irishfunds

25

celebrating 25 years as the voice of the industry

BREXIT UPDATE

October 2016

irishfunds.ie

INTRODUCTION

Pat Lardner, Chief Executive, Irish Funds

The outcome of the UK's referendum on EU membership and the impact it is having and is likely to have, has been the most significant and unanticipated European political event of the last 20 years. While much is still unclear about what form the UK's exit from the EU will take, we can be certain of our own role and determination to assist managers, irrespective of their starting point, in achieving their cross-border distribution goals.

With the initial shock of the UK's exit vote now in the past, the industry has moved towards planning and action to ensure continuing access and guard against some of the possible negative impacts of Brexit. In this post-vote/pre-Brexit stage, we must be careful about making assumptions. The widely held belief before the actual vote, that the UK would remain in the EU resulted not only in a state of shock, but also one of being unprepared. Moving forward, there will be a series of junctures along the way which will require those in our sector (and beyond) to map their businesses in terms of products/services, clients, markets, delivery mechanisms, operating models and business structures against what will be a slow emerging new reality.

Assisting fund managers

While there has been considerable volatility both in the markets and political landscape, fund managers' needs pre- and post- the Brexit result have not fundamentally changed. Managers continue to look to:

- Further their objectives to grow and scale their business cross-border by accessing passports for products and services
- Utilise effective EU-based national regulatory and taxation regimes
- Have available the expert knowledge and skills across a range of providers covering the full breadth of investment strategies and asset classes
- Have the ability to conduct business efficiently with regards to language, legal system, service culture and cost

Not surprisingly, the main questions we are being asked by managers are, how they can work with Ireland to retain access to the EU, in direct portfolio management services and by distributing funds. Our members are continuing to help managers and provide solutions and as Ireland has addressed needs in the funds industry successfully for more than 20 years, it will continue to do so post-Brexit. Ireland is a committed member of the EU and Irish-domiciled funds will continue to access the EU single market. The funds industry here remains focused on its continued ability to provide seamless access to key financial services passports, as well as to assist global and regional players examine the specifics of their product, service and distribution footprints and the business models and structures which support them.

Our priorities following the vote

Brexit adds a new and significant dimension to the Association's multi-faceted work and outreach. As always, our focus is that the 'system' here is prepared and welcoming to help new and existing clients. In moving into territory where the end-position and duration are not and cannot be fully known, our priorities are to:

- Engage with our members and stakeholders and handle inbound queries from managers and service providers
- Advocate to government and the authorities here regarding the importance of readiness for the funds industry
- Speak and listen to stakeholders and peers across various industries and regions to understand concerns

Continuing on our already strong advocacy platform, we are engaging with the Irish government, the Central Bank of Ireland and agencies to keep the funds industry high on the agenda in Brexit and related discussions and to ensure that the environment and infrastructure is available to provide solutions to those who need it. Alongside our 38 Working Groups, we are identifying and working through positions which may arise in negotiations, engaging with EU colleagues on these matters, and developing communications and informational materials. We are regularly meeting with our members, stakeholders and peers to listen, handle queries and act responsibly.

The aim of this publication

The objective of this and future updates is to provide a series of views and insights on the key areas and impacts of Brexit from the perspective of member firms and participants involved in the Association's work. The contributors come from various areas of the funds industry, including management companies, law firms, audit firms and other service providers. We hope you find these useful and that you reach out to us for assistance.

AN IRISH SOLUTION TO A BRITISH PROBLEM

Tara Doyle – Partner and Head of the Asset Management Group, Matheson

As you will be aware, on 23 June 2016 the UK held a referendum on its membership of the European Union (“**EU”**) and a majority of those voting voted in favour of the UK leaving the EU. The immediate impact of that referendum (which we will refer to as “**Brexit**”) was considerable market volatility and a significant impact on Sterling and on UK and global equity prices. The longer term impacts of Brexit have yet to be determined, as the result of the referendum had no immediate effect on the UK’s legal status as a member of the EU.

Article 50

The process by which a member state leaves the EU is governed by Article 50 of the Lisbon Treaty (“**Article 50”**), which provides for a two year period, running from the date upon which the UK formally serves notice on the European Council, during which the UK and the EU will negotiate the withdrawal agreement. The latest statement from the UK suggests that it will serve that notice by the end of March 2017, meaning the UK will remain a member of the EU until at least 2019. This two year period may be extended with the unanimous consent of the other 27 member states. It is difficult at this stage to predict what the terms of the withdrawal agreement may be, as this is the first time that the Article 50 procedure has been applied and there is no precedent for the withdrawal agreement. Indeed, there remains considerable doubt as to whether the UK will actually trigger Article 50, notwithstanding the very clear intentions expressed by the UK government.

