How will Brexit affect the asset management industry?

28 June
Getting Started

Here with you today

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Agenda

1. Political and economic developments

2. Impact on the asset management industry
   - Substance and Delegation
   - Passorting
   - Considerations for implementation

3. How regulators and firms are responding
   - The UK perspective
   - The Irish perspective
   - The Luxembourg perspective

4. Q&A
Political and economic developments
NWE growth has strengthened
Average real GDP growth rates (% annual)

<table>
<thead>
<tr>
<th>Country</th>
<th>Post-crisis average 2010-16</th>
<th>Post-crisis average 2017-19</th>
<th>Post-crisis as % of pre-crisis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finland</td>
<td>0.7</td>
<td>2.3</td>
<td>346%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1.1</td>
<td>2.5</td>
<td>227%</td>
</tr>
<tr>
<td>Denmark</td>
<td>1.3</td>
<td>1.9</td>
<td>140%</td>
</tr>
<tr>
<td>Belgium</td>
<td>1.3</td>
<td>1.6</td>
<td>126%</td>
</tr>
<tr>
<td>Norway</td>
<td>1.4</td>
<td>1.6</td>
<td>114%</td>
</tr>
<tr>
<td>Sweden</td>
<td>2.8</td>
<td>2.5</td>
<td>90%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.0</td>
<td>1.6</td>
<td>80%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1.8</td>
<td>1.3</td>
<td>73%</td>
</tr>
<tr>
<td>NWE average</td>
<td>1.6</td>
<td>1.9</td>
<td>150%</td>
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</tbody>
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Source: IMF World Economic Outlook

*Excludes Iceland
Businesses more optimistic
...but UK economy is slowing into global upswing

UK GDP

Per cent

Quarterly growth

Four-quarter growth
Current state of Brexit negotiations
There is prolonged uncertainty about the future relationship between the UK and the EU

• The UK will be leaving the EU on 29 March 2019. **The UK and the EU are still in the process of negotiating the terms of the withdrawal** (financial settlement, citizens’ rights, the Irish border, transitional arrangements).

• The current negotiating timelines are: agreement on the legal text by Autumn 2018; UK parliamentary vote soon after; and EU ratification in February 2019, ahead of the UK’s exit on 29 March 2019. This means **no legal certainty on a transition period until February 2019**.

• **The matter of the Irish border and the wider question of whether the UK should remain in the customs union, is proving to be highly contentious** (the EU requires that there should be no physical border infrastructure between Northern Ireland and the Republic of Ireland). It is not clear how it will be resolved or to what timeframe. Absent a solution, the withdrawal agreement and transitionary terms may fail.

### Expected timelines for negotiations

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<tr>
<td><strong>EU and UK Joint Report issued on Phase 1</strong></td>
<td><strong>European Council approval to move onto Phase 2 of the negotiations following “sufficient progress” on key withdrawal issues with supplementary negotiating directives on transition period</strong></td>
<td><strong>European Council to adopt draft guidelines on framework for future trading relationship</strong></td>
<td><strong>Deadline for agreement on text for Withdrawal Agreement (on withdrawal terms and transitional arrangements) before the UK and EU ratification processes</strong></td>
<td><strong>Potential transitional period subject to outcome of negotiations</strong></td>
<td><strong>Agreement on future relationship</strong></td>
</tr>
</tbody>
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**Art. 50 deadline for UK withdrawal from the EU**
Impact on asset management industry
Substance and delegation
“Substance” - ESMA’s Opinion & Principles
Principle six – NCAs should ensure that substance requirements are met

Outsourcing and delegation
- Outsourcing and delegation to third countries is only possible under strict conditions.
- Firms remain fully responsible for outsourced tasks.
- Outsourcing to third country entities requires cooperation agreements between the EU and third country authorities.

Certain key functions and activities should not be delegated outside the EU
- These includes: internal control functions; IT control infrastructure; risk assessment; compliance functions; key management functions and sector specific functions.

