

Brexit

Implications for UK Private Fund Managers

Currently, the management and marketing of private funds by UK-based managers is regulated by the European Union's Alternative Investment Fund Managers Directive ("AIFMD"). On 23 June 2016, the UK voted to leave the European Union giving rise to uncertainty as to how private funds will be regulated in the UK in future and concerns over UK fund managers' access to European investors. 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 (this assumes that the UK does not subsequently join the European Economic Area ("EEA"), in which case AIFMD would likely continue to apply as it currently does).

This note examines the potential impact that Brexit may have on: (i) regulation of UK alternative investment fund managers ("AIFMs") in respect of their management activities in the UK; and (ii) marketing of UK alternative investment funds ("AIFs") by UK AIFMs within the EEA.

How will UK fund managers be regulated post-Brexit?

In our view, there are three likely ways in which the management of UK private fund managers may be regulated following Brexit:

Option 1: The UK retains the current AIFMD regime in full

Currently, the management of private funds in the UK is governed by AIFMD. In order to set up a fund management business in the UK, managers must obtain authorisation from the UK's Financial Conduct Authority (the "FCA") under AIFMD. Subject to certain exemptions (notably the "sub-threshold" exemption, which allows those managers with assets under management below certain thresholds to avoid complying with AIFMD), UK managers have to comply with provisions relating to (amongst other things) regulatory

capital and professional indemnity insurance, operations and organisation, various transparency, disclosure and notification requirements, activities that could be construed as asset-stripping, the remuneration of staff, the use of leverage, the appointment of a depositary and the creation of valuation and risk management functions.

Following Brexit, the UK may retain the current AIFMD regime in full. In respect of UK regulation, this would not result in significant changes for UK-based managers nor in changes to the process for authorisation for new UK managers. However, even if the UK were to retain the existing regime, there could be a significant impact on UK managers' ability to market their funds to EEA investors (see "How will UK managers market their funds within the EEA" below). Although this option would lead to the least change to regulation of UK managers and pave the way for access to the AIFMD third country passport (see below), in our view, given the potential benefits of repealing the AIFMD regime and thereby lessening the regulatory burden on UK fund managers not wishing to comply with AIFMD, it is not likely to occur.

Option 2: The UK repeals AIFMD and returns to the pre-AIFMD regime

The UK may revert to the pre-AIFMD regime, or develop another, less onerous regime. The likely implications of this would be a reduction in regulation for UK fund managers. Although UK managers would continue to be authorised by the FCA and comply with the FCA's handbook (including conduct of business rules and regulatory capital requirements), compliance with the full rules under AIFMD relating to remuneration, valuation, appointment of a depositary, etc. would not be required. However, this could have significant implications on the marketing of UK funds to EEA investors and it would likely prevent access to the AIFMD third country passport (see below).

Lessening of the regulatory burden on UK fund managers makes this option attractive and reversion to the pre-AIFMD regime (potentially with certain additional requirements borrowed from AIFMD) would be a strong possibility. While this would largely be a positive development for UK fund managers which do not rely on EEA investors for capital commitments, options for fundraising from EEA investors would need to be carefully considered (see further below).

Option 3: The UK adopts a dual regulatory system

The UK may adopt a dual or hybrid system of regulation whereby UK fund managers can opt-in to a regime which mirrors the AIFMD regime (as described in Option 1 above), or choose to comply with a less onerous UK specific regime (as set out in Option 2 above). This dual regime, which combines the two options discussed above, would grant a degree of flexibility not currently available.

The object of opting in to the AIFMD-equivalent regime would be to gain access to AIFMD's third country passport (see below). This is a similar route to that which some other jurisdictions, e.g. Guernsey, have already taken in anticipation of access to the third country passport.

In our view, if feasible, this would be the most attractive option as it combines a reduced regulatory burden for UK fund managers with the option of a higher level of regulation for those managers wishing to access the AIFMD third country passport, should this become available. If this option were to be implemented, UK managers would benefit from much more flexibility than under the current regime and, assuming the third country passport becomes available, managers relying on EEA investor capital would not lose access to AIFMD's marketing benefits.

How will UK managers market their funds within the EEA?

