

Brexit

Implications for Non-UK Private Fund Managers

Currently, private fund managers based outside the UK market their funds to UK-based investors under the European Union's Alternative Investment Fund Managers Directive ("AIFMD"). Many such managers have UK-based staff – e.g. US managers often have London-based deal teams operating with Financial Conduct Authority ("FCA") authorisation under the EU's Markets in Financial Instruments Directive ("MiFID") and making use of the MiFID cross-border services passport in relation to activities in the European Union.

On 23 June 2016, the UK voted to leave the European Union giving rise to uncertainty as to how private funds and financial services firms will be regulated in the UK in future. Much remains unclear, in particular, the outcome of the UK's negotiations with the EU in relation to the single market in financial services and what the UK's relationship with the EU will look like following departure. Any changes are unlikely to take effect until at least two years following formal notification to the EU of the UK's intention to leave (which has not yet occurred and is not expected to occur until later this year). However, there are certain conclusions which can be drawn about the effect on private fund managers if the UK were to leave the EU's single market in financial services and no longer fall within scope of AIFMD or MiFID (this assumes that the UK does not subsequently join the European Economic Area ("EEA"), in which case AIFMD and MiFID would likely continue to apply as they currently do).

This note examines the potential impact that Brexit may have on: (i) non-UK managers marketing private funds to UK investors; and (ii) UK-based entities operating under the MiFID passporting regime.

How will non-UK managers market their funds in the UK?

In our view, there are two likely ways in which the marketing of private funds by non-UK managers to UK investors may be regulated following Brexit:

The UK retains the current AIFMD regime

Non-EEA managers may currently market their funds to UK investors through the UK's AIFMD national private placement regime ("NPPR"), while EEA managers may do so under the AIFMD marketing passport.

Under the current NPPR, a non-EEA manager registers with the FCA and is then subject to ongoing compliance requirements (a subset of AIFMD's requirements including disclosure and reporting requirements and asset stripping restrictions). The UK may choose to retain this regime for non-EEA managers, in which case marketing to UK investors by such managers would not change following Brexit.

In respect of EEA managers currently using the AIFMD marketing passport, the UK may permit such managers to continue to market to UK investors if they qualify for the AIFMD marketing passport in their home jurisdiction (despite the UK not being part of the EU single market following Brexit) or may treat EEA managers in the manner in which non-EEA managers are currently treated, i.e. require registration and compliance under the UK's NPPR.

The UK repeals AIFMD and returns to the pre-AIFMD regime

If Brexit occurs, the UK may repeal its NPPR and revert to the financial promotions regime of the Financial Services and Markets Act 2000 which was in place prior to AIFMD (or something similar). In practice, this regime restricts marketing of funds by non-UK managers to certain categories of investors (e.g. high net worth entities / individuals, sophisticated investors) and may involve certain compliance processes (e.g. obtaining signed certificates from high net worth investors) but is less involved than the current NPPR.

Effect on UK-based entities with MiFID authorisation

Central to the EU's vision for a single market in financial services is that financial services firms authorised by their local member state regulators may carry on business in any other member state without the need for separate authorisation in every host state. If the UK were to leave the EU and not retain membership of the EEA, the UK would be treated as a "third country" for the purposes of MiFID and there would be no automatic access to the passporting regime allowing for the provision of services on a cross-border basis. Following Brexit, UK entities would likely have the following three options.

Existing “Third Country” Route

Currently under MiFID, there is no harmonisation amongst member states in relation to access for non-EEA firms and rules for third country financial institutions wishing to provide investment services differ by jurisdiction.

UK entities operating in these circumstances would need to assess the rules for third country firms in each EEA jurisdiction in which they intend to provide services and/or conduct activities, with some jurisdictions requiring registration or authorisation by the local regulator (which can be a lengthy and onerous process involving significant ongoing obligations), others allowing provision of services only following a reverse solicitation from a potential client and some not allowing access for third country firms at all. This will clearly create difficulties for UK entities wishing to provide services or conduct activities currently regulated under MiFID and is not likely to be a practicable route for firms conducting services or activities in relation to a wider range of EEA jurisdictions.

