

Regulatory News Alert

EU Commission Brexit note on the withdrawal of the United Kingdom and EU rules in the field of asset management

23 February 2018

On 8 February 2018, the EU Commission released several papers, among which, three addressed specifically to [banks](#), [MiFID firms](#), and [investment managers](#) of both UCITS and AIFs. All three papers are official notices that highlight the expected impacts of Brexit on various financial business activities.

The target date for Brexit preparations is now firmly set to 30 March 2019 00:00 CET, exactly two years after the UK withdrawal letter was sent to the EU Commission. Unless a transition period is agreed, this date signals the split of EU law from UK law. The most significant impact will be the end of passporting into and from the UK, plus the UK becoming a Third Country with all the consequences for banks, MiFID firms, and investment managers.

In these papers, the EU Commission recalls some principles regarding authorization, distribution, as well as the potential consequences for private entities stemming from a collapse of the EU integrated law order. Independently of any transitional arrangements, now is the time to prepare for Brexit, both operationally and strategically.

Impact on authorizations and cross-border distribution

- For UK funds and UK managers:

As of 30 March 2019, UK UCITS management companies and UK AIF managers will no longer benefit from the EU passport and will be treated as non EU AIF managers. To continue pursuing their current activities across the EU as far as UCITS, EuVECA, EuSEF and ELTIF are concerned, both UK managers and UK funds may consider relocating their operations to an EU Member State and obtained the new relevant authorizations prior to this date.

To continue managing and marketing AIFs to professional investors across the EU, AIF managers may also need to consider relocating and obtaining a new authorization dependent on their business strategy. Certain Member States do permit AIF managers who are not established and authorized in the EU to market AIFs (EU AIFs and non-EU AIFs) in their territories but only once they have successfully completed the relevant notifications under the so-called National Private Placement regimes (NPPR). It is worth remembering that

such notifications need to be done on a per Member State basis and there is no harmonization in the requirements. Not to mention the fact that the marketing of AIFs to retail investors may be very difficult, if not in practice impossible, depending on the EU country.

Subsidiaries of entities established in the UK, already authorized by a EU-27 National Competent Authority (NCA) will be able to continue to operate in the EU based on their authorization as either UCITS management companies or AIF managers. However, branches of UK AIF managers based in the EU will be treated as branches of a non-EU AIF manager as of the withdrawal date and will therefore be subject to the requirements of NPPRs, where available.

- For EU managers of UK funds:

As of the withdrawal date, UCITS and AIFs authorized or registered in the UK will be classified as non-EU AIFs, hence, EU-27 UCITS management companies managing those (former) UCITS authorized in the UK will need to seek new relevant authorizations to manage non-EU AIFs.

Impact on disclosure to investors

Brexit will also impact disclosure to investors. Indeed, UCITS management companies and AIF managers will need to inform investors of the consequences of the withdrawal of the UK from the EU. This will in particular impact, amongst other documents, the content of the annual report for AIFs and the content of the UCITS Key Investor Information Document.

More generally, UCITS management companies and AIF managers must now assess whether the change in legal status of the investment fund would still ensure compliance with the investment strategy of the fund as originally communicated to the investors. Eligibility of assets in fund-of-funds structures should carefully be reviewed.

Impact on delegation arrangements

When delegating certain operational functions to entities located in the UK, AIF managers and UCITS management companies will have to comply with additional requirements and demonstrate that their delegation structure is based on objective reasons and does not include material functions.

Brexit is just the tip of the iceberg

Beyond the context of Brexit and its implications for the fund industry, other historical trends have already encourage asset managers to review their operating model and overall strategy:

- **Rising number of assets managers:** the progressive growth of mutual funds since the 1980's, has been accompanied with an intensive M&A activities in the asset management industry, leading to a surge of management companies across the EU. It is currently not uncommon to find asset servicer with several management companies within the same group.
- **Product and investment strategies:** the development of investment products has often been conducted with no clear strategy. Asset

managers have developed too many products, being distributed across numerous EU countries and with overlapping investment strategies.

- **Margin pressure and increasing costs:** at the same time, the regulatory framework surrounding the asset management industry contributes to higher compliance costs to meet higher substance, conduct obligations, and capital requirements. In addition, asset managers face increasing pressure on their margin due to more competitive management fees, limitation for inducements, and the development of low TER products. Despite the positive outlook for an economic recovery, there is a growing number of non-performing mutual funds.
- **Tax environment:** the OECD/G20 BEPS framework, which aims at closing gaps and mismatches across international tax regimes, is forcing asset managers to review their tax planning strategies. With tax authorities constantly introducing stricter rules and curbing opportunities for tax treaty benefits, many groups are reviewing their tax footprint and considering the creation of a regional hub for their asset management activities.

Against a background of perpetual evolution in the fund industry, EU asset managers are now entering into a new strategic phase. Brexit will impact all fund industry actors, regardless of the depth of their links with the UK, through the need to reorganize and restructure their business models. Given the current organization of the EU investment management industry, the value chain of collective investment will be influenced by changes in the relationship between the EU and UK, including but not limited to authorization, passporting, and delegation requirements.

Deloitte's vision for the asset management industry

At Deloitte, we know that the interactions of Brexit, Digital, Cross-border distribution and delegation rules will create systemic changes for asset managers in terms of organization, access to clients and competition, resulting in potentially major impacts on business strategy and group organization.

To maximize the benefits of this de facto required reorganization, there are already several areas to consider:

- Retain one central management company that would manage both UCITS and AIFs, and act as the European hub within a group. This operating model will ease compliance costs, information disclosure, as well as the distribution of funds across the EU thanks to the EU passport.
- Select the adequate location, which benefits from a stable geopolitical and economic environments (e.g. AAA credit rating) with international expertise, major segments of clients, and a positive scalable ecosystem. A place where an entity already exists may further facilitate the licensing process.
- Delegate high costs but low added value tasks to specialize actors (e.g., KID production, cross-border registration and maintenance, tax return and regulatory reporting).

- Transform the remaining management companies of the group in subsidiaries or branches, and leverage on the substance of the EU management company while retaining the front activities locally.
- Rationalize the range of investment products offered within the group with a view to mitigate overlapping investment strategies.
- Create a “Transformation” function within the EU management company to advise the group on innovative solutions and products. For instance, the development of low budget funds where functions like reconciliation and transfer agency would become obsolete with the development of disruptive technologies such as Blockchain and robo-advisory.

At this moment in time, approximately a year before Brexit goes live, it is of a paramount importance to start assessing the business structure, evidencing potential disruptions in the access or provision of services or products, ensuring that sources of funding remain available as well as designing and implementing remediation plans. Any transition period, however short it is or may be, must be seen as an opportunity to create a new business model.

How Deloitte can help

In this rapidly evolving crossroads between regulations and Brexit news, Deloitte can help you to stay ahead of the game with its Kaleidoscope Regulatory Watch services, which monitors and analyzes forthcoming changes.

Deloitte’s advisory experts will also help you design and implement your renewed business strategy and support your reorganization in light of this new environment. Our team can assist you with any of your operation lifecycle through our wide range of services:

- Management company operating model definition
- Service Provider Selection & Due Diligence
- KPIs definition and dashboard implementation
- Marketing & Commercial strategy
- CSSF License Application and substance requirement
- IT Strategy
- Market research & analysis

Deloitte’s advisers have in-depth experience in regulatory and organizational projects including UCITS V, AIFMD, and various other regulations, as well as in business processes or digital enabled solutions to help you meet the challenges of the new environment.

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