

EXPLANATORY MEMORANDUM TO
THE SOCIAL ENTREPRENEURSHIP FUNDS (AMENDMENT) (EU EXIT)
REGULATIONS 2019

2019 No. 343

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Act.

2. Purpose of the instrument

- 2.1 This instrument is being made in order to address the deficiencies in retained European Union (EU) law in relation to European social entrepreneurship funds (EuSEFs), arising from the withdrawal of the United Kingdom (UK) from the EU, ensuring the legislation continues to operate effectively at the point at which the UK leaves the EU.
- 2.2 The instrument relates to the EuSEF Regulation (Regulation (EU) No 346/2013 of the European Parliament and of the Council on European social entrepreneurship funds), which covers a sub-category of Alternative Investment Funds (AIFs) that focus on positive social impact and addressing social objectives.

Explanations

What did any relevant EU law do before exit day?

- 2.3 The EuSEF Regulation laid down a common framework of rules regarding the use of the designation “EuSEF” for qualifying social entrepreneurship funds. In particular it sets out the composition of the portfolio of funds that operate under that designation, providing investment information to investors, the investment tools they may employ, and the categories of investors that are eligible to invest in them. The Regulation also established a “passporting” system that enables small Alternative Investment Fund Managers (AIFMs) to market qualifying social entrepreneurship funds in the EEA.
- 2.4 EuSEFs are a sub-category of AIFs and are therefore also have to comply with the Alternative Investment Fund Managers Directive (AIFMD) (Directive 2011/61/EU), which was implemented by the Alternative Investment Fund Managers Regulations 2013.

Why is it being changed?

- 2.5 This instrument forms part of HM Treasury’s contingency planning in the event that the UK leaves the EU without a deal. To prepare for a no deal scenario, it is necessary to address deficiencies in domestic and retained EU law to ensure that the legislation continues to operate effectively at the point at which the UK leaves the EU.
- 2.6 References to EU law in UK legislation will need to be amended so that they continue to operate effectively after exit day. Some of these references will need to be amended to reflect changes in the versions of EU regulations which will become retained EU law when the UK leaves the EU.

- 2.7 The passporting system relies upon a legal framework agreed between EEA Member States and implemented in their domestic legislation. If the UK leaves the EU without a deal, there will be no agreed legal framework upon which the passporting system can continue. As a result, any references in UK legislation to the EEA passporting system will become deficient at the point of exit.
- 2.8 When the UK is no longer a member of the EU single market for financial services, it would not be appropriate for UK authorities to be obliged to share information or cooperate with the EU on a unilateral basis, with no guarantee of reciprocity.
- 2.9 Once the UK leaves the EU, it would no longer be appropriate for UK funds to use the EuSEF label.
- 2.10 The instrument also needs to assign responsibility for the functions of the European supervisory bodies and the Commission that are set out in the EuSEF Regulation to UK bodies.
- 2.11 If this instrument was not in place by exit day, certain regulations will cease to apply to EuSEFs set up and registered in the UK.

What will it now do?

- 2.12 In line with the approach taken in other financial services EU Exit instruments, this instrument will amend the EuSEF Regulation, and the Alternative Investment Fund Managers Regulation 2013 to ensure it continues to operate effectively in a no deal scenario after exit day, and so that the Regulation only applies to qualifying social entrepreneurship funds established within the UK.
- 2.13 Amendments that this instrument makes are outlined in section 7, however key amendments include:
- Replacing references to the Union with references to the UK, and references to EU legislation which are no longer appropriate with references to UK legislation and rules made by the regulators (see regulation 3);
 - Maintaining the eligible investment arrangements of qualifying social entrepreneurship funds established in the UK (see regulation 3);
 - Removing references to the EEA passporting system so that qualifying social entrepreneurship funds will no longer be able to automatically market throughout the EEA (see regulation 3);
 - Changing the designation “EuSEF” to “Social Entrepreneurship Fund” (SEF) (see regulation 4);
 - Establishing a transitional regime for managers and funds registered with the Financial Conduct Authority (FCA) before exit day, which will automatically transfer them to the new “SEF” designation (see regulation 5-8).

