



#eurofundscomment

A photograph of the London skyline at dusk or dawn, featuring several prominent skyscrapers. From left to right, the buildings include a tall, thin tower with a green facade, a cylindrical tower with a blue facade, a tall, thin tower with a yellow facade, the Gherkin (a blue, conical building), and the Shard (a tall, thin, glass-clad tower). Construction cranes are visible in the background.

Hard Brexit: Consequences and recommendations

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Agenda

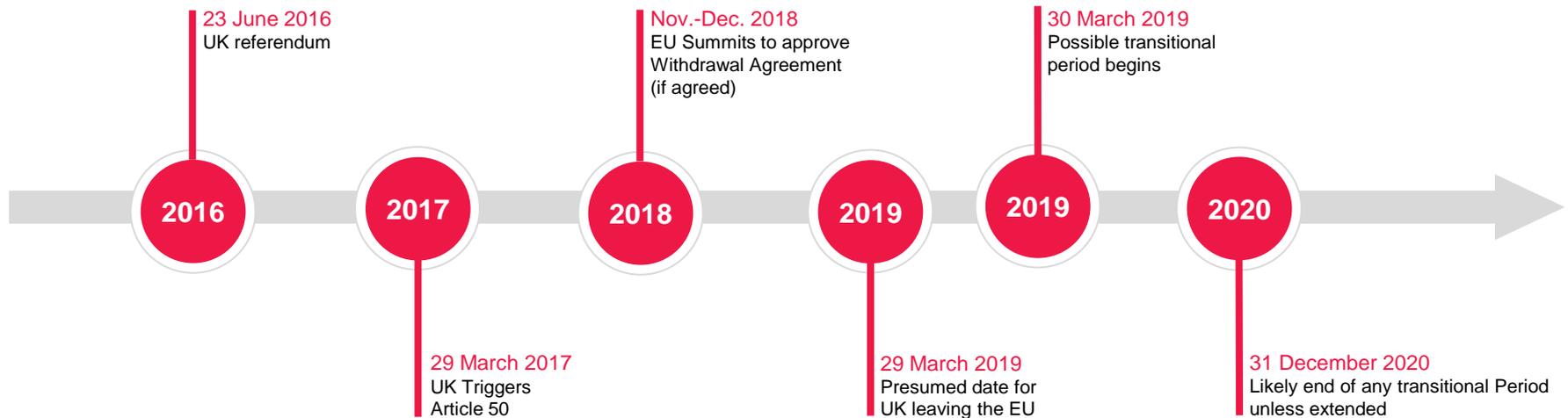
- I. Introduction and Brexit state of play, Timeline**
- II. Transitional period**
- III. “Enhanced” equivalence and third country rules**
- IV. No-deal and the UK’s temporary permission regime**
- V. Marketing matrix post Brexit (assuming no deal)**
- VI. Relevance of cooperation arrangements**
- VII. Impact on structures and operations**
- VIII. Q&A**

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I. Introduction and Brexit state of play

Brexit Timeline – Key Dates



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II. Transitional period

- Part of Article 50 withdrawal agreement:
 - runs to 31 December 2020.
 - EU law continues to apply in the UK and EU institutions have same jurisdiction (despite repeal of European Communities Act 1972 on exit day).
 - UK does not participate in EU decision-making.
- Regulatory impact – is it business as usual?
- Contractual obligations:
 - Definitions of “Europe”.
 - Requirement for an “EU AIF” or “EU AIFM”.
 - Management Agreements/Depository Agreements.
 - Solvency II etc. grandfathering?

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III. “Enhanced” equivalence and third country rules

- Is “enhanced” equivalence the basis for a future deal?
- Enhanced means:
 - Accelerated equivalence decisions.
 - Alignment of outcomes based on agreed principles.
 - Safeguards to preserve decisions in future, including consultation on withdrawal and arbitration.
- Implications for PE:
 - MiFID third country passport available for EU fund-raising and deal activities (but does not encompass opted up professional clients).
 - AIFMD third country passport - does the industry want it, given impact on NPPR? AIFMD also under review.