Sound governance
- Board members and senior managers in the EU need effective decision making powers.
- Key executives and senior managers are expected to be employed in the entity’s Member State.
- EU entities should have adequate levels of own funds as well as liquidity.

NCAs must be in a position to effectively supervise and enforce EU law
- NCAs should ensure that initial conditions set at the moment of authorisation are met on a continuous basis.
- NCAs should ensure that they have all the relevant information to properly supervise EU entities.
Delegation of Portfolio Management
The issues and the uncertainties

What has been said/proposed

ESMA’s Opinion

• EU entities must evidence objective reasons for delegation, especially where delegation is to non-EU entities
• UCITS investors should benefit from the same level of protection as AIF investors even though the UCITS delegation rules are less detailed
• Firms should not delegate investment management functions to an extent that exceeds by a substantial margin the investment management function performed internally.

European Commission proposal

• The Commission has published proposals which would grant ESMA new powers to monitor authorities’ practices in allowing fund managers and investment firms to delegate and outsource to non-EU entities

Deloitte’s perspective

1. ESMA’s Opinion is non-binding guidance
2. ESMA notes that delegation may be an efficient way to perform functions and activities
3. A CSSF spokesperson stated that Brexit should not be used as an excuse to trigger debates on granting ESAs more power
4. Regulatory scrutiny of delegation and outsourcing arrangements looks set to continue
5. The risk of some tightening of regulatory expectations on delegation should feature in firms future contingency plans
Passporting
Target operating model
UK Fund Manager and Distributor – UCITS and EU AIF options
Target operating model
UK Fund Manager and Distributor – Non EU AIF options (assuming no third country passport for the UK under AIFMD)
Target operating model
UK Portfolio Manager / Segregated Accounts – MiFID II options (assuming no equivalence)
# Equivalence and third country passporting

The issues and uncertainties

## The expected process and issues

### ESMA’s role
- The granting of equivalence or a third country passport requires cooperation agreements between the relevant EU and UK authorities.
- To date, ESMA has provided advice on the extension of the passport under AIFMD to 12 non-EU countries. That advice has been submitted to the European Commission.

### The role of the European Commission
- The Commission carries out its assessments on the basis of technical advice from ESMA.
- The European Commission’s decision on the granting of equivalence or a third country passport can apply in whole or in part and a decision can be changed or withdrawn by the EU at any moment.
- So far, no country has been granted the third country passport under AIFMD.

## Deloitte’s perspective

1. Since the UK has implemented all the relevant EU Directives, it would appear reasonable to expect ESMA provide a positive assessment for the UK.

2. Any ESMA assessment is unlikely to begin until the UK has left the EU and will take at least a few months.

3. The experience with AIFMD shows that the decision-making process is not quick, with timelines still unclear.

4. The final decision is made by the European Commission and Parliament and so it could well involve some political discussion.

5. We cannot be certain about the timing of this process so firms should not place undue reliance on the UK swiftly being granted equivalence or a non-EU passport.
Considerations for implementation
Key considerations for implementation

There are a number of critical considerations which facilitate a successful transition from high-level design towards implementation, as focus shifts from analysis to implementation.

Key TOM design decisions include:
- business model
- strategy and location option
- legal entity structure
- regulated activities and permissions required
- TOM aligned to MIFID II target state

Real Estate
- Need to define business model and number of FTEs
- Relocating staff with their supporting IT infrastructures could drive additional requirements and increase timelines
- Additional locations may be required for BCM planning

Outsourcing Arrangements
- Review existing outsourcing arrangements
- Assess outsourcers’ capabilities
- Consider changes to oversight arrangements
- Consider client implications
- Feed any new requirements into legal, regulatory and IT change streams

TOM Design
Key considerations for implementation (continued)

**TAX**
- Early engagement of Tax in decision making
- Implications of operating the target structure (use of DTAs, Tax Treaties and Withholding Tax)
- Consideration of legal mechanism for transfer of assets as this could have material implications for tax
- Valuation of assets leaving the UK, and exit charges

**REPAPERING**
- Documents / contracts that need to be repapered to be identified to determine the impact depending on the type of Brexit.
- Minimum viable contract framework for contracting to be established before repapering

**HR**
- C-suite in place by end of Q3 2018
- Workforce analysis will need to be completed by end of Q2 2018
- Access to local talent pool and employment structure and terms
How regulators and firms are responding
The UK perspective
Approach of the UK authorities

**Continuity of applicable regulation**
The UK government and the FCA are working together to incorporate all EU legislation which is currently directly applicable to UK firms into UK law, with the aim of providing continuity.