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 The territorial application of this instrument includes Scotland and Northern Ireland.
- 3.3 The powers under which this instrument is made cover the entire UK (see European Union (Withdrawal) Act 2018) and the territorial application of this instrument is not limited either by the Act or by the instrument.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is to the whole UK.
- 4.2 The territorial application of this instrument is to the whole UK.

5. European Convention on Human Rights

- 5.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding Human Rights:
- 5.2 “In my view the provisions of the Social Entrepreneurship Funds (Amendment) (EU Exit) Regulations 2019 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 To address deficiencies of retained EU law to operate effectively and other deficiencies arising from the withdrawal of the UK from the EU, this instrument amends Regulation (EU) 346/2013 of the European Parliament and of the Council on European social entrepreneurship funds.
- 6.2 EuSEFs are a sub-category of AIFs and are therefore also have to comply with the Alternative Investment Fund Managers Directive (AIFMD) (Directive 2011/61/EU). The proposed Alternative Investment Fund Managers (Amendment) (EU Exit) Regulations 2019 amend the EU and UK legislation relating to AIFMD (to be released shortly).
- 6.3 This instrument also modifies the Alternative Investment Fund Managers Regulations 2013, which implemented AIFMD.

7. Policy background

What is being done and why?

- 7.1 The UK will leave the EU on 29 March 2019. The UK and the EU have agreed the terms of an implementation period that will start on 29 March 2019 and last until 31 December 2020. This will provide time to introduce the new arrangements that will underpin the UK-EU future relationship, and provide valuable certainty for businesses and individuals. During the implementation period, common rules will continue to apply. The UK will continue to implement new EU law that comes into effect and the UK will continue to be treated as part of the EU’s single market in financial services. This will mean that access to each other’s markets will continue on current terms and businesses, including financial services firms, will be able to trade on the same terms as now until 31 December 2020. UK firms will need to comply with any new EU legislation that becomes applicable during the implementation period.
- 7.2 The government is seeking a deep and special future partnership with the EU, which should be greater in scope and ambition than any such agreement before and

encompass financial services. Given the highly regulated nature of financial services, the volume of trade between UK and EU markets, and a shared desire to manage financial stability risks, the UK proposes a new economic and regulatory arrangement that will preserve mutually beneficial cross-border business models and economic integration for the benefit of businesses and consumers. Decisions on market access would be autonomous in our proposed model, but would be underpinned by stable institutional processes in a bilateral agreement and continued close regulatory and supervisory cooperation.

- 7.3 While the government has every confidence that a deal will be reached, and the implementation period will be in place, it has a duty to plan for all eventualities, including a ‘no deal’ scenario. The government is clear that this scenario is in neither the UK’s nor the EU’s interest, and the government does not anticipate it arising. To prepare for this unlikely eventuality, HM Treasury intends to use powers in the European Union (Withdrawal) Act (EUWA) 2018 to ensure that the UK continues to have a functioning financial services regulatory regime in all scenarios.
- 7.4 The EUWA repeals the European Communities Act 1972 and converts into UK domestic law the existing body of directly applicable EU law (including EU Regulations). It also preserves UK laws relating to EU membership – e.g. legislation implementing EU Directives. This body of law is referred to as “retained EU law”. The EUWA also gives ministers a power to prevent, remedy or mitigate any failure of EU law to operate effectively, or any other deficiency in retained EU law, through SIs. These contingency preparations for financial services legislation are sometimes referred to as ‘onshoring’. These SIs are not intended to make policy changes, other than to reflect the UK’s new position outside the EU, and to smooth the transition to this situation. The scope of the power is drafted to reflect this purpose and is subject to further restrictions, such as the inability to use the power to impose or increase taxation, or establish a public authority. The power is also time-limited and falls away two years after exit day.
- 7.5 Wherever practicable, the proposed approach is that the same laws and rules that are currently in place in the UK would continue to apply at the point of exit, providing continuity and certainty as we leave the EU. However, if the UK does not enter an implementation period, some changes would be required to reflect the UK’s new position outside the EU from 29 March 2019.
- 7.6 In the unlikely scenario that the UK leaves the EU without a deal, the UK would be outside the EU’s framework for financial services. The UK’s position in relation to the EU would be determined by the default Member State and EU rules that apply to third countries at the relevant time. The European Commission has confirmed that this would be the case.
- 7.7 In light of this, the approach in this scenario cannot and does not rely on any new, specific arrangements being in place between the UK and the EU. As a general principle, the UK would also need to default to treating EU Member States largely as it does other third countries, although there are cases where a different approach would be needed including to provide for a smooth transition to the new circumstances.
- 7.8 HM Treasury published a document on 27 June 2018, which sets out in more detail HM Treasury’s approach to financial services legislation under the European Union

