Potential implications of a “hard Brexit” for fund managers: a UK perspective

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Brexit Manoeuvres

Potential implications of a "hard Brexit" for fund managers: A UK perspective

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A. Introduction

This note sets out at a high level the potential impact of the United Kingdom's ("UK") exit ("Brexit") from the European Union ("EU") without a negotiated agreement on UK and European Economic Area ("EEA") (a) alternative investment fund managers ("AIFMs"), (b) UCITS management companies ("ManCos") and (c) investment management firms operating under a Markets in Financial Instruments Directive (2014/65/EU) ("MiFID") licence.

These observations are subject to change – in fact, they may well do so, as the political and regulatory approach to Brexit continues to evolve.

This note assumes, for the purpose of forward planning (save as expressly noted) that:

- no specific terms are put in place for the UK financial services sector in connection with Brexit, in effect, a "hard Brexit" following which the UK will be treated by the remaining EU member states (the "EU 27") as a "third country";
- the UK will implement EU law "as is" into domestic law with effect from the date of exit, with the UK and Gibraltar being the only "EEA states" for such purposes and all other states, including the EU 27 being, from the UK perspective, third countries; and
- the UK will continue to provide a level of access to the UK market for products or managers from the EU 27, including alternative investment funds or "AIFs" within the meaning of the alternative investment fund managers directive (2011/61/EU) ("AIFMD") and undertakings for collective investments in transferrable securities or "UCITS" within the meaning of Directive (2009/65/EC) (the "UCITS Directive"), and management entities including AIFMs and ManCos and investment firms holding a MiFID licence.

B. AIFs and AIFMs

1. Non-EEA AIF / UK AIFM

(a) Management

Generally speaking, a UK investment manager operating as a UK AIFM under its "managing an unauthorised AIF" permission should be able to continue to manage a non-EEA AIF from the UK in the same manner as before Brexit. See Section F. below for certain service provider and trading arrangement considerations.

(b) Marketing

A UK AIFM should not need to change its approach to marketing outside of the EU 27 (e.g. the UK and the rest of the world) after Brexit.

Currently, the marketing of non-EEA AIFs in the UK and the wider EU by a UK AIFM must be conducted on the basis of each country's national private placement regime under Article 36 of AIFMD, where available. Following Brexit, UK marketing would continue on the basis of Article 36, however, in the EU 27, both the AIF and the AIFM would be considered non-EEA and therefore any marketing of the AIF in the EU 27 would need to be undertaken pursuant to Article 42 of AIFMD, assuming private placement of this kind is permitted in the relevant EU member state.

Access to the Article 42 regime by a UK AIFM would require a cooperation agreement to be in place between both (i) the competent authority of the relevant EU 27 member state and the UK Financial Conduct Authority (the "FCA") as the supervisory authority of the now third-country UK AIFM and (ii) the competent authority of the EU 27 member state and the competent authority of the non-EEA AIF's jurisdiction of establishment. On 1 February 2019, each of the FCA and the European Securities and Markets Authority ("ESMA") announced that a multi-lateral memorandum of understanding ("MOU") had been agreed between EU and EEA securities regulators and the FCA which would take effect in the event of a no-deal Brexit. The press releases stated that the MOU would cover supervisory cooperation, enforcement and information exchange between individual European regulators and the FCA. It is expected that the MOU should be sufficient to permit delegation and outsourcing by EEA based entities to UK firms and marketing by UK AIFMs under Article 42; however, at the time of writing this briefing the text of the MOU has not yet been made available[1].

2. EEA AIF / UK AIFM

(a) Management

In principle, a UK AIFM should be able to continue to manage an EEA AIF to the same degree that, for example, a US investment adviser is currently permitted to manage an EEA AIF. As the AIFMD third country passport provisions have not been activated, the management of EEA AIFs by non-EEA AIFMs is outside the scope of the current AIFMD rules. Accordingly, whether such an arrangement is permitted will be determined on a jurisdiction by jurisdiction basis and the position is very unclear in some jurisdictions.

The Central Bank of Ireland ("CBI") has confirmed that an Irish Qualifying Investor AIF ("QIAIF") will be permitted to designate a UK AIFM as its AIFM when the UK exits the EU, provided that the QIAIF and its UK AIFM have notified the CBI of the same and updated the AIF's documentation to reflect the same within the relevant deadlines[2] and comply with the provisions of the AIF Rulebook that apply in the case of QIAIFs with registered AIFMs. These QIAIF are subject to the full AIFMD depositary regime including the AIFMD depositary liability provisions. However, as is currently the case, non-EEA AIFMs are unable to manage Irish retail investor AIFs ("RIAIFs"), so UK AIFMs currently managing Irish RIAIFs will be required to cease to do so by the effective date of the UK's withdrawal either by substituting a new EEA AIFM or by winding down the fund.