**Temporary permissions regime**
If no transitional period is agreed, the UK will create a temporary permissions regime for EU27 firms and funds, enabling them to carry out business in the UK without a sudden loss of permission.

**Open markets**
The UK government and the FCA support open markets in financial services following the UK’s withdrawal from the EU.
## UK Asset Management Industry Perspectives

### A view on progress and activities across the UK asset management industry

### Diagnostic & Contingency planning

<table>
<thead>
<tr>
<th>Key Activities</th>
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<tbody>
<tr>
<td>• Strategic impact assessment</td>
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<tr>
<td>• Preferred location assessment</td>
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<tr>
<td>• High level structural option design</td>
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<tr>
<td>• Roadmap and plan</td>
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<tr>
<td>• Business plan, capital and liquidity plans</td>
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### Preparation of entity

<table>
<thead>
<tr>
<th>Execution of non-regrettable actions:</th>
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<tbody>
<tr>
<td>• Identification of some senior staff (e.g. C-Suite)</td>
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<tr>
<td>• Lease of buildings</td>
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<tr>
<td>• Regulatory applications</td>
</tr>
<tr>
<td>• TOM and governance design</td>
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</tbody>
</table>

### Implementation

<table>
<thead>
<tr>
<th>New subsidiary:</th>
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<tbody>
<tr>
<td>• Client outreach</td>
</tr>
<tr>
<td>• IT infrastructure</td>
</tr>
<tr>
<td>• Regulatory engagement</td>
</tr>
<tr>
<td>• Outsourcing and front office capability</td>
</tr>
<tr>
<td>• Governance structure</td>
</tr>
<tr>
<td>• Novations</td>
</tr>
<tr>
<td>• Transfer of staff</td>
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### Industry Progress

| Most large firms have set up Brexit working groups to consider their options, including comparing different jurisdictions on regulatory approach, tax regime and employment conditions. |
| Most managers looking to build from an existing presence where viable. |
| Some managers are still to undertake proper impact assessments. |

| Some asset managers have already confirmed that they will set up new EU entities. |
| Many large firms have started discussions with EU regulators. |
| Firms are designing their new operating model. |
| More controversial options will need discussions with regulators. |
| Firms are identifying roles that need to be filled. |

| Most firms are considering non-regrettable actions |
| Managers with an almost certain loss of market access have moved to full implementation. |
| Most managers expect to implement in 2018 as authorisation processes can take 6-9 months. |
| Those not requiring authorisation or permission changes may be able to wait until transitional arrangements are clearer. |
The Irish perspective
The Irish Market
An overview

Domicile for 5% of world wide investment funds assets
- 3rd largest global centre
- 2nd largest in Europe

Authorised Investment Funds:
- UCITS
  - ETF
  - MMFs
- Non-UCITS (AIFs)
  - Qualifying Investor AIF (QUIAF)
  - Retail Investor AIF (RIAIF)

Irish UCITS distributed in over 70 countries.

Major hub for cross-border UCITS domicile

Over 14% asset growth of AIFs since 2016

Total # of Irish Domiciled Funds:
- UCITS: 4,259
- AIFs: 2,569

Irish Domiciled Funds
UCITS v AIFs

€1,835 BN
UCITS

24%

76%
Key Areas of Focus as part of the Application Process

**Being able to clearly articulate in a simplified and transparent manner:**

- **Governance and Organisation** - local, independent functions and controls which report locally to the Board.

- **Culture** - how the firm's culture promotes good regulatory behaviour. Quantitative and qualitative measures to be provided.