(Withdrawal) Act. (<https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act>)

- 7.9 This SI will amend the EuSEF Regulation so that it operates effectively in a UK only context.

Naming convention and registration with the FCA

- 7.10 Currently, UK AIFMs must register EuSEFs in order to market funds throughout the EU using this specific label. If the UK leaves the EU without a deal, it would no longer be possible for UK fund managers to market these funds under the EU regime.
- 7.11 This instrument amends the EuSEF Regulation so that it only applies to UK AIFMs and funds established in the UK. The label for these funds will be changed to “Social Entrepreneurship Fund”, which will apply in the UK. Existing managers of EuSEFs that are already registered with the FCA will automatically be transferred to the new UK regime.

Removing EEA passporting rights

- 7.12 This instrument removes the references to the EEA passporting system, meaning that registration under the Regulation will no longer automatically enable UK social entrepreneurship funds to be marketed throughout the EEA.
- 7.13 EuSEF funds (as AIFs) which are passported into the UK before exit day will be able to access the UK market through the temporary permissions regime, as set out in the Alternative Investment Funds Managers (Amendment) (EU Exit) Regulations. The temporary permissions regime, introduces provisions for EEA AIFMs currently marketing EEA AIFs and UK AIFs to have temporary marketing permissions in the UK for a limited period, while they apply for and obtain the relevant UK permissions.

Eligible investments

- 7.14 The EuSEF Regulation currently sets out the investment rules for EuSEFs, which can only invest in eligible assets as defined by the Regulation. In some cases, EEA assets are given preferential treatment over third country assets, with the Regulation making a distinction between investment in EEA Member States and investments in the rest of the world. To ensure continuity for investors, this instrument will make sure the eligible investments of EuSEFs established in the UK remain the same and maintains the existing investment rules for UK EuSEFs.
- 7.15 Replacing references to the Union with references to the UK, and references to EU legislation which are no longer appropriate with references to UK legislation and rules made by the regulators.

Supervisory cooperation

- 7.16 As the UK will no longer be part of the single market, it would not be appropriate for the UK supervisors to be obliged to share information or cooperate with EU authorities, without any guarantee of reciprocity. As such, provisions in legislation relating to cooperation and information sharing have been removed. However, this will not preclude UK supervisors from sharing information with EU authorities where necessary, as the existing domestic framework for cooperation and information sharing with countries outside the UK already allows for this on a discretionary basis.

Transfer of functions

- 7.17 EU regulation of financial services sets out a range of functions to be carried out by EU institutions. Many of these functions will need to be incorporated into the UK's regulatory framework so that the UK has a fully functioning regulatory regime outside of the EU. Broadly speaking, these functions fall into two categories: functions for making legislation and a wide range of other functions which relate to the supervision of financial services institutions.
- 7.18 Regulatory supervision is currently held by the European Supervisory and Markets Authority (ESMA). Where functions were previously held by the ESMA, they will be transferred to the FCA. The power transferred to the FCA is the power to make technical standards and to maintain the data of registered funds. This is considered appropriate because it will give the FCA the responsibility of ensuring that EU-derived technical standards and regulator rules operate effectively after exit from the EU.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

- 8.1 This instrument is being made using powers in the European Union (Withdrawal) Act 2018 in order to address failures of retained EU law to operate effectively or other deficiencies arising from the withdrawal of the UK from the EU. In accordance with the requirements of that Act the Minister has made the relevant statements as detailed in Part 2 of the Annex to this Explanatory Memorandum.