Luxembourg has provided for a transitional regime which will permit a UK AIFM that manages Luxembourg AIFs pursuant to the AIFMD management passport to continue to manage such Luxembourg AIFs for a maximum of 12 months after a "no-deal" Brexit, provided that it makes a notification filing with the *Commission de Surveillance du Secteur Financier* (the "CSSF") advising that the UK AIFM wishes to continue in its management activities during the transitional regime and advising the CSSF as to the measures it will take following the transitional period. The CSSF has published necessary notification forms which were to be filed by the UK AIFMs by 15 September 2019. The forms proposed a number of the most common solutions that may be adopted by each UK AIFM

[1] No further information has been forthcoming about the content of the MOU from the FCA nor ESMA. However, we understand that the MOU will be published by the FCA and ESMA in the event of a "hard Brexit".

[2] As of the most recent iteration of the Brexit deadline, 31 October 2019, the notification deadline for the CBI was 6 September 2019 to provide notice of intention for the UK AIFM to continue to manage (or not) the Irish QIAIF, with updated documentation to be submitted by 1 October 2019.

post hard Brexit, such as appointment of another Luxembourg or EU AIFM or liquidation of the relevant Luxembourg AIF. However, the CSSF left the door open for the relevant AIFM to contact it by email, should none of the options offered by the notification forms fit the UK AIFM's plans. This notification deadline was the first step in order to obtain the benefit of the transitional period and must be followed, at the latest on 31 October 2019, by the relevant steps necessary to implement the chosen options, such as submission of an application for authorization as a Luxembourg AIFM, or proof of the appointment (or planned appointment) of another existing AIFM within the EU 27, etc. The requests for transitional relief are subject to CSSF review and approval on a case by case basis. The CSSF will notify a UK AIFM of its decision within 10 business days of all required information having been submitted, and currently the CSSF indicates that they will respond to all such requests by 1 November 2019.

The CSSF issued a press release on 11 October 2019 informing UK authorised AIFMs (whether they have completed the 15 September notification or not) that they may opt to remain non-EU (UK) AIFMs of the Luxembourg AIFs (whether regulated or unregulated) in the case of hard Brexit. This option is only available to Luxembourg AIFs where its direct or indirect investors are professional investors as defined under AIFMD, and/or well-informed investors as defined applicable Luxembourg law. Such an arrangement requires the approval of the AIF's investors which consent is to be evidenced (or justification as to the reason for any delay together with the draft notice to investors to be submitted) to the CSSF prior to 31 October 2019.[3]

A number of other EEA jurisdictions have provided for temporary regimes, however, few of them address acting as AIFM of locally established AIFs. While one would hope that the relevant member states will take a pragmatic view, given the length of time that Brexit has been in consideration, it is likely that there would be an expectation that the relevant firm has had ample time to take the necessary steps to prepare for a no deal Brexit.

Even where a UK AIFM is permitted to continue to manage EEA AIFs, there will be certain categories for which this will not work, for example, if the AIF in question is subject to specific regulation or where it may cause difficulties in pursuing the strategy of the AIF (for example, an AIF engaged in direct lending in Germany must be managed by an EEA AIFM to take advantage of exemptions from broader banking regulations).

(b) Marketing

There should be no change in the manner in which marketing an EEA AIF outside of the EU 27 or the UK is conducted by a UK AIFM.

However, a UK AIFM will no longer be able to market an EEA AIF pursuant to Article 31 of AIFMD in the UK because, for the purposes of the UK implementation of AIFMD, the EEA AIF will be treated after Brexit as a non-EEA AIF. As such, it would instead need to be marketed in the UK pursuant to Regulation 57 of the UK Alternative Investment Fund Managers Regulations 2013 (the "Regulations") implementing Article 36 of AIFMD. Any arrangements to market a new EEA AIF in the UK will, therefore, require the making of an Article 36 national private placement regime ("NPPR") notification with the FCA. For EEA AIFs with a UK AIFM that are currently approved for marketing in the UK, the statutory instrument published by the UK Government on the post-Brexit changes to the AIFMD regulatory regime (i.e. The Alternative Investment Fund Manager (Amendment etc.) (EU Exit) Regulations 2019) does remove UK AIFMs of such AIFs from Regulation 54 of the Regulations (which implements Article 31 of AIFMD) and does not currently provide any grandfathering arrangements or transitional arrangements or any automatic transfer

[3] Although the CSSF press release only relates to the existing structures, it is the first open and public recognition by the CSSF of the possibility for Luxembourg AIFs being managed by a non-EU AIFM and it remains to be seen whether any further guidance or clarification will follow as to whether such arrangements will be permitted for newly established AIFs in the future.

of marketing approval to the NPPR in Regulation 57. However, the FCA has indicated[4] that it intends to uses its Brexit Temporary Transitional Power to enable such AIFs to continue to be marketed in the UK on the same basis as they were before Brexit until midnight on 31 December 2020.

When marketing in the EU 27, the EEA marketing passport under Article 32 of AIFMD will cease to be available because the UK AIFM from the EU 27 perspective will be considered a non-EEA AIFM and (subject to any local transitional relief) the UK AIFM will need to rely on private placement pursuant to Article 42 of AIFMD to market an EEA AIF in the EU 27 (note the need for cooperation agreements discussed at Section B.1(b) above). A number of member states either do not permit or make it prohibitively complicated or costly to market under Article 42 of AIFMD and there is no reason at this time to expect this approach to change. To retain the AIFMD marketing passport, a replacement EU 27 AIFM would need to be appointed by the EEA AIF.