Implications for Asset Managers and Investment Funds

The significance of Brexit for the asset management industry cannot be underestimated. European distribution of mutual funds, and increasingly of alternative funds, is done on a cross-border passporting basis. A fund authorised in one EU member state can be readily marketed in another EU member state without having to go through a separate approval process. Similarly the EU principle of free movement of services means that a manager authorised in one EU member state can manage funds established in any other EU member state. Many UK managers currently avail of this principle to manage funds domiciled in Ireland. If the UK leaves the EU then, depending on the terms of its Article 50 withdrawal agreement, a UK manager may not be able to manage funds domiciled in other EU member states and may not be able to distribute UK domiciled funds in the EU.

Potential Irish solutions

Ireland remains committed to its membership of the EU and retains its important position as an English speaking gateway to one of the world’s largest markets. A recent PwC survey ranked Dublin as the second most attractive European financial centre after London, based on criteria such as market access, ease of doing business, legal rights and education levels. This makes Ireland a natural home for UK investment management businesses looking to maintain a European footprint post-Brexit.

Irish investment funds will continue to benefit from marketing passports post Brexit and so UK managers with UK domiciled funds which are currently distributed cross-border may look to re-domicile their fund ranges in Ireland. In addition, Irish managers will continue to benefit from EU passports and so UK managers may look to establish Irish affiliate managers who can act as managers to their Irish domiciled funds and also to funds which may be domiciled in other EU member states. As Irish managers currently delegate investment management activities to a significant number of managers authorised in other OECD member states, it should be possible for them to delegate to UK managers post-Brexit.

Are UK managers looking for these solutions now?

It is important to remember that the UK continues to be a full EU member and so no immediate action is required from UK managers. However, UK managers are looking to put in place contingency plans, so that if the UK does leave the EU, they will be ready to take the necessary steps to maintain their presence in Europe. Given the strong historical trade links between Ireland and the UK, the degree of commonality between our legal systems and language and the familiarity of UK managers with the Irish funds industry, Ireland is well placed to solve any problems which Brexit poses for UK managers.

MANAGING THE UNCERTAINTY OF BREXIT

Des Fullam – Director, Carne Group

Article 50; Passporting; Norwegian model; Swiss-plus; Michel Barnier; David Davis; Fear; Uncertainty.

All of a sudden the language of Brexit is part of our everyday lexicon yet none of us know what the outcome is likely to be. In a business where we are asking investors to commit significant amounts of capital over at least three to five-year time horizons, political uncertainty can lead to inaction. Whilst the exact outcome of Brexit is unknown its impact in the investment funds sector can be managed. We are going to consider Brexit's impact on EU access under 3 headings; Investment Management, Product Manufacture and Distribution.

Investment Management

Much of the European asset management community is based in London. This need not change post Brexit. It should be entirely possible for UK based asset managers to manage EU UCITS and AIF funds under a delegated arrangement. This arrangement is commonplace today for US, Swiss and other managers of well-regulated third country jurisdictions. Regardless of whether there is a hard or soft Brexit it seems inconceivable that UK managers would be prohibited from managing EU funds on a similar basis.

Product Manufacture

Most funds which are marketed on a cross border basis are established in either Ireland or Luxembourg. Over the past 25 years the Irish funds business has grown in parallel with the success of the City of London and has significant expertise in establishing and servicing all types of UCITS and AIFs. We share a common language with the UK, we both operate under a common law legal system, we are geographically and culturally close to the UK and the London/Dublin route is the best served international airline route in the world. The Irish government has been clear that Ireland's future lies within the EU. Utilising an enhanced self-managed solution, an established third party management company and your own management company Ireland can continue to provide the platform for UK managers to access the EU. Ireland's market leading position in the servicing of hedge funds makes it the natural home for UK firms seeking to establish an AIFM within the EU27 block.

Distribution

One area where the impact may be more pronounced is on distribution. While UCITS and AIFMD offer a product passport, a separate licence is needed to sell the product. This is typically carried out under a MiFID passport. While MiFID 2 offers the potential of third country access, the denial of passport rights to UK firms using their MiFID passport to distribute their EU funds post Brexit would be a challenge that would have to be addressed. That said, solutions will be at hand - a MiFID licence could be sought in a remaining EU jurisdiction such as Ireland and third party distribution arrangements are possible. It is likely that solutions similar to the UK authorized representative regime and other secondee solutions may emerge. There is also time for these solutions to emerge. While an EU investor may well require an EU product in which to invest, until Brexit occurs UK MiFID firms will be able to continue to distribute product manufactured in Ireland or Luxembourg.