9. Consolidation

- 9.1 There are currently no plans to consolidate the relevant legislation.

10. Consultation outcome

- 10.1 HM Treasury has not undertaken a consultation on the instrument, but has engaged with relevant stakeholders on its approach to Financial Services legislation under the European Union (Withdrawal) Act 2018, including on this instrument, in order to familiarise them with the legislation ahead of laying.
- 10.2 The instrument was also published in draft, along with an explanatory policy note, on 31 October 2018 in order to maximise transparency ahead of laying.

11. Guidance

- 11.1 No further guidance is being published alongside this instrument. As mentioned above in section 10, an explanatory policy note was published alongside the draft instrument.

12. Impact

- 12.1 The impact on businesses will primarily be on fund managers and funds that currently operate under the EuSEF Regulation. Impacted firms will need to understand the changing regulatory environment. As the EuSEF regime is already in place in the UK, firms will already be complying with the regime; the familiarisation costs relating to this instrument should be limited and a one-off cost to firms. There will also be a cost to firms as a result of the change in the naming convention from "EuSEF" to "SEF".
- 12.2 There is no impact on charities or voluntary bodies.

- 12.3 There is no impact on the public sector.
- 12.4 A full Impact Assessment will be published alongside the Explanatory Memorandum on the [legislation.gov.uk](https://www.legislation.gov.uk) website, when an opinion from the Regulatory Policy Committee has been received.
- 13. Regulating small business**
- 13.1 The legislation applies to activities undertaken by small businesses if they manage EuSEFs.
- 13.2 Registration as an EuSEF manager has in the past only been available to managers with assets under management below the specified threshold in Article 3(2)(b) of AIFMD, although recent changes to the EuSEF Regulation has opened up this label to fund managers of all sizes. This SI does not affect previous measures that were taken to address the possible impact on small businesses. The intention of this SI is to ensure that the regulatory regime for investment funds in the UK continues to operate effectively in a UK context and to minimise the impact of the UK's withdrawal from the EU on all firms, including small business.
- 14. Monitoring & review**
- 14.1 As this instrument is made under the EU Withdrawal Act 2018, no review clause is required.
- 15. Contact**
- 15.1 Janice Chui at the HM Treasury (Telephone:02072701081 or email: Janice.Chui@HMTreasury.gov.uk) can be contacted with any queries regarding the instrument.
- 15.2 John Owen, Deputy Director for the Personal Finances and Funds Team at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 The Economic Secretary to the Treasury at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

Annex

Statements under the European Union (Withdrawal) Act 2018

Part 1

Table of Statements under the 2018 Act

This table sets out the statements that may be required under the 2018 Act.

Statement	Where the requirement sits	To whom it applies	What it requires
Sifting	Paragraphs 3(3), 3(7) and 17(3) and 17(7) of Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) to make a Negative SI	Explain why the instrument should be subject to the negative procedure and, if applicable, why they disagree with the recommendation(s) of the SLSC/Sifting Committees
Appropriate-ness	Sub-paragraph (2) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	A statement that the SI does no more than is appropriate.
Good Reasons	Sub-paragraph (3) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain the good reasons for making the instrument and that what is being done is a reasonable course of action.
Equalities	Sub-paragraphs (4) and (5) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain what, if any, amendment, repeals or revocations are being made to the Equalities Acts 2006 and 2010 and legislation made under them. State that the Minister has had due regard to the need to eliminate discrimination and other conduct prohibited under the Equality Act 2010.
Explanations	Sub-paragraph (6) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2 In addition to the statutory obligation the Government has made a political commitment to include these statements alongside all EUWA SIs	Explain the instrument, identify the relevant law before exit day, explain the instrument's effect on retained EU law and give information about the purpose of the instrument, e.g., whether minor or technical changes only are intended to the EU retained law.
Criminal offences	Sub-paragraphs (3) and (7) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9, and	Set out the 'good reasons' for creating a criminal offence, and the penalty attached.