3. EEA AIF / EEA AIFM / UK delegate MiFID manager

(a) Management

In principle an EEA AIFM should be able to delegate to a UK investment manager operating under UK MiFID permissions. Such delegation will need to be notified to the regulator of the relevant EEA AIFM (and generally to the regulator of the relevant AIF where it is a regulated fund) and a written arrangement will also need to be in place between the FCA and the competent authority of the EU member state of the EEA AIFM. It is expected that the MOU referenced at Section B.1(b) above would constitute such an arrangement. It will be important that the delegation does not result in the EEA AIFM constituting a letterbox entity and therefore it will be essential that the AIFM (i) has sufficient substance and retains the "expertise and resources to supervise the delegated tasks effectively" and (ii) ensures that it does not delegate performance of the investment management functions (e.g. risk management and portfolio management) "to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself". (See Article 82 of the Commission Delegated Regulation (EU) No 231/2013 supplementing AIFMD.) What constitutes sufficient substance in the key EU 27 fund jurisdictions is still evolving, with ESMA pressing for greater substance and regulators taking different (and changing) approaches to the question. There is a general move towards requiring significantly more substance than previously. Items of consideration in terms of substance may include the nature of the manager, the strategies managed and the number of funds and quantum of assets under management.

(b) Marketing

There should be no change in the manner in which marketing is conducted outside of the UK and the EU 27.

In respect of marketing in the UK, the AIF will not be a UK AIF and will not have a UK AIFM and therefore will be unable to continue to rely on the marketing passport under Article 32 of AIFMD but would instead be subject to the requirements of Regulation 59 (which implements AIFMD Article 42) and require an NPPR notification to the FCA.

In preparation for a "hard Brexit", the FCA notification process under the proposed "temporary permissions regime" for EEA AIFMs (and EEA ManCos, MiFID firms and other specified types of firms) currently passporting into the UK ("inbound firms and funds") is live. The temporary permissions regime will allow EEA firms to continue providing services in the UK within the scope of their current passports for a limited period of up to three years after Brexit, while at the same time seeking full FCA authorisation to provide services, and/or market funds, into the UK. This regime will also allow EEA AIFs (and UCITS funds) currently marketed under a passport in the UK to continue to be marketed in the UK post Brexit on the same terms and subject to the same conditions as they could have been before exit day during

[4] Please see the FCA statement https://www.fca.org.uk/brexit/temporary-permissions-regime#funds

the continuance of the regime. [5] Note also the paragraph in Section B.2(b) above, which details how the FCA intends to use its transitional powers.

In order to avail itself of the temporary permission regime, the EEA AIFM will need to notify the FCA that it wishes to use the regime using the FCA's web-based Connect system. The FCA has published a guide to Connect covering the notification process, which is available on its website. Notifications must be submitted by 30 October 2019. The FCA's stated position is that these firms should not wait for confirmation of whether there will be an implementation or transitional period post-Brexit before they submit their notification. There is no fee for making the notification to the FCA. Post Brexit, EEA AIFs for which a notification has not been submitted will not be eligible for the temporary permissions regime.

Other than a statement that the FCA will allocate a "landing slot" to a firm by which it must obtain FCA authorisation once it has submitted this notification, there is no information from the FCA yet regarding how an EEA AIFM will exit the temporary permissions regime, although the FCA will provide this in due course.[6]

In respect of an EU 27 AIFM marketing an EU 27 AIF within the EU 27, the AIFMD marketing passport should remain available. However, the ability of the UK delegate MiFID manager to market the EEA AIF within the EU 27 may be curtailed as, subject to alternative arrangements being made (such as the establishment of an EU 27 MiFID firm) it will no longer be able to provide MiFID investment services in the EU 27 under its MiFID passport.

Post-Brexit, MiFID II's third country regime might (someday) provide a quasi-passport permitting UK investment firms to provide MiFID investment services on a cross-border basis in the EU 27. Such services could include "reception and transmission of orders" in the course of distributing and marketing of AIFs and UCITS funds. However, any use of this regime would first require the EU Commission to adopt an "equivalence" decision in respect of the UK's post-Brexit regulation of matters within the scope of MiFID. The European Commission has adopted no MiFID "equivalence" decisions to date, and there is no current indication that it would do so in connection with a hard Brexit. Indeed, the European Commission is expected to revisit the EU's approach to equivalence in general during the coming legislative term[7].

4. Non-EEA AIF /Non-EEA AIFM / UK delegate MiFID manager

(a) Management

There will be no change in the manner in which a UK delegate MiFID manager may be appointed the delegated portfolio manager of a non-EEA AIF managed by a non-EEA AIFM.

(b) Marketing

There should be no change in the manner in which any marketing carried out by the UK delegated MiFID Manager is conducted outside of the EU 27, or within the UK.

