UK intermediary who handles the complaint as typically the complaints cover issues related to the actions taken or services provided by the intermediary.

**14. Where UK investors access ADR services in an EU country as a result of complaining against a passporting fund, are the complaints dealt with within a reasonable timeframe, fairly, and in English?**

We have no experience in this area.

**15. Have any UK investors been disadvantaged by a lack of access to the FOS for complaints concerning passported EU funds? In what way?**

We do not believe that UK investors have been disadvantaged.

**16. Are financial compensation schemes typically available to UK investors in overseas funds?**

No, as outside the UK in the EU investor compensation schemes do not typically apply to funds.

**17. Are you aware of any examples of loss or harm to UK investors in passporting funds as a result of lack of access to financial compensation schemes?**

We note that outside the UK the EU's Investor Compensation Scheme Directive was not extended to funds when last consideration was given to updating this Directive. This is largely due to the impact of the then forthcoming rules on strict liability for depositaries under the AIFMD and UCITS V Directives which require depositaries to compensate the fund in the event of loss of assets.

Jurisdictions such as Ireland and Luxembourg also have comprehensive rules on investor compensation in the case of NAV error calculations which also serve to provide consumers with compensation payable into the fund.

**18. Where overseas compensation schemes have been available to UK investors, are there examples of UK investors requesting compensation from the overseas compensation scheme, and have any successfully received compensation? What part does the overseas regulator play under such compensation arrangements?**

We are not aware of any such examples.

**19. In your view is it necessary to extend the scope of FSCS to apply to funds recognised under the OFR? What are the advantages and disadvantages of this approach?**

As noted above, we believe the nature of intermediated sales of offshore funds and the level of depositary liability in the UCITS regime mean that it is highly unlikely that UK retail investors will be disadvantaged if the scope of the FSCS is not extended to funds recognised under the OFR.

**20. Assuming the scope of the FSCS and the FOS remain unchanged, should funds be required to seek acknowledgement from investors about the availability of compensation schemes and ADR? If yes, what form should this take to be most effective?**

The most effective form would be to add this information to any additional UK disclosure document



**21. Would the PRIIPs disclosures on redress and complaints ensure that investors are in an informed position as regards the availability of such schemes, in the event that the scope of FOS and FSCS remain unchanged?**

The PRIIPs disclosures do not cover every jurisdiction in which the fund is distributed. We suggest that any additional wording is included in the application form for UK investors or in an additional disclosure statement for UK investors rather than in the PRIIPs KID itself.

**22. Do you agree with the government's proposed approach to financial promotions set out in paragraph 5.30-5.31? To what extent are the operators of EU funds already relying on UK authorised entities to make or approve financial promotions?**

Typically, BlackRock would rely on its UK authorised principal distributor to make financial promotions in respect of EU funds.

**23. Do you agree with the proposed changes to the individual fund recognition process (i.e. section 272) set out in paragraphs 7.3-7.5?**

No comment.

**24. Are there any other aspects of the individual fund recognition process which could be improved? Please give specific suggestions and explain how.**

No comment.

**25. Could you provide a brief overview of your firm, your key markets, and investor groups?**

We have provided answers on questions 25 to 37 to the Investment Association as part of its industry survey. Specific details are available on request.

**26. How many retail funds (including sub-funds) does your firm operate which market in the UK and what is the total assets under management (AUM)?**

**27. In relation to your response to question 26, what is the total AUM and number of retail funds that are:**

- a. UK-domiciled, and portfolio managed in the UK?**
- b. UK-domiciled, but portfolio managed overseas?**
- c. domiciled overseas, but portfolio managed in the UK?**

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28. In relation to your response to question 26, do all the retail funds that your firm operates have UK investors?
29. In relation to your response to question 26, how many of these retail funds have you notified (or intend to notify) under the TMPR?
30. How many MMF funds (including sub-funds) does your firm operate which market in the UK and what is the total AUM?
31. In relation to your response to question 30, what is the total AUM and number of MMFs that are:
- structured as UCITS?
  - structured as AIFs?
  - marketed to retail investors?
  - UK-domiciled, and portfolio managed in the UK?
  - UK-domiciled, but portfolio managed overseas?
  - domiciled in the EU, but portfolio managed in the UK?
32. In relation to your response to question 30, do all the MMFs that your firm operates have UK investors?
33. In relation to your response to question 30, how many of these MMFs have you notified (or intend to notify) under the TMPR?
34. For funds which you market in the UK, how many have their management company function undertaken in another country via the EU UCITS management passport?
35. How many funds (including sub-funds) do you expect to register or notify under the OFR? What is their approximate AUM?
36. In relation to your response to question 35, of those funds and sub-funds that you expect to register or notify under the OFR, how many are structured as:
- MMFs?
  - ETFs?
  - UCITS (including MMFs and ETFs structured as UCITS)?
37. In relation to your response to question 36, what is the total AUM of the funds under each of these categories?
38. Could you outline the steps for an individual fund required on your part, and the estimated time taken, and costs incurred, to gain recognition under section 264 for a UCITS?

In respect of questions 38 to 41 we refer to the relevant trade association responses. Our experience does not differ from the standard industry responses in this respect.

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**39. Could you outline the steps for an individual fund required on your part, and the estimated time taken, and costs incurred, to market an EU MMF in the UK under the EU MMF passporting regime?**

**40. Could you outline the steps for an individual fund required on your part, the estimated time taken, and costs incurred, to carry out a section 272 application process? Please indicate the amount of costs that would be charged to the fund itself.**

**41. Given the information set out in this consultation document, could you estimate, for an individual fund, the time and costs likely to be incurred under the OFR to gain recognition for a fund? Or to gain market access as a non-retail MMF?**