



# Brexit – what asset managers need to know



It is no understatement that the UK referendum to leave the European Union has sent shock waves throughout all sectors of the financial services industry, with specific implications for investment management and investment funds in particular. In this briefing note, we will explore these implications and how firms in this sector might respond to what seems inevitably to have become a new reality.

## The legal background

Relevant EU law is based on the untested notification of withdrawal procedure Article 50 of the Treaty on European Union and the subsequent withdrawal negotiations under Article 218(3) of the Treaty on the Functioning of the European Union (TFEU) – both of these Treaties are often referred to as the Lisbon Treaty. This states that the Member State planning to leave the EU must notify the EU formally and then commence a two year withdrawal and negotiation process.

But the UK referendum has not triggered the Article 50 notification. It is the duty of Theresa May, the newly appointed UK Prime Minister and leader of the Conservative Party, to trigger Article 50 and begin the process of the UK's exit from the European Union. Once Article 50 is invoked, the UK will enter the two year withdrawal and negotiation process.

The final outcome of the withdrawal negotiations is obviously uncertain, but the reality is that until Article 50 is triggered and the withdrawal negotiations concluded, the UK remains part of the EU and subject to EU law. Indeed the UK Financial Conduct Authority (FCA), in a statement immediately after the referendum outcome stated that:

***'EU regulation will remain applicable until any changes are made, which will be a matter for Government and Parliament.'***

***Firms must continue to abide by their obligations under UK law, including those***

***derived from EU law and continue with implementation plans for legislation that is still to come into effect.***

***The longer term impacts of the decision to leave the EU on the overall regulatory framework for the UK will depend, in part, on the relationship that the UK seeks with the EU in the future.'***

## What does this mean in reality?

Until the Article 50 withdrawal process is concluded, all UK-domiciled and regulated fund management companies and funds will need to comply with the FCA's rules in relation to the Alternative Investment Fund Managers Directive (AIFMD), UCITS, the Markets in Financial Instruments Directive (MiFID), European Market Infrastructure Regulation (EMIR) and any other relevant pan-European directive or regulation.

The implementation of MiFID II for UK investment firms should continue. And the rules in relation to transaction reporting and capital market infrastructure as set out in Markets in Financial Instruments Regulation (MiFIR) are legally binding at a pan-European level.

The timetable for the implementation of MiFID II is still January 2018 and on the basis that the UK withdrawal negotiations have not been completed by that date – a highly likely scenario – MiFID II will come into effect.

There are some investor protection rules that have always been implemented at the local Member State level and that remains the case.



## What is the potential long-term regulatory impact?

Many firms with UK operations are facing a period of uncertainty and the impact of UK withdrawal on individual firms will depend on the agreement that is reached with the EU and the firm's own individual circumstances.

If the UK becomes a "third country" – non-EU and non-EEA (European Economic area), then the following applies:

- **UK domiciled investment funds:** UK-domiciled UCITS would no longer be able to use the EU marketing passport. In order for a fund to be marketed in Europe, marketing could take place under the national private placement regimes or the fund could re-domicile to an EU Member State such as Ireland.

If the AIFMD passport is extended to third countries, UK domiciled AIFs could continue to be marketed in the EU without any great change and UK UCITS could then be marketed to professional investors in the EU as UK AIFs. Extending the AIFMD third country passport to the UK would require an equivalence of UK law to EU law assessment by ESMA and a recommendation to the European Commission. Additional local requirements will need to be met for UK AIFs to be marketed to retail investors.

- **UK authorised UCITS Management Companies and AIFMs:** UK authorised UCITS management companies and AIFMs of EU funds would also lose their EU management passports. In order for UK firms to continue to manage EU funds then they would have to appoint an EU UCITS management company or AIFM, or the funds would have to become self-managed.

UK AIFMs may still be able to manage EU AIFs (as a non EU AIFM) but would only be able to market the funds under national private placement regimes and would have to consider any additional gold-plating in individual jurisdictions. If, however, the AIFMD third country passport is extended to the UK, then UK AIFMs would still be able to operate without substantial change.