For marketing within the EU 27, please see Section B.1(b) above.

C. UCITS and ManCos

[5] To continue marketing the relevant AIF or UCITS fund after the end of the temporary permissions regime, the relevant AIFM or ManCo must qualify the fund under the relevant NPPR and, where retail marketing is required, also under Section 272 of FSMA. The AIFM / ManCo will be directed by the FCA to make its notifications and/or applications within two years from exit day.

[6] At the time of writing the FCA has not made any information available about how to exit the Temporary Permissions Regime.

[7] The European Commission has issued a paper on this area entitled "Equivalence in the area of financial services" which can be found at https://eur-lex.europa.eu/resource.html?uri=cellar:989ca6f3-b1de-11e9-9d01-01aa75ed71a1.0001.02/DOC_1&format=PDF.

1. UK UCITS / UK ManCo

(a) Management

There should be no change in the manner in which management is carried out.

(b) Marketing

There should be no change in the manner in which marketing is conducted outside of the UK and the EU 27.

There should also be no change in the manner in which marketing is carried out within the UK.

Marketing of the UK UCITS by a UK ManCo in the EU 27 on the basis of the UCITS marketing passport will no longer be possible as the UCITS would "default" to being a non-EEA AIF with a non-EEA AIFM from an EU 27 perspective, meaning that marketing in the EU 27 would be subject to Article 42 of AIFMD and, accordingly, the private placement rules of each member state. See further Section B.1(b) above.

2. UK UCITS / EU 27 ManCo / UK delegate MiFID manager

(a) Management

The UK implementation of the UCITS Directive does not envisage a UCITS scheme being managed by a third country ManCo (i.e. an EU 27 ManCo post Brexit). As such, a new UK ManCo would need to be appointed to act as the management company of the UK UCITS, which might be the MiFID manager if it varied its permissions (provided that it can do so within its current business profile). If the MiFID manager does not vary its permissions, a new UK ManCo would need to be appointed, which then could delegate to the UK MiFID manager. Note the EU 27 ManCo could also benefit from the temporary permission regime to permit it to continue managing the UK UCITS. See further Section B.3(b) above.

(b) Marketing

Assuming the UK UCITS would be managed by a new UK ManCo, there should be no change in the manner in which marketing is conducted outside of the UK and the EU 27. There should also be no change in the manner in which marketing is carried out within the UK. See Section C.1(b) above. See also Section D. below regarding marketing in the EU 27 by the UK MiFID manager. Whilst a UK UCITS could still be managed by an EU 27 ManCo provided that this EU 27 ManCo has taken advantage of and made a notification to the FCA under the UK's temporary permissions regime, this EU 27 ManCo would not have UCITS passport rights to market the UK UCITS into other EU 27 member states.

3. EU 27 UCITS / UK ManCo

(a) Management

The UCITS Directive does not envisage an EU 27 UCITS being managed by a third country ManCo (i.e. the UK ManCo post Brexit). As such, a new EU 27 ManCo would need to be appointed to act as the management company of the EU 27 UCITS or the EU 27 UCITS could be converted to self-managed status (where possible – this is increasingly difficult).

As regards delegation by the EU 27 ManCo back to the UK manager, see Section C.4 below.

Note that certain EU 27 countries will, following a hard Brexit, permit a currently passported UK ManCo to continue to manage an EU 27 UCITS on the basis of a national time limited transitional regime. However, there is no common approach across the EU 27 and these regimes are established

unilaterally under the law of an EU 27 country, meaning they do not give transitional rights to the UK ManCo to manage or market across all of the EU 27 member states. For example, while it should be possible for a UK ManCo to continue to manage an EU 27 UCITS on the basis of a national transitional regime in the home state of that UCITS, in the absence of relevant provisions in another national transitional regime, the UK ManCo would have no UCITS passport rights to market that UCITS into such other EU 27 member state.

(b) Marketing

Save for the change of ManCo noted at (a) above, there should be no change to marketing the EU 27 UCITS outside of the UK or EU 27.

Assuming an EU 27 ManCo is appointed as the management company of the EU 27 UCITS, the EU 27 ManCo can market the EU 27 UCITS in the EEA on the basis of its UCITS marketing passport.

Please refer to Section B.3(b) above regarding the FCA's temporary permission regime. This regime is available to EU 27 ManCos currently passporting their UCITS funds into the UK. If an EU 27 ManCo has notified an EU 27 UCITS to the FCA prior to Brexit under the temporary permission regime, it may market new sub-funds of this EU 27 UCITS (i.e. those authorised by the relevant home state regulator of the EU 27 UCITS after Brexit) in the UK after Brexit.

For new EU 27 UCITS or where such UCITS does not make use of the temporary permission regime, UK retail marketing may be permitted under Section 272 of the UK Financial Services and Markets Act 2000 through the FCA approving the EU 27 UCITS as a "recognised scheme" (although, unless the FCA makes a blanket determination in this regard for EU 27 UCITS, the process could be time consuming). In addition, the EU 27 UCITS will likely be treated as an AIF and subject to private placement under Regulation 59 (which implements Article 42 of AIFMD) and require an NPPR notification to the FCA. The scope to market the EU 27 UCITS to retail investors in the UK accordingly, would become limited.