- **Risk Management and Internal Control** - proportionate to the scale and complexity of the business model.

- **Outsourcing & Business Continuity** - detail of material outsourcing, contracts, objective rationale for selection oversight, selection, due diligence, ongoing monitoring and control, etc.

- **Business Model** - including strategy, products and services, business lines, regulated/unregulated activities, and details of clients, etc.

- **Production of certain policies, procedures, documentation** - ICAAP/ ILAAP/ Recovery Plans, Client Asset Management Plans, Market Abuse, etc.

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**Substance**

“What our opinions are seeking to address is the risk of letterbox entities. I hope you would all agree that it is in no-one’s interest to allow the creation of such entities. Both the UCITS Directive and the AIFMD explicitly require there to be enough substance in the entity established in the home Member State” Steven Maijoor on CMU, Brexit and ESA review – What’s next?

“Organise themselves so that when they are up and running their business will truly be run from here, be clearly governed by EU norms and standards, and be set up to meet our robust, analytical, intensive and outcomes-focused supervisory expectations” The provision of financial services in Ireland and from Ireland after Brexit – Deputy Governor Ed Sibley
Asset Management Activity
Changes and challenges

Further to the EC Notice to Stakeholders on the withdrawal of the UK and EU rules in field of Asset Management – 8 February 2018

**Investment Criteria**
EU investors should review their investment criteria to assess compliance with the change of legal status of the funds they have invested into.

**Compliance with investment strategy**
UCITS management companies and AIF managers must assess whether the change of legal status of the investment fund would still be compliant with the investment strategy.

**Cooperation Agreement**
An agreement between the competent authority of the home Member State of the UCITS/AIF manager (e.g. Ireland) and the supervisory authority of the undertaking carrying out the delegated function in the 3rd country (e.g. UK) must be in place.

**Objective Reasons**
For the use of UK branches there needs to be objective reasons linked to the services provided in the non-EU jurisdiction and may not result in a situation where such non-EU branches provide material services back into the EU (e.g. Ireland).

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**Other Challenges**

**Staff/ Transfer of Resources**
The ability to continue to recruit/retain staff from the UK after Brexit and ESMA’s staffing/substance expectations could be considered a potential challenge.

**Passporting**
UK UCITS management companies and UK AIF managers will lose the so-called ‘EU passports’ and will be treated as 3rd country AIF managers.

**Level of outsourcing**
Risk of firms seeking authorisation that plan to outsource substantial activity to the extent that there is nothing more than a “letter box entity” in Ireland.

**GDPR**
The nature of the asset management business model, and the collection and processing extensive volumes of personal data by several parties to a fund creates a likely challenge.

**Uncertainty**
The high relevance of the cooperation agreements to be created between UK and EU Member States creates an uncertainty due to its importance.
**Authorisation**

**Indicative Timeline**

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### Key Facts Document

- **Drafting of KFD, Governance and Approval**
  - Week 1 to 4-8

- **Submission of KFD to CBI**
  - Week 4-8

- **CBI Feedback and Questions**
  - +6 weeks from submission

- **Response, Approval, KFD updates**
  - +4 weeks from feedback

- **Re-submit updated KFD and answers to CBI.**

- **CBI Feedback, Questions (if any) or Approval of KFD**
  - +6 weeks

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### Application

- **Drafting of Application, Governance, Approval and submission to CBI.**
  - +8 weeks

- **CBI Feedback and Questions**
  - +8 weeks from application submission

- **Response, approval, updates to application**
  - +4 weeks from feedback

- **Re-submit updated application and answers.**

- **Back and Forth with CBI**
  - +8-12 weeks

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**Statutory Clock begins**

**Regulatory Approval**
The Luxembourg perspective
Luxembourg market trends
An Overview

Sources: ALFI Statistics

- Among legal entities, **SIFs are gradually replacing Part II funds**, while Part I funds remain stable.
- The **emergence of RAIFs** (legal entity launched in 2016) is noticeable, with the rise from 22 at end of 2016 to 182 as of 5th October 2017.
- Part I funds still represent the largest portion of Luxembourg market, with more than 84% of Luxembourg total AuM.
Perspective of the Luxembourg regulator
CSSF anticipates the outcome of July 2017 ESMA advice on delegation