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IV. No-deal and the UK's temporary permission regime

- The regime is conditional on “hard” Brexit in March 2019.
- A new “temporary permissions regime” for EEA (ex-UK) firms currently passporting into the UK:
 - for EEA firms passporting on a branch or cross-border services basis.
 - for funds currently being marketed in UK on basis of passport.
- Related statutory instrument contemplates three year transitional period – but FCA consultation (on related rules) contemplates all firms within regime to apply for authorisation in fixed “landing slots” (starting in October 2019).
- How will incoming firms be supervised by the FCA?
- UK legislative onshoring project: under government’s power to onshore existing EU law and modify it to correct “deficiencies”.
- FCA also has new power to waive or modify an obligation which has changed as a result of onshoring – expect regulatory forbearance.

IV. No-deal and the UK's temporary permission regime (2)

Basic principles...

- UK will treat EEA (ex-UK) states as “third country” states.
- Transfer of functions from European Commission and ESMA to UK Treasury and FCA.
- FCA jurisdiction will only encompass UK activities (e.g., anti-asset stripping rules will only apply to acquisitions of UK companies).
- UK-EU cooperation arrangements required for cross-border activity.



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V. Relevance of cooperation arrangements

Cooperation arrangements are relevant for “hard” Brexit (no transition and UK is treated as third country in March 2019).

- **AIFMD**

With hard Brexit, UK is treated as non-EU country - where the AIFMD requires cooperation arrangements these must be in place between FCA and the competent authority of the relevant EEA member state.

- **MiFID**

MiFID services which are provided by an EEA firm in or into the UK do not require cooperation arrangement under the UK temporary permission regime.

Services which are provided by a UK firm in or into (or treated as provided in) the EEA are only permitted depending on local state law – unless at a later stage there is a third country passport, in which case such third country passport will require cooperation arrangements.

V. Relevance of cooperation arrangements (2)

- Cooperation arrangements are a matter of national law - so negotiated and entered into bilaterally between competent authority of the relevant EEA member state and FCA.
- In practice, ESMA plays an important role: it pre-negotiates templates of cooperation arrangement which can and typically are used by competent national authorities, but they are free to do otherwise.



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VI. Marketing matrix post Brexit (assuming no deal)

Location of manager	Location of fund	Management	Marketing in UK	Marketing in EEA
UK	UK	No change	No change	Private placement instead of passport – new filing required. Cooperation arrangement required.
UK	Non-EEA	No change	No change	No change
UK	EEA	No passport available – query if needed. Cooperation arrangement required.	Use TPR for existing funds, private placement for new funds. Cooperation arrangement required.	Private placement instead of passport – new filing required. Cooperation arrangement required.
EEA	UK	No passport available – query if needed. Cooperation arrangement required.	Use TPR for existing funds, private placement for new funds. Cooperation arrangement required.	Private placement instead of passport – new filing required. Cooperation arrangement required.
EEA	EEA	No change	Use TPR for existing funds, private placement for new funds. Cooperation arrangement required.	No change
EEA	Non-EEA	No change	Use TPR for existing funds, private placement for new funds. Cooperation arrangement required.	No change

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VII. Impact on structures and operations – Why an EU Structure (1)

EU Structure Gives Benefit of the EU Marketing Passport

- Relevant where your target investors are located in such EU countries, where non-EU funds/non-EU managers have no or very difficult access to marketing (i.e., no national private placement regime “NPPR” exists).
 - Problematic countries include France, Italy, Austria, Spain; for Cayman manager: Finland, Norway.
 - Intermediate countries include Germany, Denmark.
 - Easy countries include UK, Luxembourg, Ireland, Sweden, Belgium.

VII. Impact on structures and operations – Why an EU Structure (2)

Certain Regulated Investors Need/Prefer EU Funds

- **Solvency II:** Under Solvency II, for unlisted equity investments insurance companies benefit from a lower capital reserve treatment (39%) if the fund is an EU fund, closed ended and not leveraged.
 - For debt funds less relevant if look-through possible.
- **Pension Funds Regulation:** Certain countries have special requirements and only permit investments in EU structures.
 - e.g., in Germany according to the German Investment Ordinance, investments in debt funds are only permitted if fund is an EU AIF managed by EU AIFM,
 - many German insurance companies also still comply with these standards.
- **Upcoming regulation on ESG:** investors will be subject to ESG standards and so will require/want their fund managers to be subject to the same standards (makes it easier to meet their own targets).