Third Country Passport and the Introduction of MiFID II

Directive 2014/65/EU (“**MiFID II**”), which is currently scheduled to revise MiFID in January 2018, contemplates access to the MiFID passporting regime for third country firms. MiFID II includes a new arrangement which would allow third country firms access to the MiFID third country passport to provide cross-border investment services to professional clients and eligible counterparties across the EEA, following approval of the third country, on the condition that the third country firm is authorised in a jurisdiction which has a regulatory regime equivalent to that in the EEA and which provides an effective reciprocal mechanism offering access to EEA firms.

Assuming that the UK continues to ensure that its regulatory regime is equivalent to the MiFID regime by maintaining its existing regulatory regime (which in our view is likely) and offers reciprocal access to EEA firms, this mechanism could provide an important means of managing the changes caused by Brexit by providing UK entities a route to continued access to MiFID’s passporting regime.

There are however, a number of uncertainties surrounding the MiFID third country passport regime and its availability to UK entities following Brexit.

The key issue is whether MiFID II will come into effect prior to the UK’s exit from the EU. The current date for implementation of MiFID II has recently been delayed from 3 January 2017 to 3 January 2018. A UK exit from the EU would likely follow a formal negotiation process lasting at

least two years with national member states and the EU parliament approving the final terms and conditions. On the current timeline, MiFID II will come into force prior to the anticipated conclusion of such process. However, this is by no means certain and much will depend on the final arrangement negotiated between the UK and the EU.

Additionally, there is a question as to whether the EU would give the UK the same treatment as envisaged for non-EEA countries under MiFID II and approve the UK in respect of the MiFID third country passport regime. Although it seems likely that the UK would be granted such approval, there is a possibility that a particularly acrimonious break-up could result in UK entities not begin given the same rights as entities based in other third countries.

There is also a possibility that the UK may wish to avoid certain of the more onerous requirements of the obligations under MiFID. If the UK implemented a regime which was not fully equivalent to the MiFID regime, the MiFID third country passport may not be made available to UK entities.

Establish an Authorised Subsidiary in an EEA Member State

This option requires UK firms to establish a subsidiary elsewhere in the EEA (e.g. Ireland, Luxembourg, Germany or France), seek authorisation for the subsidiary from the local regulator and access the MiFID passporting regime through such subsidiary in order to continue to provide services and conduct activities across the EEA. Firms may have to relocate staff as regulators will likely require significant substance in the relevant jurisdiction in order to grant MiFID authorisation.

Conclusion

Marketing of private funds to UK investors is unlikely to become significantly more onerous for non-UK managers.

The more important concern for non-UK fund managers is likely to be the regulatory effect of Brexit on their UK-based entities and the timing of the UK’s exit from the EU and the effective date of MiFID II will be key considerations. If the third country regimes contemplated by MiFID II were to enter into force prior to Brexit, then it is likely that the UK would be deemed a suitably equivalent “third country” and UK entities granted access to the MiFID third country passport. However, if the UK seeks to amend aspects of its current regulatory regime and divergences appear between the regulatory regime in the UK and the EU, then this could jeopardise regulatory equivalence and result in the MiFID third country passport being denied to UK entities. Although the current expectation is that the MiFID third country passport regime

should become effective in January 2018, this could be delayed and it is unclear whether the UK would be assessed for approval under the regime until after its departure from the EU. This could create a period of delay between the UK's departure from the EU and the MiFID third country passport becoming available to UK entities.

In the event that the third country passport under MiFID II is not made available to the UK or there is a delay in its becoming available following Brexit, UK firms wishing to provide services or conduct activities in a particular EEA jurisdiction will need to either: (i) review the local "third country" regime in respect of the relevant service or activity; or (ii) establish an authorised subsidiary in an EEA member state to access the MiFID passporting regime.

For further information please contact:



Marc Schubert

Associate

marc.schubert@weil.com

+44 20 7903 1128

or your client relationship partner:



Ed Gander

Partner

ed.gander@weil.com

+44 20 7903 1138



Nigel Clark

Partner

nigel.clark@weil.com

+44 20 7903 1025



Stephen Fox

Partner

stephen.fox@weil.com

+44 20 7903 1026