Fast Track Procedure
- Proactive towards large asset managers
- Encourages preliminary visits and early filings in order to avoid traffic while approaching transformation deadline

Informal involvement of ESMA
- Draft regulation of September 2017 ESMA, EBA and EIOPA act in order to encourage cohesion among the EU-27 Member States and deter plausible secessionist ideals
- CSSF started to refer large asset managers’ projects on no name basis to ESMA for preliminary opinion and discussion

CSSF building its own doctrine though Circulars pending EU final position
- CSSF initiated a working group with the objective of proposing a Circular that will deliver practical translations of the points of focus in the July 2017 ESMA Advice
- CSSF Circular is expected to be released in July 2018
- Likely major point of focus: reliance on group resources
Perspective of the Luxembourg industry

UK players

UK UCITS

UK managers have faced liquidity issues since 2016 and had to decide early on their strategy

- UCITS managers had the options to stop distributing in the EU or to start building a sustainable solution to continue to service both sides of the Brexit border:
  - UCITS Relocation
  - UCITS Merger
  - UK Master Lux Feeder
  - Parallel funds

- Now focused on anticipating the impact of Brexit on their operations and product features (currency hedging, eligibility of master fund etc.)

UK Private Equity Real Estate Houses

Early concerns of investors regarding the tax implications of Brexit on their revenues have calmed down. Few players have already transformed their business model while a majority are still in the planning phase

UK players with group presence in Luxembourg

- Will not always be able to rely on group capabilities established in Luxembourg (other business lines and strategies of local entities)

UK players with no presence in Luxembourg

- Have the choice between building or renting a Manco

- Delegate portfolio management back to the UK
- Have issues re-organizing client facing activities (relocation of staff, new hires?),
- … except for those UK entities relying on EU local branches or local delegates; in this case limited disruption to their model.
- May consider renting a third party ManCo
- UK players often run their portfolio management activities and marketing activities under different roofs: management company on one hand, MiFid entity on the other responsible for distributing the funds and for Discretionary Portfolio Management activities.
Perspective of the Luxembourg industry
US and Asian PERE players

Impact
- Impacted though their UK presence
- New entrants/new projects will no longer consider the UK for their EU target strategy
- Many of them have SPV established in Luxembourg in relation to which they need to solve the BEPS tax issue in the short term
- This tax pressure is an accelerator either to implement a strategy supported by strong substance or to withdraw from the EU

Action
- Some are firms seriously considering the opportunity to continue using Luxembourg as a pass-through to other countries for investment purposes and they look at alternative jurisdictions—such as Singapore—both for establishing their products and SPVs.
- For other firms the challenges can become an opportunity to start looking at development opportunities in the EU both in terms of products to be distributed but also in terms of establishing new businesses (ex: Trust, management company etc.).

Focus
- For most of them it is important that they can rely on the resources and expertise centralised with their Headquarters or with a dedicated group service point. CSSF recently confirmed the validity of such set-ups, to the extent that control and capacity to act remains at all times in Luxembourg.
- Challenges they encounter in this context concern the convergence to be achieved between the regulatory practices of multijurisdictional entities.
- Reliance on group resources (business continuity plan, IT, investor relationship management etc.) however is likely to be under increasing scrutiny by ESMA.
- Will often be focused on the costs of compliance which are perceived negatively.
Perspective of the Luxembourg industry
The different relocation models

Build a ManCo

Rent a ManCo

UCITS ManCo
AIFM
MiFID activities

UCITS ManCo
AIFM
MiFID activities

Fund
Appointment

Fund
Appointment

Fund
Delegation
Third party ManCo

Group Entity

UK Portfolio Manager
Q&A
Next Link ‘n’ Learn - Thursday 13th of September

Topic – Regulated PERE funds