



Brexit Industry Insights

Asset Management

September 2019

With the UK's default to leave the EU without a deal, the asset management sector is vulnerable to disruption. The sector is faced with simultaneously navigating business growth whilst mitigating the impacts of Brexit – including the free movement of capital and market access. The winners will be those in the sector prepared for change and alive to the opportunities.

Several factors ensured the financial services industry was among the first to begin Brexit preparations, including regulatory barriers to the continuity of service provision, the time taken to secure the correct authorisations and licences, and the importance of the industry to the wider economy.

As the financial services sector is among the most mature in its preparations for Brexit and has been through the process from impact assessments to implementation, there are lessons that can be taken and applied to the preparation of other sectors of the economy.

Brexit and the Asset Management Sector

The UK has the second largest asset management sector in the world with over £8 trillion assets under management¹, with assets managed¹ on behalf of overseas clients currently over £3 trillion², more than half of which comes from EEA investors. The financial services sector as a whole will be among one of the most impacted industries due to the level of regulation market participants are subject to, and the level of interconnection between the UK and EU financial systems. The asset management industry is a vital component of the UK economy, facilitating the channelling of capital to businesses and investment in to all sectors. Any decline in the health of the industry could have far reaching impacts for the financing of other sectors.

A lack of access for UK-based asset managers to the EEA market could limit access to EEA funding, having a negative impact on the levels of investment into UK-based investment schemes. The asset management industry not only brings investment into UK companies and improves their access to capital, it also brings in revenue from overseas, stimulates investment in property and infrastructure and provides the



1. Asset Manager Sector Report –Parliament UK. Available here: <https://www.parliament.uk/documents/commons-committees/Exiting-the-European-Union/17-19/Sectoral%20Analyses/3-Sectoral-Analyses-Asset-Management%20Report.pdf>
2. Asset Management in the UK 2017-2018 – The Investment Association. Available here: <https://www.theia.org/sites/default/files/2019-04/20180913-fullsummary.pdf>

opportunity for individuals to effectively manage their wealth.

Any restrictions on the industry's ability to provide these services to the same extent as currently could have knock on effects on businesses and industries who rely on these services.

What does this mean for business?

Some of the key considerations for businesses operating in this sector:



Market Access

The issue of changing degrees of market access remains among the biggest concerns for the asset management industry. Once the UK withdraws from the EU, UK-based businesses will lose the ability to provide their services throughout the EEA without the need for authorisation from an EEA national regulator³. As the UK becomes a third country, and subsequently UK-based businesses can no longer take advantage of passporting rights, the ability of UK-based asset managers to continue accessing European markets remains uncertain, despite some agreements between the respective regulators.

The FCA and the Prudential Regulation Authority (PRA) have been transparent and communicative about their expectations of market participants through regulatory outputs and educational briefings, while also conducting supervision to ensure businesses are making appropriate preparations. The FCA and PRA also required regulated businesses to plan for the scenario of maximum change, i.e. a no deal Brexit, and demanded evidence of businesses' preparations to ensure the industry is sufficiently planning. As a result, the industry worked towards ensuring market participants can continue to service clients by looking at the transfer of authorisation and portfolios to EU entities where necessary.



Supervisory cooperation

There has been strong cooperation between EU and UK Regulators to minimise the potential disruption caused by a no-deal Brexit to the financial services industry. This has manifested itself in agreements between regulators which aim to provide business continuity and allow certain activities to continue regardless of the terms of the UK's withdrawal from the EU. For example, ESMA and the FCA have come to an agreement that will allow certain activities, such as fund manager outsourcing and delegation, to continue to be carried out by UK-based entities on behalf of counterparties in the EEA.

The UK and US have also taken measures to minimise regulatory uncertainty in derivatives markets caused by Brexit, in whatever form it takes. The FCA, Bank of England, and the US Commodity Futures Trading Commission (CFTC) reaffirmed their commitment to close cooperation and the orderly functioning of the US and UK derivatives markets in an announcement in February 2019.

The cooperation between regulators with the aim of minimising disruption and ensuring the orderly functioning of markets from the date of withdrawal is in part due to the importance of the industry for both the UK and the EU. The degree of cooperation and transparency of regulators has been a vital component of the Brexit planning undertaken by the industry.

In focus: Space

Equivalence Decisions: A third country can be granted equivalence by the European Commission in certain areas if they deem that country's standards and regulatory regimes to be of an equivalent standard to the EU's. This would allow that country's financial services covered by the equivalence decision to access the EEA market without the need for separate authorisation in each jurisdiction. This can be withdrawn unilaterally by the European Commission at any time.

Memoranda of Understanding (MoUs): MoUs are frameworks in which supervisory authorities agree to cooperate and share information. There have been several MoUs signed between UK and EU² supervisory authorities to continue cooperating in the event of a no-deal Brexit.

For example, the European Securities and Markets Authority (ESMA) and the Financial Conduct Authority (FCA) have signed MoUs concerning the continued exchange of information. A separate MoU has been agreed between the FCA and EU/EEA securities regulators to cover supervisory cooperation. This MoU will allow certain activities such as fund manager outsourcing and delegation to continue to be carried out by UK based entities on behalf of counterparties based in the EEA.

Adequacy: An adequacy decision, in relation to data flows, determines whether a third country has a comparable level of personal data protection to that in the EU. As a result of an adequacy decision, personal data can flow freely from the third country to and from the EU. Without this, there would be restrictions on the flow of data between the UK and the EU and the need for alternative arrangements to be put in place.

3. Currently, UK asset managers can passport their services to another EEA jurisdiction with only notification to the local regulator required rather than a separate authorisation. UK-based asset managers are able to access the EEA market through their authorisation by the FCA and make use of passporting regimes in EU regulations and directives including the Markets in Financial Instruments Directive (MiFID II), the Alternative Investment Fund Managers Directive (AIFMD), the Undertakings for Collective Investment in Transferable Securities Directive (UCITS).