		23(1) or jointly exercising powers in Schedule 2 to create a criminal offence	
Sub-delegation	Paragraph 30, Schedule 7	Ministers of the Crown exercising sections 10(1), 12 and part 1 of Schedule 4 to create a legislative power exercisable not by a Minister of the Crown or a Devolved Authority by Statutory Instrument.	State why it is appropriate to create such a sub-delegated power.
Urgency	Paragraph 34, Schedule 7	Ministers of the Crown using the urgent procedure in paragraphs 4 or 14, Schedule 7.	Statement of the reasons for the Minister's opinion that the SI is urgent.
Explanations where amending regulations under 2(2) ECA 1972	Paragraph 13, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement explaining the good reasons for modifying the instrument made under s. 2(2) ECA, identifying the relevant law before exit day, and explaining the instrument's effect on retained EU law.
Scrutiny statement where amending regulations under 2(2) ECA 1972	Paragraph 16, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement setting out: a) the steps which the relevant authority has taken to make the draft instrument published in accordance with paragraph 16(2), Schedule 8 available to each House of Parliament, b) containing information about the relevant authority's response to— (i) any recommendations made by a committee of either House of Parliament about the published draft instrument, and (ii) any other representations made to the relevant authority about the published draft instrument, and, c) containing any other information that the relevant authority considers appropriate in relation to the scrutiny of the instrument or draft instrument which is to be laid.

Part 2

Statements required when using enabling powers under the European Union (Withdrawal) 2018 Act

1. Appropriateness statement

- 1.1 The Economic Secretary to the Treasury (John Glen MP) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:
- 1.2 “In my view the Social Entrepreneurship Funds (Amendment) (EU Exit) Regulations 2019 does no more than is appropriate”.
- 1.3 This is the case because: the instrument does no more than amend the EuSEF Regulation, and modify the Alternative Investment Fund Managers Regulations 2013, to correct deficiencies arising from the UK’s exit from the EU, and treat the EU as a third country going forward. Further explanation of the policy purpose of this instrument can be found in paragraphs 7.1-7.18 of this Explanatory Memorandum.

2. Good reasons

- 2.1 The Economic Secretary to the Treasury (John Glen MP) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:
- 2.2 “In my view there are good reasons for the provisions in this instrument, and I have concluded they are a reasonable course of action”.
- 2.3 These are: without this instrument, the legislation regulating EuSEFs in the UK would contain deficiencies and cease to function appropriately after the UK’s exit from the EU. Further explanation of the policy purpose of this instrument can be found in paragraphs 7.1-7.18 of this Explanatory Memorandum.

3. Equalities

- 3.1 The Economic Secretary to the Treasury (John Glen MP) has made the following statement(s):
- 3.2 “The instrument does not amend, repeal or revoke a provision or provisions in the Equality Act 2006 or the Equality Act 2010 or subordinate legislation made under those Acts.
- 3.3 The Economic Secretary to the Treasury (John Glen MP) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:
- 3.4 “In relation to the instrument, I, Economic Secretary to the Treasury (John Glen MP) have had due regard to the need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010.”

4. Explanations

- 4.1 The explanations statement has been made in section 2 of the main body of this explanatory memorandum.

5. Legislative sub-delegation

- 5.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:
- 5.2 “In my view it is appropriate to create a relevant sub-delegated power in the Social Entrepreneurship Funds (Amendment) (EU Exit) Regulations 2019.”
- 5.3 It is appropriate to delegate the power to make regulatory technical standards to the FCA because it will give them the necessary powers to ensure that EU-derived technical regulations for which they are responsible will operate effectively after exit, subject to mechanisms to ensure robust HM Treasury oversight. This is considered appropriate as the FCA will have the requisite technical knowledge to make assessment of certain matters. For example, the FCA have the power to make technical standards to specify further the information to be provided to it in order to complete registration.
- 5.4 This is in line with the approach that the government has set out in which legislative responsibility for Level 2 technical legislation in financial services will be transferred to the financial regulators, while the Treasury will have responsibility for changes to Level 1 legislation which Parliament will approve.