Note the limitation referred to at (a) above on marketing by a UK ManCo of an EU 27 UCITS making use of an EU27 member state's transitional regime to continue to manage the UCITS.

4. EU 27 UCITS / EU 27 ManCo / UK delegate MiFID manager

(a) Management

The EU 27 ManCo can only delegate to the UK MiFID manager if cooperation between the regulator of the EU 27 ManCo and the FCA (as the regulator of the UK delegate MiFID manager, as a "third-country undertaking") is ensured. It is expected that the MOU referenced at Section B.1(b) above would constitute such arrangement.

Notification of the intention to delegate to a third country firm will need to be made to the regulator of the EU 27 ManCo.

The EU 27 ManCo must still have sufficient substance to not be viewed as a "letterbox" following the delegation – this obligation applies regardless of the domicile of the delegate.

Note that certain EU 27 countries will, following a hard Brexit, also permit a currently passported UK delegate MiFID manager to continue to manage an EU 27 UCITS as delegate of an EU 27 ManCo on the basis of a time limited transitional regime. However, there is no common approach across the EU 27. Further information is available via our "World Compass" platform.

(b) Marketing

Please refer to Section B.3(b) generally above. The ability of the UK delegate to market the UCITS within the EU 27 may be curtailed as, subject to alternative arrangements being made (such as the

establishment of an EU 27 MiFID firm), it will no longer be able to provide MiFID investment services in the EU 27 under a MiFID passport. See also further Section D. below.

D. Managed Accounts and MiFID Services

1. UK MiFID manager/ EEA managed account client

(a) Management

A UK MiFID manager would be considered a "third country" (i.e. non-EEA) firm after Brexit, and would therefore need to comply with any relevant restrictions and exemptions for the provision of investment services from third countries into the EU 27. There is currently no EU regulatory harmonization of these requirements (e.g. via an EU directive or regulation) and the positions of individual member states therefore differ. Moreover, there are a number of categories of clients in the EU 27 that are prohibited, either by applicable law or by their own constitutions, from directly appointing a third country investment manager. Analysis of the third country firm restrictions and exemptions applicable in a particular member state of the EU 27, and the particular client type in that member state, would therefore be required post Brexit. We maintain information in this regard via our "World Compass" platform. See also the discussion regarding equivalence in Section B.3(b) above.

Note that certain EU 27 countries will, following a hard Brexit, permit a currently passported UK MiFID manager to continue to provide services to an EEA managed account client on the basis of a time limited transitional regime. However, there is no common approach across the EU 27. Further information is available via our "World Compass" platform.

(b) Marketing

After Brexit, marketing of the portfolio management services of a UK MiFID manager within the EU 27 would need to comply with the same relevant restrictions and exemptions for the provision of investment services and jurisdiction specific requirements relating to marketing by a third country manager in the relevant EU 27 member state as noted above. This information is also available on "World Compass".

E. Additional Considerations

1. Investor relations and documentation changes

Investor interest in Brexit – and how fund managers are dealing with its implications – is once again increasing as 31 October 2019 nears. In addition, the ramifications of Brexit on any given manager are very likely to require changes to fund documentation and other materials. As the exit deadline quickly approaches, managers need to consider to what extent they need to obtain investor consent to any changes and make further communications to investors, notwithstanding that the Brexit outcome remains uncertain.

In a fundraising context, firms may also need to consider the extent to which the role of any UK based investor relations professional amounts to the MiFID service of 'receiving and transmitting orders' on a cross-border basis in the EU 27. See further subsections (b) in Section B above.

2. Deal activity

Investment professionals at private equity and other private assets firms may currently use a MiFID or AIFMD passport to facilitate cross border EU deal activity. Even where the asset being bought or sold is not a security or other regulated financial instrument (such as a derivative), the transaction may involve holding companies and other structures for that asset which may still involve the issue or transfer of shares and/or other financial instruments. Structuring and consummating such transactions may therefore involve one or more "investment services"' in the relevant EU 27 member state, in which case firms will need to consider the basis on which their

UK based investment professionals are involved. In the absence of any temporary regimes, solutions may involve secondment or 'dual hat' arrangements for investment professionals with an EU 27 regulated firm in order to obtain regulatory coverage; utilising alternative group or third party entities; or structuring transactions and deal processes in order to avoid the issue arising in the first place (for example, an acquisition or disposal of a portfolio company arranged and executed by the board of the portfolio company itself, rather than through arrangements made a third party).

3. Regulatory liaison

Brexit has prompted a whole range of enquiries directed at UK based managers by regulators in the EU 27. The enquiries may lead to more substantive regulatory interaction with the relevant regulators or other ramifications. Such interaction also needs to be consistent with any other regulatory processes that may be necessary in the context of Brexit; for example, changes to approved persons or variations of permission.