Conclusion

While the outcome of Brexit remains far from certain, solutions do exist which, with a few modifications, will allow UK fund managers to continue to manage, manufacture and distribute their products in the EU in much the same way as they do today. Investors are very familiar with this model and Ireland is well placed to continue its successful partnership with the UK in manufacturing and servicing investment funds which are sold to EU and other investors based farther afield regardless of the form the UK/EU relationship takes post Brexit. Fear of Brexit need not lead us to radical solutions where familiar ones are at hand.

NAVIGATING IN THE WAKE OF BREXIT

Vanora Madigan – Associate Director
DMS Investment Management Services (Europe) Ltd

As a result of the UK vote to leave the European Union (EU), businesses must address crucial challenges and questions before formal separation negotiations begin. The long-term consequences of how the UK will fit into the Alternative Investment Fund Manager Directive (AIFMD) and the Undertaking for Collective Investment in Transferable Securities (UCITS) regulatory environment are uncertain. Whilst there will be political and economic consequences, changes to the legal and regulatory environment will be gradual.

EU Domiciled Funds

One of the most important negotiations will be around "passporting." Currently, the EU marketing passport allows UK managers access to the EU single market without restriction. While speculating at this early stage about the outcome of negotiations is difficult, the UK will likely negotiate to retain its passport rights throughout the EU. UK investment firms and AIFMD and UCITS funds may, however, become "third-country" firms unable to benefit from MiFID, AIFMD, and UCITS passport rights.

As the withdrawal process develops, all regulatory regimes driven by EU legislation will need to be assessed and reconsidered. It is vital that businesses educate themselves about their options so they can make informed choices. The possibility of loss of passport rights and the uncertainty around how EU domiciled funds may be marketed in the UK requires careful planning to ensure that businesses retain passport rights through re-domiciling or establishing parallel vehicles in the EU.

One notable difference now is EU funds will be added to the offering, if only UK funds are being currently presented. This will allow the marketing passport to be availed of for distribution throughout the EU. It is yet to be seen how an EU domiciled fund may be marketed into the UK.

Non-EU Domiciled Funds

Traditionally, the UK has been one of the more popular countries in the EU for marketing non-EU domiciled funds. At this stage more needs to be understood from the UK Financial Regulator on how this will be permitted going forward under AIFMD. How marketing these funds will proceed is presently unclear, especially in light of the recent ESMA Advice and Opinion on the extension of the passport to non-EU jurisdictions, and the UK vote only serves to increase the uncertainty as to if and when the European Commission will make a decision on this.

Regulatory regimes like MiFID, EMIR, and AML which are driven by EU legislation will also need to be considered as the UK withdrawal process develops.

The Ireland Solution

For both investors and managers looking for pan-European marketing and distribution solutions, Ireland, as an EU Gateway Hub, is certainly a domicile of choice. Irish domiciled funds can continue to avail of the marketing passport and be sold into every EU member state without the need for local authorisation.

In addition to its well established fund industry, its geographical proximity to the UK and mainland Europe, it is the only other EU jurisdiction with English as its official language. Furthermore Ireland has significant standing within the EU, a favourable taxation regime and treaties, and a comprehensive legal and regulatory landscape.

MAINTAINING DISTRIBUTION ACCESS FOR IRISH FUNDS POST-BREXIT

Ken Owens – Asset & Wealth Management partner PwC Ireland

Ireland enjoys many deep and strong business links with the UK asset management industry. In addition to the excellent service providers, there are many reasons for the close links which exist between Ireland and the UK such as: geographical proximity; shared language; shared legal framework; time zone; business environment and; long standing cultural and social links. This close partnership is demonstrated by the fact that over one third of all managers establishing funds in Ireland are from the UK, and more than 40% of the 520 overseas AIFMs operating in Ireland on a cross border basis are UK AIFMs. This relationship gives Ireland a unique perspective on the potential implications of and solutions to a post Brexit scenario for asset managers and investors alike.

One of the key consequences of the UK's decision to leave the EU is that UK investment firms are likely to lose passporting rights into the EU based on the current rules. Of course this could also mean that EU funds may lose passport distribution rights into the UK. In light of these scenarios, it is worth examining three key Directives - the UCITS, AIFMD and MiFID Directives - and the detailed regulatory requirements they apply to firms based in EU member states which are, in return, given passporting rights elsewhere in the EU.