- **EU-domiciled UCITS and AIFs:** The situation would operate in reverse for EU UCITS and AIFs which would lose their rights to be marketed in the UK. The indications are, however, that the UK would allow these funds to be marketed in the UK, particularly where they have a UK investment manager.
- **UK distributors of investment funds:** UK distributors would no longer be able to use the EU passport to market investment funds across borders in EU countries. Instead, to continue marketing in the EU, they would need to comply with local third country rules, with all the associated administrative and regulatory burden. Alternatively, a new distribution entity could be established in an EU Member State.

UK distributors, however, may be able to continue marketing to professional clients within the EU under MiFID's new third country regime – if the EU is designated as "equivalent" under MiFID II and pending a formal equivalence assessment from ESMA.

- **UK portfolio managers:** Similarly, UK-based portfolio managers would need to comply with local third country rules to continue EU portfolio management activity. Alternatively, a new portfolio management entity could be established in an EU Member State. However, if the UK is designated as equivalent under MiFID II, UK portfolio managers would be able to continue to manage the assets of EU professional clients without substantial change.
- **Other firms:** Firms in the US or anywhere else outside the EU and the UK will need to assess their options based on their own individual arrangements – whether to use their own EU subsidiaries and/or whether to use third party management companies. In addition, sub-investment management by a UK MiFID/AIFM firm for an EU fund (outside of the UK) may need to be reviewed.



## So what are the possible outcomes of the Article 50 process?

Ultimately, the UK will need to present a draft agreement to the European Commission. Any negotiated agreement will need to be adopted by a qualified majority of 20 of the remaining 27 EU Member States, representing 65 percent of the total EU population. The European Parliament also has the right to veto or extend the negotiation process.

Ireland, as a committed member of the EU and with a very significant investment management industry, will be fully engaged throughout this process.

It is possible that no agreement is reached within the two year time frame, and that the UK will then begin repealing legislation, but this worst case scenario is seen as unlikely.

## The options for a new EU-UK relationship

The potential trade options available are:

- **European Economic Area (EEA) Arrangement**  
If the UK decide they want to have an EEA type arrangement (such as the one in place with Norway) they will essentially have to keep the EU legislative rulebook and lose any influence on future rule-making. An EEA arrangement would however, preserve the UK's access rights to the single market and passporting rights.
- **European Free Trade Agreement (EFTA)**  
If the UK seek a version of the EFTA, such as that in place with Switzerland, this would preserve some passporting rights but would require a separate legal rulebook. However, the UK would be treated as a third-country and UK firms would be assessed for equivalence by ESMA or be required to establish a branch or subsidiary.
- **Customs Union Arrangement**  
Customs Union, such as that in Turkey, entails the free movement of goods and services. However, from the perspective of financial services there is no clear roadmap to instigating this option as currently financial services do not form part of this type of arrangement.

- **World Trade Organisation (WTO) Agreement**

A WTO agreement would effectively make the UK a third-country from a legal and regulatory perspective and an assessment would still need to be done, in order for there to be any pan-European marketing or management of funds.

- **Bilateral Arrangements**

No pan-European agreement is reached and a series of bilateral arrangements are put in place.

- **UK Specific Deal**

A UK specific deal, not based on any of the aforementioned options, may be arrived at.

It is possible that if no agreement is reached within the two year time frame, and EU law ceases to apply in the UK that this will see the UK beginning to repeal EU legislation e.g. 1972 European Communities Act. This is seen as unlikely.

## How we can help

KPMG is here to assist and discuss potential impacts on your organisation. Our experienced Irish tax, regulatory and wider consulting practices can provide insight, in order to help firms meet the challenges of Brexit.

The outcome of the UK-EU negotiations are unclear and the above is based on the currently known options. The information set out above is general in nature and we would advise firms to consider their own individual arrangements before making any decisions.

Should you require more information on the broader implications of Brexit, please visit

[www.kpmg.ie/Brexit](http://www.kpmg.ie/Brexit)



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