4. Taxation issues

Although each firm's response to a hard Brexit may be different in the light of that firm's own particular circumstances, it will often mean that functions previously carried out in the UK will henceforth be carried out in one or more of the EU 27 jurisdictions. Accordingly, careful consideration should be given to the potential UK and EU 27 taxation issues arising both as a consequence of any transactions implementing a change in the firm's business structure and contractual arrangements (including issues relating to fee flows, employment, governance and substance) as well as the ongoing taxation consequences of the post Brexit arrangements. In particular:

(a) avoiding any risk of UK exit taxes arising as a result of transactions implementing changes to the jurisdiction in which functions are carried out;

(b) the transfer pricing implications of the new operating arrangements between the UK and EU 27 entities and the respective tax rates in the relevant EU 27 jurisdictions; and

(c) the potential VAT implications of any transactions implementing changes to the jurisdiction in which functions are carried out or arising as a result of the new post Brexit contractual arrangements.

5. Other matters

This note focuses on regulatory matters specific to fund managers, but it is worth bearing in mind that a range of other Brexit-related issues will also be relevant to fund management businesses and need to be considered side by side. For example:

- Employment matters, with attention to immigration issues, 'dual hatting' arrangements, amendments to employment terms as well as consideration of relocation, retention and incentive arrangements.
- Data protection considerations, especially bearing in mind that the management and operation of funds almost invariably involves personal data issues.
- Intellectual property considerations.
- Sanctions, tariffs, and other compliance matters affecting portfolio companies or investment opportunities.

F. Service Providers and Trading Arrangements

1. Non-trading service provider relationships

In principle there should not be any changes to relationships with service providers that are not providing custody / brokerage/ collateral management services or are part of the existing investment management structure. Whereas, EEA established AIFs / UCITS generally require local administrative, audit and depositary service

providers, there are no such local service provider requirements for non-EEA AIFs, and this is unlikely to change. As UK AIFs / UCITS will continue to be subject to the equivalent requirements of AIFMD and the UCITS Directive, UK AIFs / UCITS will continue to need local UK service providers, whereas non-UK AIFs may make use of alternative service providers as permitted by the jurisdiction of the AIF's establishment.

Notwithstanding the foregoing, where the relevant service provider is a UK firm making use of an EU 27 branch or an EU 27 service provider operating out of a UK branch, the relationship may be subject to change with the relevant service provider either potentially seeking to establish a new entity in the EU 27 member state / UK (but note the potential availability of the FCA's temporary permission regime for certain types of EU firms making use of an inbound passport under Section B.3(b) above), as applicable, or withdrawing from providing the service in the relevant jurisdiction. Section F.2 immediately below explores this in further detail, in the context of trading relationships.

2. Trading relationships

Trading relationships raise a number of potential issues in relation to Brexit and exact effects must be considered in the context of a given entity or group's existing trading relationship set-up.

The key questions to consider are:

- What UK nexus does the counterparty have?
- As a counterparty, which dealers is the counterparty facing and where are those dealers established?
- What agreements are in place and how may these be affected?
- How does the counterparty currently satisfy its trading related regulatory requirements?

The application of similar rules in EU 27 countries and the UK may give rise to perverse results, where each treats the other as a third country. Set out below are some key considerations, both generally and with respect to specific EU regulation.

(a) Choice of Governing Law

Where English law is the choice of governing law in trading documentation:

(i) Rome I and II (EC Regulations 593/2008 and 864/2007) will continue to apply in the EU 27, meaning that clauses in contracts specifying English law as the governing law of contractual and non-contractual obligations should continue to be recognised by the EU 27 courts; and

(ii) the Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc.) (EU Exit) Regulations 2019 were made on 29 March 2019 meaning that from exit day the substantive rules of Rome I and II will continue to apply in the UK to determine the law applicable to contractual and non-contractual obligations.

Accordingly, while ISDAs subject to Irish or French law are available, it is not clear that there is any advantage to be obtained by moving to an Irish or French-law governed ISDA.

After Brexit, EU 27 institutions using English law trading documents may need to draft into the contract certain additional clauses to capture other governing law related items. For example, because post Brexit, English law will become "third country" law, English law agreements with EU 27 dealers may require amending to include contractual recognition of bail-in provisions in order to be compliant with the Bank Recovery and Resolution Directive (2014/59/EU). The jurisdiction provisions of trading documentation may also require revisiting to ensure that the intentions of the parties are captured with respect to the location of any relevant court proceedings. This will depend on the final position with

respect to the 2005 Hague Convention, the 2007 Lugano Convention and the Brussels I Recast Regulation.

(b) Agreement Defaults / Termination Events / Brexit prompted amendments

In its most recent Brexit Q&A (version published on 17 July 2019[8]), ISDA examines the possibility that a no-deal Brexit may trigger the Force Majeure, Illegality and/or Impossibility Termination Events of the ISDA 1992 and 2002 Master Agreements. There is no absolute conclusion and the result will depend on the specific facts, type of derivative transaction, if the derivatives transaction is existing, new or existing but materially changed following a no-deal Brexit and the particular jurisdictions involved in any given fact pattern. The stronger argument is however that a no-deal Brexit is unlikely to trigger any of the foregoing Termination Events.

