'No-Deal' Brexit – EU Regulators Take Small Steps to Maintain Status Quo for UK Fund Managers

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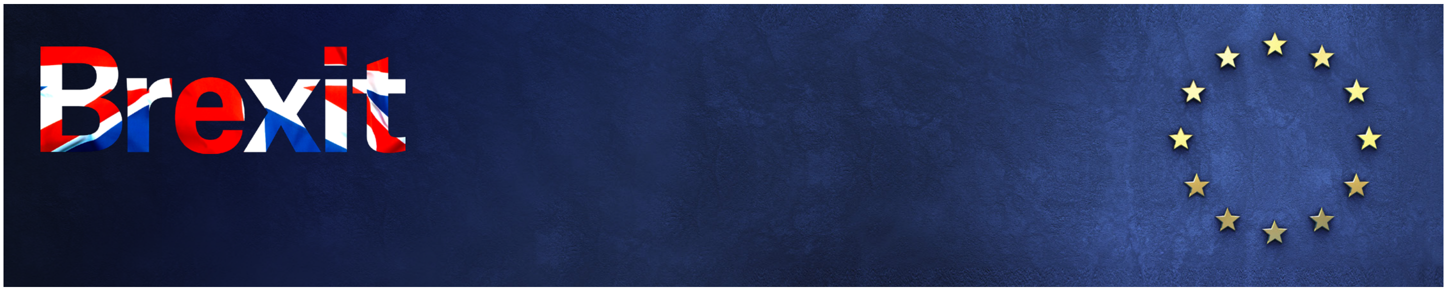

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In the middle of February 2019, Brexit continues to be debated between Westminster and Brussels, despite the rapidly approaching deadline for the United Kingdom (U.K.) to leave the European Union (EU) on March 29, 2019. With negotiations stalling, businesses are increasing their focus on the consequences of a "no-deal" Brexit. For private fund managers operating in or from the U.K. who either manage or market funds in the rest of the EU, the main regulatory concern is over the prospect of losing the "passport" that allows private fund managers to operate across the EU.

However, since the start of 2019, some European regulators have begun to take steps in an attempt to mitigate some of the effects that a no-deal Brexit would have on private fund managers. First, on January 7, 2019, the U.K. Financial Conduct Authority (FCA) opened a temporary permissions regime for fund managers currently using a passport to manage U.K. funds or to market EU funds in the U.K., effectively allowing those managers to continue their operations in the U.K. (albeit for a limited time) despite the loss of the "passport." Then, on January 31, 2019, the FCA and European Securities and Markets Authority (ESMA) announced that they had agreed a Memorandum of Understanding (MoU) covering a broad range of financial services cooperation. It is expected that such cooperation would permit fund managers that currently have delegation arrangements between entities in the U.K. and entities in the EU to continue those arrangements without a need for change. On the same day, the Luxembourg legislature introduced a bill (the Luxembourg Bill) that, if passed, would permit the Luxembourg Financial Sector Supervisory Authority (CSSF) to continue to apply the management passporting regime for U.K. fund managers managing funds in Luxembourg.

UK Temporary Permissions Regime

Alternative investment fund managers (AIFMs) established in other EU member states are currently able to manage U.K. alternative investment funds (AIFs) and market EU AIFs in the U.K. using the passports available under the Alternative Investment Fund Management Directive (AIFMD).

A no-deal Brexit would mean these passports would cease to be available; therefore, on January 7, 2019, the FCA opened a temporary regime (TPR) for AIFMs currently using a passport to manage U.K. AIFs or market EU AIFs in the U.K. In order to benefit from the TPR, AIFMs must submit a notification to the FCA before March 28, 2019. The TPR effectively will allow European Economic Area-based firms and funds currently passporting into the U.K. to continue as normal for a period of time should the U.K. leave the EU without a deal.

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AIFMs can notify the FCA of their intention to fall under the TPR now, even though the relevant statutory instrument is not yet in force, and are encouraged to do so as soon as possible. There is no fee for the notification and the FCA has stressed that firms and funds should not wait for confirmation as to whether there will be an implementation period before submitting their notification. It is expected that the regime would last for a maximum of three years, by which time firms and funds would be required to obtain authorisation or recognition in the U.K.

ESMA/FCA Memorandum of Understanding

A number of fund managers operate a structure with an EU AIFM (*e.g.*, in Luxembourg or Ireland) that delegates portfolio management (or other functions) to a U.K. entity. Following a no-deal Brexit, the U.K. entity in such a structure would become a non-EU entity and so the delegation arrangement would not be permitted under the AIFMD unless a cooperation agreement is in place between the FCA (as the U.K.'s competent authority) and the regulator in the EU jurisdiction where the AIFM is located. The MoU agreed upon between ESMA and the FCA seeks to address this. The MoU covers a broader range of financial services cooperation but it should include provisions that satisfy the requirement for a cooperation agreement pursuant to the AIFMD. Assuming the MoU is implemented before March 29, 2019, EU AIFMs will not have to change any existing delegation arrangements with U.K. entities if there is a no-deal Brexit.

The MoU still needs to be signed by regulators from each of the 27 remaining EU member states. Interestingly, the CSSF confirmed in a press release on January 25, 2019, (before the MoU was announced) that U.K. delegates would continue to be authorised to perform investment management functions and risk management activities in a no-deal scenario as long as the other existing provisions in Luxembourg legislation are satisfied. This would suggest that the requirement of member state approval should be forthcoming.

What About the Passport?

Although the steps taken by the FCA and ESMA are helpful for some fund managers, they do not help U.K. AIFMs that rely on the passport to manage and, perhaps more importantly, market across the EU. The Luxembourg Bill, if passed, should allow U.K. AIFMs to continue managing Luxembourg AIFs for up to 21 months after a no-deal Brexit. This is clearly to the benefit of Luxembourg as a major jurisdiction for establishing fund vehicles and has been proposed for the purposes of maintaining market stability. It remains to be seen whether other EU member states will take similar steps.

It is notable that the Luxembourg Bill only addresses the management passport and it would not allow U.K. AIFMs to continue to market U.K. funds to Luxembourg investors. Luxembourg is generally not considered a key jurisdiction for most funds marketing in the EU, and this may not make much difference to U.K. AIFMs. However, one of the key benefits of the AIFMD passport is the ability for AIFMs to market funds across the EU. Even if other EU member states were to open up the management passport to U.K. AIFMs, it seems unlikely that they will do the same for the marketing passport. Assuming that is the case, even with the steps taken by the regulators so far, U.K. AIFMs will find themselves at a disadvantage (at least when it comes to fundraising in Europe) when compared to their EU peers.

Trainee solicitor Eleanor Williams assisted in the preparation of this alert.