VII. Impact on structures and operations – Why an EU Structure (3)

- Lending is subject to banking license requirements in some EU Member states (e.g. France, Germany, Austria, Italy).
- Some countries provide for exemptions from license requirements for EU-funds with EU AIFMs (e.g. Italy and Germany).
- EU initiative on EU-wide harmonized regulation for loan-originating funds:
 - Closed ended funds.
 - With only professional investors.
 - Limited leverage.
 - Additional reporting and risk management requirements.

VII. Impact on structures and operations – What EU Jurisdictions are we seeing? (1)

Luxembourg structures:

- SCS: limited partnership with legal personality
- SCSp: legal partnership without legal personality (easier to set up)
- SCA: limited partnership by shares

Both SCS and SCSp but also corporate structures (e.g., SCA) can be structured as a “RAIF” (unregulated but registered with CSSF- not relevant for SCS and SCSp) or “SICAV-SIF” (regulated) and thereby get certain tax benefits and investment regulatory benefits under Luxembourg law.

VII. Impact on structures and operations – What EU Jurisdictions are we seeing? (2)

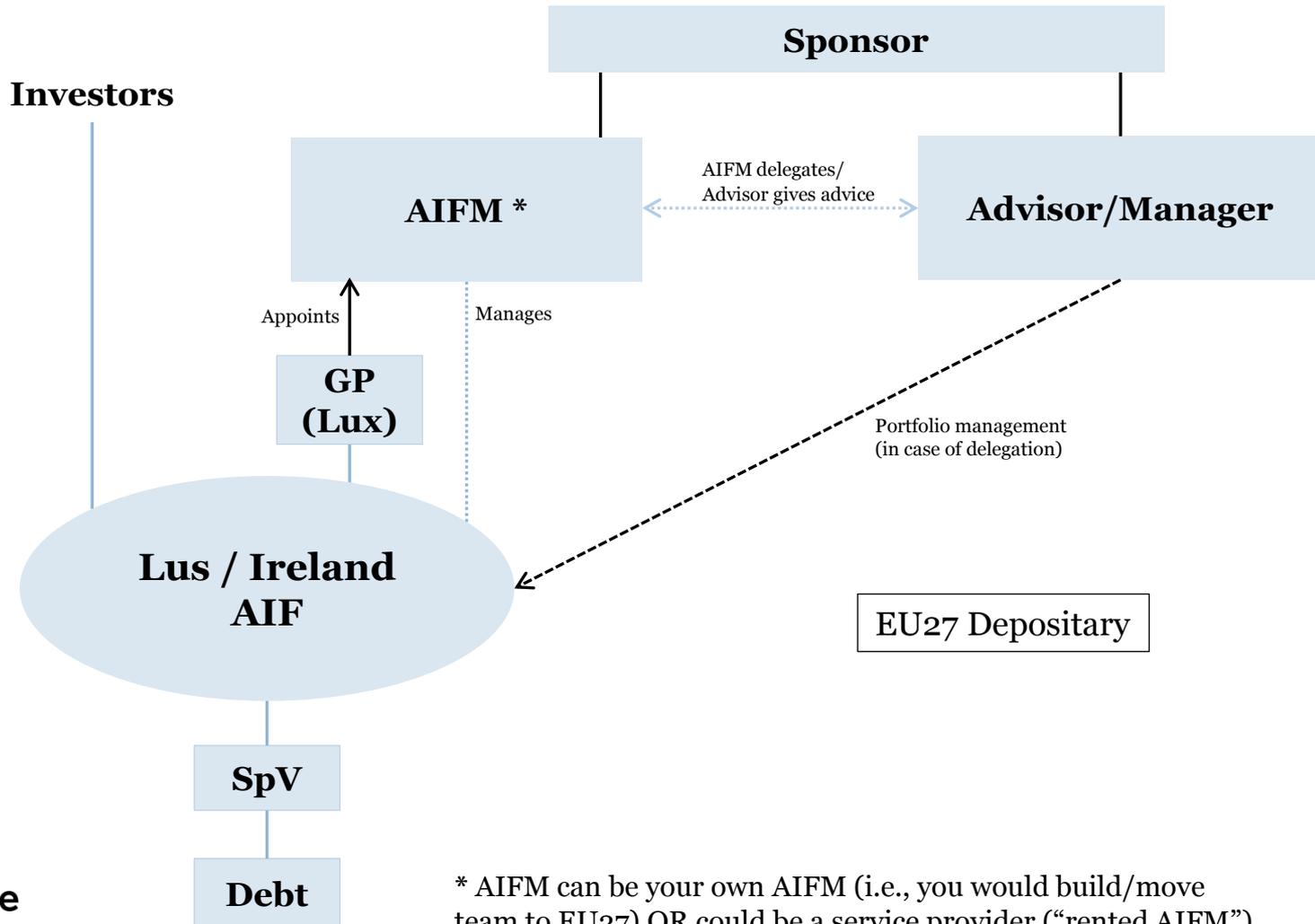
Irish Structures

Types of structures:

- Regulated (Qualifying Investor AIFs “QIAIFs”): Irish Collective Asset Management Vehicle (“ICAV”), Investment Company, Unit Trust, Common Contractual Fund, Investment Limited Partnership.
- Limited Partnership (reform to the legislation expected to be in place in 2018 ... ?), but also regulated (unregulated LP not suitable).

QIAIFs: Most flexible regulated fund category (no investment, borrowing or leverage limits, filing process with the Central Bank in 24 hours) often used for debt funds.

VII. Impact on structures and operations – Possible EU27 Set-Up (1)



VII. Impact on structures and operations – Possible EU27 Set-Up (2)

AIFMs (“own” AIFM or “rented” AIFM)

- Role of the AIFM.
- US tax considerations for US carry recipients.

Setting up your own affiliated AIFM (in the EU 27) requires substance and time

- In principle same in all EU member states as governed by EU Law.
- Some guidance on the meaning of substance given by the regulator(s) on resource, risk management and decision making may vary among jurisdictions.
- Usually takes between 6 to 12 months (depending on jurisdiction).

VII. Impact on structures and operations – Possible EU27 Set-Up (3)

Rented AIFM (1/2)

In this case sponsor uses a service provider to act as an AIFM which then delegates to or is advised by the sponsor affiliate.

- **Advantages**

- Supporting functions such as compliance are taken care of by a third party service provider.
- Recognized by regulators.
- Easy and quick to set up.

VII. Impact on structures and operations – Possible EU27 Set-Up (4)

Relationship between AIFM and Sponsor (1):

Delegation of Portfolio Management (1/2)

- European Securities and Market Authority (ESMA)'s Opinion (31 May and 13 July 2017).
 - Special attention should be granted to avoid letter-box entities in the EU27.
 - Outsourcing and delegation to third countries is only possible under strict conditions (including effective supervision by the NCAs).
 - Contractual arrangements ensure that authorized entities, internal control functions, external auditors and NCAs have effective access to data related to the delegated functions.
 - Delegates to cooperate with these parties at all times.

VII. Impact on structures and operations – Possible EU27 Set-Up (5)

Relationship between AIFM and Sponsor (2):

Delegation of Portfolio Management (2/2)

- ESA's Legal Framework Review (20 September 2017) by the European Commission proposes new powers to ESMA:
 - New provision to strengthen the coordination function of the ESAs (competent authorities to effectively supervise outsourcing, delegation and risk transfer arrangements in third countries).
 - Assessment of newly set-up AIFMs prior to the authorization and registration by the national regulator.
 - Ongoing compliance monitoring.