UCITS Directive

From a fund distribution perspective, the UK is the most significant market for the registration of Irish UCITS funds for sale. According to a PricewaterhouseCoopers (PwC) report benchmarking fund distribution across the EU there were 2,128 Irish fund registrations in the UK at the end of 2015 (55% of all Irish funds at the end of 2015). This was the largest number of fund registrations for Irish funds in any country and amounted to 11% of the total fund registrations for Irish funds in Europe. The UK has consistently been the number 1 market for the sale of Irish domiciled UCITS funds and is usually the first market that an international asset manager establishing funds in Ireland will look to sell to once established.

It is therefore important for both UK based investors and asset managers providing funds for sale in the UK, that this inbound access for Irish funds into the UK is maintained. For continuation of business with least disruption and from an investor choice viewpoint, maintaining this access is something which has been identified as an important factor that the industry in Ireland will work with relevant authorities to maintain.

Alternative Investment Fund Managers Directive (AIFMD)

In addition to the large number of UK AIFMs using Ireland, there are many Irish AIFMs and self-managed AIFs which delegate (or sub-delegate) elements of portfolio management to a third country, e.g. US fund manager. Therefore, it would be possible and indeed highly likely, for Irish AIFMs and self-managed AIFs to delegate portfolio management elements to UK firms. In order for Irish AIFMs and self-managed AIFs to delegate portfolio management to UK managers post-Brexit, the UK will need to be subject to equivalent AIFMD remuneration rules, which are currently already in place.

As previously discussed, the position of Irish based AIFMs and self-managed AIFs in relation to distributing products in the UK will depend on what is negotiated and the UK's position as a result. However, it is important to note that the UK has a long tradition of favourable private placement for funds from outside the EU to UK based investors. It should be the case that Irish AIFs would have at least the same access as non EU AIFs and this is again something which industry will work to ensure.

MiFID II: Passporting and delegating

Brexit is likely to remove any passporting rights to UK investment firms wishing to access the EU market. Therefore, some UK firms may need to create new EU hubs to market funds in the EU or provide other services to retail clients. This could present opportunities for Ireland to provide solutions for any problems that might be encountered as a result.

A concern amongst UK investment managers is in relation to maintaining rights to manage Irish funds under delegation arrangements. Under the UCITS Directive, the approval of portfolio management delegates and arrangements concerning delegates coming from outside the EU is a Member State discretion.

The Central Bank of Ireland (CBI) already has a process in place with many jurisdictions. Given the existence of the already very close relationship with the UK, including Memorandum of Understanding in place between both regulators, it is again highly likely the CBI would quickly and effectively extend this to include the UK if required.

With respect to AIFMD, the picture is complicated by the need for an ESMA cooperation arrangement to be in place which must be signed by each Member State, which given the UK would have already signed with 3rd country regulators (as an existing ESMA member) should mean this is something which could be put in place early.

As a fund domicile, Ireland is a leading location to establish fund ranges for global distribution as evidenced by the distribution of Irish funds in 70 countries globally. For many reasons, Ireland has a particularly close relationship with the UK, with many managers of Irish UCITS and AIFs delegating day to day portfolio management to affiliates or to third party entities based in the UK. Many of these investment managers will need to assess their future options post-Brexit, since their European fund operations are often established in the UK (under a MiFID authorisation) to access the EU market (via Irish domiciled funds). The industry in Ireland will strive to ensure that whatever option is chosen, including establishing a new EU MiFID entity, Ireland provides the most efficient and effective route for continuing business.

To ensure that there is no lack of service to existing investors and to minimise the risk of market disruption, it is imperative that the Central Bank of Ireland (CBI) sets out a clear roadmap for ensuring the maintenance of existing delegation relationships in Irish fund ranges at a domestic level, where there is national discretion, and at European level within ESMA if necessary. The focus should be on effective grandfathering arrangements for existing funds and the speedy adoption of cooperation agreements with the UK FCA to be effective as of the date of Brexit, to avoid any discontinuity of service. It is particularly encouraging to see recent publicly announced steps being taken by the CBI to ensure appropriate structures and resources are in place to address the needs of the asset management industry following the Brexit referendum.

We are confident the many reasons underpinning the close links Ireland has with the UK investment management industry will be deployed as often before, to ensure the partnerships and solutions provided by Ireland persist, and are expanded for UK managers and investors post Brexit. The industry in Ireland will work hard to make sure this is the case.

Irish Funds
10th Floor, One George's Quay Plaza,
George's Quay, Dublin 2, Ireland.

t: +353 (0) 1 **675 3200**

e: **info@**irishfunds.ie
w: **irishfunds**.ie

October 2016