A key concern when considering these Termination Events is the widely discussed "contractual continuity" issue i.e. how authorisation changes caused by Brexit may disrupt existing trades with a particular focus on the implications of certain trade life-cycle events. The UK has implemented measures to confirm and the EU has indicated that pre-existing obligations under an ISDA transaction will not require authorisation, although the final result on contractual continuity, required authorization and the effect of life-cycle events requires consideration on a jurisdiction-by-jurisdiction basis (particularly in relation to dealing-type activities). As further considered generally herein certain EU 27 member states have introduced measures targeting contractual continuity for derivatives.

Market volatility post-Brexit could also lead to greater margin calls, breaches in position limits, the occurrence of hedging disruption events and / or breaches in net asset value decline triggers, leading to other ISDA documentation issues.

Pre-empting contractual continuity and related issues with trading documentation, ahead of the original 31 March 2019 deadline, some dealers restructured their trading services (for example by novating contracts to a non-UK group member) and work done ahead of the original March deadline means that a significant "no deal" infrastructure is already in place. Responding to concerns that such novations to EU 27 entities from UK entities may trigger EMIR clearing and margin requirements, the European Commission adopted two delegated regulations that, in the event of a hard Brexit, provide limited time and scope exemptions for margin and clearing. Restructuring of trading activities is ongoing and some dealers are transferring, or have recently transferred, contracts.

Trading relationships may also need to be restructured where an EU 27 dealer is currently providing services through a UK branch, or where a UK dealer is currently providing services through an EU 27 branch. Such a restructuring could affect a counterparty's economics or legal terms or the availability of particular trading lines.

EU firms conducting trading activities in the UK after Brexit may benefit from the temporary permissions regime, as described under Section B.3(b) above. Firms that do not subscribe or are ineligible for the temporary permissions regime, will be able to continue their UK activities automatically through the "Financial Services Contracts Regime", which ultimately seeks to ensure an orderly run-off of UK activity. For derivatives contracts, this provides a 5 year period from exit day that will allow EEA based firms to continue undertaking their UK activities.

Time afforded by the extension to October 2019 means Brexit protections are now becoming embedded into trading documents more routinely and their inclusion is now common for the purpose of: (i) updating statutory references with respect to EMIR related provisions, (ii) to more widely incorporate transfer provisions and (iii) to provide for references to both UK and EU regimes.

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[8] https://www.isda.org/2019/07/17/brexit-faq-copy/

(c) EMIR / SFTR/ Other relevant European legislation

Pursuant to the UK's European Union (Withdrawal) Act 2018, the UK government has published a number of SIs relating to existing derivatives and trading related European legislation. Under these SIs, post Brexit many of the existing regimes will be effectively replicated or "onshored" into UK law. These include Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories ("EMIR"), Regulation (EU) 2015/2365 on transparency of securities financing transactions and of reuse ("SFTR"), Regulation 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the "European Benchmarks Regulation" or "BMR") and Regulation 236/2012 on short selling and certain aspects of credit default swaps (the "Short Selling Regulation"). In July 2019 a draft SI was published to address the EMIR "Refit" changes i.e. those changes to EMIR introduced by Regulation (EU) No. 2019/834 which entered into force on 17 June 2019. At the time of writing this remains in draft form.

In the absence of a transitional period, regulatory requirements that take effect following 31 October 2019 (including items such as SFTR reporting, EMIR initial margin rules and future EMIR Refit updates) are not expected to automatically form part of English Law and will require further legislative action. The British Parliament had proposed the Financial Services (Implementation of Legislation) Bill or the "in-flight files bill" which would empower the government to onshore and adjust European legislation that is currently adopted or in progress but it is not yet in effect. However, Parliament updated its webpage on 8 October 2019 and confirmed that the "in-flight files bill" failed to complete its passage through Parliament before the end of the current Parliamentary session and will make no further progress. Despite this, the UK, of course, could chose to make changes to onshored EU regulation as it applies to trading activity post-Brexit. This could, for example, include a move to one sided reporting under EMIR and SFTR, although such changes are not expected to be a priority. Currently in the event of a hard Brexit we expect the position to be as follows:

(i) UK dealers will continue to classify UK counterparties and AIFs with UK AIFMs as "Financial Counterparties" or "FCs" for the purposes of the (UK) or "onshored" EMIR and (UK) SFTR implementing legislation and these entities will continue to be subject to the clearing and margining rules.

(ii) UK dealers will also continue to classify counterparties which are both non-EEA and non-UK as "third country entities". These counterparties will generally continue to be out of scope of the (UK) EMIR clearing and margining rules unless they are required by the UK dealer to comply due to their legal form, if they trade a high volume of derivatives or if one of a limited number of other exceptions apply.

(iii) UK dealers will classify EU 27 counterparties and AIFs with EEA AIFMs as "third country entities". However, this may become largely irrelevant depending on the extent of the restructuring of EEA/UK trading relationships that takes place.