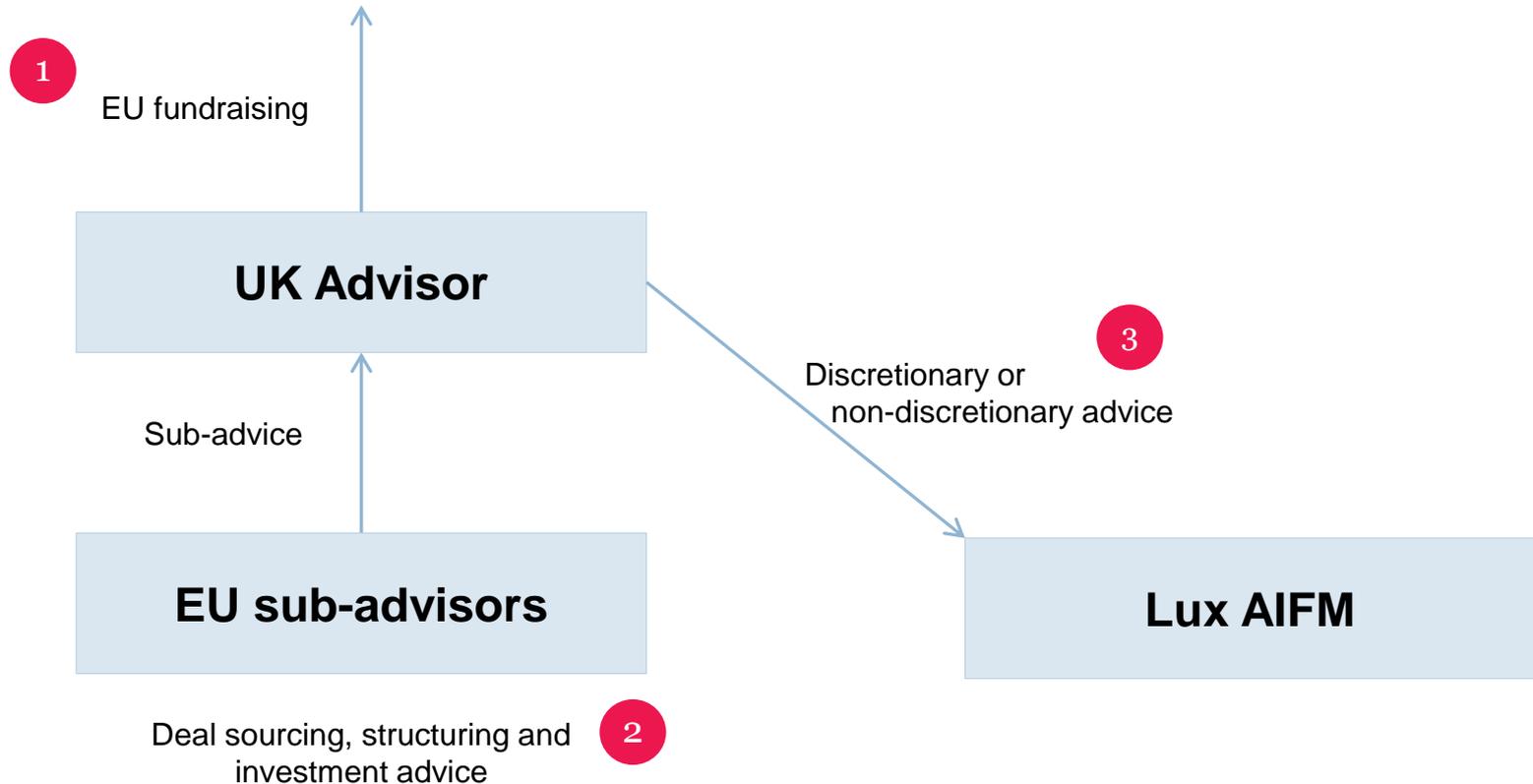
VII. Impact on structures and operations – Possible EU27 Set-Up (6)

Relationship between AIFM and Sponsor (3):

Investment Advice

- Qualification as advisory service versus delegation of portfolio management ?
 - Advisory is deemed delegation if AIFM base their investment decision on the advice without carrying out their own qualified analysis before concluding a transaction.

VII. Impact on structures and operations - MiFID concerns



VII. Impact on structures and operations - MiFID concerns (2)

Explanatory notes to chart

- 1) Advice by UK Advisor to EEA AIFM
 - If discretionary, delegation of PM to non-EU firm is still permitted under AIFMD if authorized as portfolio manager in its home country and cooperation arrangement between CSSF and FCA.
 - If non-discretionary: investment advice to Luxembourg AIFM remains possible.
 - From an AIFMD perspective delegation or advisory service to EEA AIFM?
 - Deal sourcing by EU sub-advisor.
- 2) If the beneficiary of (sub)-advice is, the UK Advisor and if UK Advisor, has no investment decision authority, no license is required by sub-advisor because the advice is not rendered to the „client“ (i.e. the investor or its representative).
 - If UK Advisor has investment decision authority, the (sub)-advice qualifies as investment advice and sub-advisor requires license under local laws of EEA jurisdiction (unless exemption is available).
- 3) Fundraising
 - If RTO in the relevant EEA member state where investors are based and deemed to be conducted IN such member state, license under laws of EEA jurisdiction is required (unless exemption available).
 - Possible solutions: secondment of staff to Lux AIFM with UK branch.
 - Setting up MiFID firm in the EEA or Lux AIFM having EEA branch.

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