

# Fried Frank

# BREXIT Alert



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## Brexit – what now for fund managers?

The UK referendum of June 23 will have historic implications for the UK and the EU as a whole. We have attempted here to look at some issues for financial services businesses, and in particular fund managers, transacting with the UK and EU.

It is difficult to be definitive because although the vote to leave was decisive (albeit by a fairly narrow margin) what happens next remains to be seen and depends on the stance taken by the UK Government (which will soon be under new leadership), with what seems to be a wide range of options including somehow ignoring the referendum altogether on the one hand, to withdrawing from any dialogue whatsoever with the EU on the other.

There is also uncertainty on the timing, with some in the UK saying there is no need to start the formal leaving process yet, whilst some in the EU say the opposite – so for now all we can do is assume that the provisions of Article 50 of the Lisbon Treaty, which provide that a member state can withdraw and has two years to negotiate exit will, once activated, be followed.

To recap, right now and until such time as the UK/EU separation is complete, all existing EU Directives remain in full force and effect in the UK, so any firms based in the UK continue to be able to exercise passport rights during this period, and similarly UK branches of EU firms continue to be able to operate under the passport.

The first option to consider is membership of the European Economic Area or EEA – the so called “Norwegian model”. Although no longer a member of the EU, as a member of the EEA the UK would continue to benefit from access to the EU’s single market, meaning that UK firms would continue to benefit from the passport to provide services into the EU. However, this would also mean compliance with EU rules, compliance with EU free-movement requirements and a continuing obligation to contribute to EU finances – all whilst having lost the seat at the EU rule-making table. It would also mean that for global firms looking to do business or market investments into the UK, the existing EU rules would continue to apply.

Whilst this is probably the most attractive option in terms of continued market-access for UK firms and international firms with a UK presence, it must be regarded as relatively unlikely given the rhetoric that has imbued the referendum campaign and the requirement under this model to continue to adhere to many of the EU requirements which arguably led to the referendum in the first place.

Any other option, whether this is some sort of free-trade agreement or customs union or even simple reliance on the UK’s WTO membership, would involve a complete withdrawal from the EU/EEA and potentially negotiation of a specific agreement with the EU. The outcome here would be entirely down to the negotiations at the time and, as such, anything could be on the table. A point worth mentioning,

however, relates to the Swiss example. Switzerland has negotiated largely unrestricted access to the EU market, but has done so at the price of accepting EU free-movement principles, whilst failing to obtain a passport under the EU financial services directives, despite being a long-standing European financial centre.

From a global perspective, this could mean that the UK becomes more attractive as a place to do business since it may no longer be necessary to comply with EU regulatory requirements – making it easier, for example, to market funds into the UK. However, against this must be weighed the likely removal of the financial services passport for UK businesses, or UK subsidiaries of global businesses, looking to transact with clients in the EU.

As mentioned above, it must be regarded as highly unlikely that the UK would be able to negotiate any specific passporting right under EU financial services directives as if it were an EU/EEA member without being one. However, this may not mean all is lost. AIFMD at least contemplates a passport for third-country managers in jurisdictions that can demonstrate equivalence, with an announcement on this due from ESMA imminently (though the announcement relates to a second wave of equivalent jurisdictions and not to Brexit). Although it must be assumed that the UK could not be considered for this until it was no longer in the EU, it must further be assumed that it would have to be able to demonstrate equivalence – providing all the AIFMD rules (which were subject of much debate and pushback) were retained. This should, however, enable the UK to adopt a “dual track” approach like the Channel Islands, under which funds seeking access to the passport are subject to AIFMD-equivalent regulation, with funds seeking only domestic or international (non-EU) access subject to a lighter touch. There are some open questions about the ability of a third-country manager operating under the passport to undertake deal activity in the EU since that would be outside the scope of the AIFMD marketing passport and potentially subject to a different directive (MiFID), but the approach taken here varies from country to country.

The EU’s other financial services directives on banking, investment services and insurance do not currently contemplate a third-country passport and it seems unlikely that these aspects of the UK’s financial services industry could escape so lightly, so in many respects the third-country passporting provisions in the AIFMD may, notwithstanding that it has largely been seen as an unhelpful and burdensome piece of regulation, take some of the sting out of Brexit as well.

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