“How will UK managers market their funds within the EEA” National Private Placement Regimes

If the UK ceases to be part of the EEA, it is likely to be treated as a “third country” for the purposes of AIFMD and UK managers should be able to market their AIFs in the EEA under the existing national private placement regimes (“NPPRs”) of each relevant jurisdiction, subject to cooperation agreements being put in place between the UK and the relevant jurisdiction.

Most NPPRs provide for marketing to professional investors but do not permit funds to be marketed to retail investors. The NPPRs require registration with the local regulator in each jurisdiction in which marketing is to take place and there are ongoing compliance requirements. AIFMD establishes a minimum regime (which involves only a small subset of AIFMD's requirements, including disclosure and reporting requirements and asset stripping restrictions, but is much less onerous than the full AIFMD regime). However, individual jurisdictions may choose to implement additional requirements or not to implement a NPPR at all (notably

France and Italy). Registration processes and ongoing requirements differ by jurisdiction but are generally relatively easy to navigate for managers.

Unless the AIFMD third country passport regime is opened up to UK managers (which would only realistically occur if the UK implements an AIFMD-equivalent regulatory regime, i.e. Options 1 and 3), NPPRs are likely to be the only option for UK managers actively marketing funds to EEA investors. While loss of access to the AIFMD marketing passport following Brexit is a key concern for many UK fund managers, over the past few years Weil has successfully assisted non-EEA fund managers based in the US, Asia, the Middle East, the Channel Islands and elsewhere in raising significant capital from EEA investors by navigating through the NPPRs, which overall present a lower compliance burden than full compliance with AIFMD. Even where the AIFMD third country passport is made available to UK managers, our expectation is that many will prefer to market through the NPPRs and avoid compliance with the full scope of AIFMD – for individual managers this will depend on the jurisdictional makeup of their European investor base.

Third Country Passport

AIFMD sets out a procedure by which the AIFMD marketing passport regime currently available for EEA AIFMs can be extended to non-EEA (i.e. third country) AIFMs. This might be available to UK managers if the UK were to cease to be part of the EEA.

In order to be eligible for the third country passport, AIFMs would still need to comply with all of the requirements set out in AIFMD and, in addition, be registered with a regulator in an EEA member state (e.g. a UK manager would, in addition to being authorised by the FCA, need to register with a regulator in a “member state of reference”, e.g. Luxembourg, Ireland or another suitable jurisdiction within the EEA). In addition, the AIFM's home jurisdiction (i.e. the UK) would need to become an approved jurisdiction in respect of the third country passport.

The third country passport regime is currently being assessed by the European Securities and Markets Authority (“ESMA”) and, following a delay, it is unclear when the regime will become effective, although the expectation is that this may happen during 2017. Once the regime is in place, the UK would need to secure approval under the regime, which, given ESMA's positions to date, would likely require the UK to have an AIFMD-equivalent regulatory regime, i.e. Options 1 and 3.

Assuming that the third country passport regime is implemented and the UK becomes an approved jurisdiction,

UK managers who are in full compliance with AIFMD would be able to use the third country passport to market to professional investors in the EEA (as they currently do under the existing AIFMD marketing passport). However, there would be some additional requirements, including the requirement to register with a regulator in an EEA member state of reference.

If this option was to become available, UK managers relying on the AIFMD passport could continue to do so under the third country passport regime, with some additional requirements. However, as noted above, we would expect many UK managers to opt for the lower compliance requirements of the NPPRs (as long as this was permitted by UK law, i.e. Option 2 or 3 were adopted). A key consideration is timing – although the current expectation is that the third country passport regime should become effective in 2017, this could be delayed and it is unclear whether ESMA would assess the UK 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 third country passport becoming available to UK managers, in which period the NPPRs may be the only option for UK managers marketing to EEA investors.

There are also important implications for non-UK managers. Although marketing to UK investors is unlikely to become significantly more onerous, the more important concern for non-UK fund managers is likely to be the regulatory effect of Brexit on their UK-based deal teams – e.g. US managers often have London-based deal teams operating with FCA authorisation under the EU's Markets in Financial Instruments Directive ("MiFID") which, following Brexit, may no longer allow access to the MiFID cross-border services passport. Please see Weil's note for non-UK managers for further information.

Conclusion

For now, AIFMD, along with all existing EU Directives, remains in full force in the UK. AIFMs based in the UK are still able to exercise passporting rights until such time as any new regime comes into force. What the shape of that will be remains to be seen.

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