Compliance function

The highly regulated nature of the industry has meant businesses already have an established regulatory compliance function, and are generally fully aware of the requirements for authorisation in each jurisdiction they operate. As monitoring regulatory change has always been important in the sector, asset managers have been well placed to understand what changes may be necessary to continue business as usual operations as well as develop and implement comprehensive Brexit mitigation plans. Together with regulators that have been vocal and clear about what they expect from market participants, this has contributed to a generally high-level of preparedness in the industry.



Tax

Restructuring in response to regulatory barriers has resulted in a number of tax issues for companies to manage, including assessing whether the activity of transitioning to a new EU company is a transfer of a business going concern (i.e. with goodwill or intangibles attached) in order to determine potential exit tax charges and associated valuation issues.

Post-restructuring, the tax implications for ongoing operations present different tax challenges, for example, new cross-border charges for services provided by an old UK hub company to a new EU company will have transfer pricing and VAT implications, as will back-to-back arrangements where the UK company seeks to continue some of the key entrepreneurial risk-taking functions in respect of the financial assets that may now be originated and entered into by the EU company with EU customers. The employment tax position for staff moving to new locations will need to be considered. European taxes such as French and Italian Financial Transaction Tax (FTT) also pose operational challenges, such as securing appropriate exemptions for broker dealers similar to Stamp Duty Reserve Tax intermediary relief.



People

Under a no deal, free movement of people will end once the UK leaves the EU. EU/EEA citizens resident in the UK before 31 October 2019 will retain their rights to settlement and access to services, and they will need to apply under the EU settlement scheme by 31 December 2020. EU/EEA citizens moving to the UK after 31 October 2019 will for a transitional period be able to move to the UK to live and work as they do now. But those wishing to stay beyond December 2020 will either need to apply for European Temporary Leave to Remain by 31 December 2020 or leave the UK. The UK is expected to introduce a new immigration regime from January 2021 for all EU nationals arriving in the UK after this date.

Multinational asset management companies often have a highly mobile international workforce and are reliant on the efficient deployment of individuals around the world including within the EU. Post-Brexit changes will need to be factored into existing processes to avoid delays in putting feet on the ground and/or increased costs. For example, immigration requirements for UK nationals planning to work in the EU will need to be confirmed on a country-by-country basis including expected time lines for completion of the immigration process.

Dual social security liabilities could arise for employers and mobile employees if member states do not agree to reciprocal arrangements with the UK.

What can businesses do to prepare?

Companies of all industries can learn from the Brexit preparations of the asset management sector which have been driven by the following questions and considerations:

Case study

Deloitte aided a leading global US investment bank on its strategy to manage Brexit and the changes this will have on its business and operational model. We helped the client:

- Perform a Brexit impact assessment.
- Design and implement funding models for a new entity with front to back trade flows for all product classes.
- Create a margin and collateral approach to enable European clients to continue trading activity post-Brexit.
- Analyse tax consequences of business change including on implementation and under the future-state operating model.
- Assess the client asset protection requirements of the new regulator, formulating a plan to adapt the current client assets architecture.

We successfully brought together multiple business functions that had been operating in silos, and applied a systematic approach to manage the complexity and volume of analysis required.

- Monitoring regulatory developments: Asset managers have benefitted from having developed compliance functions which monitor developments from regulators. These functions have been integral in examining the regulator's publications and incorporating them into Brexit preparations.
- The regulatory requirements for having a presence of "substance" in EU27 jurisdictions. Requirements for a local presence depends on the size, nature and complexity of a business's activities. There are local regulatory expectations in each jurisdiction which must be met in order to receive authorisation from the local competent authority.
- If relocating certain functions is necessary, what are the key considerations to take into account when deciding in which jurisdiction to be based? There is inherent harmonisation in EU directives however local regulators will have regulatory expectations in each jurisdiction which should be taken account of when developing location strategies.
- Where are your counterparties based? Is your business contracting with UK or EU entities? For businesses contracting with EU brokers, changes to market access may limit your ability to continue contracting through EU brokers and necessitate operational transformation.
- How does ESMA's opinion on delegation of Portfolio Management to Third Countries impact Brexit planning? ESMA's opinion on delegation has not changed the rules on such activities but acts as guidance for national regulators. The MoUs between the FCA and EU/EEA securities regulators mentioned above do not change local authorisation criteria.
- What is an optimal management structure for continuing operations in the EU27 and the UK post-Brexit? Management structures will vary depending on business model and existing ownership arrangements and hence a case by case analysis is needed.
- Manage all key stakeholders to understand commitments and expectations.

How can Deloitte help?

Deloitte has been supporting multiple businesses across a range of industries to understand the implications of, and prepare for, the UK's withdrawal from the EU. We have supported many client engagements with their Brexit planning.

Our teams combine Brexit insights, industry knowledge and technical expertise to support our clients with their Brexit readiness planning – from risk assessment to applying the lessons learned to optimise for the future trading environment.

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Further reading

No-deal guidance for the asset management sector

UK No-deal Technical Notices:

Banking, insurance and other financial services if there's no Brexit deal

UK Business Preparation Tool:

Prepare your business or organisation for Brexit

European Commission Brexit Preparedness:

Financial Services and Capital Markets Union
Asset management preparedness notice

Further guidance:

FCA Brexit guidance
Bank of England Brexit pages
ESMA Brexit guidance
European Central Bank

This no-deal guidance is not exhaustive. Companies should routinely review the latest official updates and technical guidance as and when they are published by the UK, EU, and individual EU Member States.