(iv) Where UK counterparties and AIFs with UK AIFMs continue to face EU 27 dealers, those EU 27 dealers will classify such counterparties as "third country entities". This will bring many of these entities out of direct scope of the (EU) EMIR margining and clearing rules although they would be brought in scope of the (UK) EMIR provisions, and depending on the volume of their derivatives and legal form could be indirectly subject to EMIR due to (EU) EMIR obligations of their EU 27 dealer. This would be alleviated by equivalence decisions where the UK entity already complies with (UK) EMIR requirements.

(v) For UK counterparties to report trades under the (UK) or "on-shored" EMIR to a non-UK trade repository or to clear trades through a non-UK central counterparty clearing house ("CCP"), there would need to be an equivalence decision in relation to any non-UK CCPs and non-UK trade

repositories. To address this, the UK established a temporary registration regime for those trade repositories not currently established in the UK and a temporary recognition regime with respect to CCPs, where the Bank of England assumes the role currently ESMA has in relation to third-country CCPs.

(vi) The same concerns apply in reverse if, post Brexit, an EU 27 counterparty wishes to report to a UK trade repository or clear through a UK CCP to satisfy its (EU) EMIR obligations – ESMA would need to deem such UK CCP equivalent and formally "recognise" the relevant UK trade repository. On 19 December 2018, the European Commission adopted a temporary equivalence decision in relation to the UK's regulatory framework for CCPs, valid for 12 months from the original exit day. That equivalence decision is expected to expire on 30 March 2020 following which the UK will require a permanent equivalence decision.

(vii) Currently there are no similar relief provisions that would allow EU counterparties and CCPs to continue reporting to a UK based trade repository. On 1 February 2019 ESMA published a statement on issues affecting reporting, recordkeeping, reconciliation, data access, portability and aggregation of derivatives in the event of Brexit. The FCA also published a related statement and has since published a general statement on the reporting of derivatives under the UK EMIR regime in a no-deal scenario, last updated on 10 October 2019. In the October update the FCA recognises the operational challenges for UK reporting counterparties and FCA registered trade repositories if the UK withdraws from the EU mid-week, without an agreed deal and has stated that it will take a proportionate and pragmatic approach to supervising reporting on Friday November 1. All UK reporting counterparties are expected to report details of all derivative transactions concluded, terminated or modified on 1, 2 and 3 November 2019 to an FCA registered trade repository by no later than 4 November 2019. Similarly, UK reporting counterparties must also ensure that any details of their derivative transactions concluded, terminated or modified on 30 and 31 October 2019 that cannot be reported by the point of exit are back-reported by no later than 4 November 2019. On 11 October, the FCA published a press release setting out its expectations for firms on Brexit. The FCA again acknowledged the operational challenges of leaving the EU during the working week but stated that firms should take reasonable steps to comply with post-exit transaction reporting and trade reporting requirements under the MiFID II, the Markets in Financial Instruments Regulation (600/2014) (MiFIR) and EMIR. The FCA reiterated that it will take a proportionate and pragmatic approach to supervising reporting around exit day but stated that firms who cannot fully comply with the MiFID transaction reporting regime at the time of the UK's withdrawal from the EU will need to back-report missing, incomplete or inaccurate transactions as soon as possible after 31 October 2019.

(viii) In its 4 September 2019 communication, "Finalising preparations for the withdrawal of the United Kingdom from the EU on 1 November 2019", the Commission's position is that the adoption of additional contingency measures is not necessary and that it will continue to assess the situation after the withdrawal date. At the time of writing therefore, it appears unlikely an equivalence decision will be forthcoming.

(ix) For those UK or US counterparties who currently rely on the EU-US position to satisfy their regulatory requirements, for example, in relation to clearing, in the same way as currently applies for EU CCPs, UK CCPs would need to be deemed compliant with the US Dodd-Frank regime in order to benefit from substituted compliance in the US. Similarly, the UK would need to grant an equivalence determination for UK counterparties to continue to rely on the use of US arrangements to satisfy their (UK) EMIR requirements. With the exception of CCPs (see above by reference to the new process) (UK) EMIR generally incorporates existing EMIR third country equivalence decisions into UK law. Whilst there is no formal position nor rule making on the continuity of UK-US trading or clearing posit-Brexit, the general expectation is that such measures will be in place, if and as required ahead of any no-deal Brexit. This position, referred to as the "bridge over Brexit" was clearly conveyed in the detailed Joint Statement from the Bank of England including the Prudential

Regulation Authority, FCA and US CFTC on 25 February 2019 which refers to measures in "whatever form it takes".

G. Conclusion

The analysis and conclusions above are subject to change. This document is not legal advice and should not be relied on as such. Firms should seek advice on their particular circumstances. Brexit is a fast moving, highly political event and the approach of member states and regulatory bodies continues to evolve. We are monitoring developments and, together with our European colleagues, are advising our clients on the practical implications of Brexit on their particular circumstances and approaches to effective Brexit planning.

For further information, please do not hesitate to get in touch with a member of Dechert's financial services team or your usual Dechert contact.

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