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Brexit Statutory Instruments – a series of briefings

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Alternative Investment Fund Managers (Amendment) (EU Exit) Regulations 2018

This paper is part of a series of briefings for clients and contacts of Allen & Overy on the review of financial services statutory instruments (**SIs**) to be laid down under the European Union (Withdrawal) Act 2018 (the **Withdrawal Act**).

Introduction

The purpose of the SIs is to help with a range of legal issues caused by the UK's exit from the EU and to prevent, remedy or mitigate any failure of EU law to operate effectively or any other deficiency in retained EU law. SIs are not intended to make policy changes, other than to reflect the UK's new position outside the EU. The changes in the SI will not take effect on 29 March 2019 if a transitional agreement is reached.

The Alternative Investment Fund Managers Directive

The Alternative Investment Fund Managers Directive (**AIFMD**) is a regulatory framework for alternative investment fund managers (**AIFMs**), which are managers of alternative investment funds (**AIFs**). AIFs are funds other than UCITS funds, including hedge funds, private equity funds, non-UCITS retail investment funds, investment companies and real estate funds. Its focus is on regulating the AIFM rather than the AIF.

The AIFMD:

- establishes an EU-wide harmonised framework for monitoring and supervising risks posed by AIFMs and the AIFs they manage, and for strengthening the internal market in alternative funds
- includes requirements for firms acting as a depositary for an AIF
- establishes a 'passporting' system that enables 'full-scope' EEA AIFMs (those with assets under management above the specified size threshold) to market and manage AIFs in any other member state

What does the AIFMD SI do?

The Alternative Investment Fund Managers (Amendment) (EU Exit) Regulations 2018 (**AIFMD SI**) makes amendments to retained EU law related to AIFMs to ensure that it continues to operate effectively in the UK once the UK has left the EU. A separate statutory instrument has been published in relation to the UCITS regime, although the two are closely intertwined.

Some of the main amendments relate to the following:

Meaning of AIF

The SI amends the definition of AIF such that any investment fund that is not subject to the UK UCITS regime would become an AIF. The SI confirms that this would apply to all non-UK funds, including EEA UCITS.

This is no small change given that 7,291 funds currently passport into the UK under the UCITS Directive, and is therefore one of the most controversial aspects of the AIFMD SI.

It also means that, subject to limited exceptions, in order to continue to market an EEA UCITS in the UK after the end of the TPR, an EEA UCITS manager will have to satisfy all the requirements of the UK 'onshored' AIFMD regime – ie this will apply in parallel to the requirements under the EU UCITS Directive (to which the manager will of course remain subject). It is not clear whether this is commercially practicable or viable, or whether it is necessary from a public policy perspective.

Establishment of Temporary Permissions Regime for AIFMs

This SI sets out the design and structure of a Temporary Permissions Regime (**TPR**) for EEA AIFs (including EuVECAs, EuSEFs, ELTIFs and Money Market Funds which use an AIF structure). Firms will need to notify the FCA of their intention to benefit from the TPR. It will last for a period of up to three years from exit day. To continue marketing the relevant EEA AIF after the end of the TPR, the AIFM must notify under the national private placement regime (**NPPR**). The AIFM will be directed by the FCA to make the notification within two years from exit day.

Provision of information

The SI disapplies the NPPR information and reporting requirements for funds that are recognised under section 272 of the Financial Services and Markets Act 2000 for marketing to retail investors.

This is being done in view of the fact that:

- as noted above, EEA UCITS falling within the UCITS TPR will technically be regarded as AIFs in due course under UK law, and subject to the new 'onshored' AIFMD regime
- at the end of the TPR period, they will only be capable of being marketed to retail investors in the UK if they have been recognised under the section 272 regime

To be clear, funds recognised under section 272 can be marketed to the public and will not be subject to the UK NPPR regime.

EEA AIFMs currently marketing third-country AIFs

The SI aligns the treatment of EEA AIFMs with that of other third-country AIFMs by requiring them to notify under regulation 59 of the UK AIFMD regulations (which implemented Article 42 of AIFMD). Article 42 of AIFMD imposed a regime on non-EU AIFMs wishing to market in the EU, eg imposing annual reporting, investor disclosure and FCA reporting requirements.

The SI will enable the EEA AIFM to enter the TPR, and market the relevant fund on the same terms and subject to the same conditions as it could have been before exit day, before notifying and becoming recognised under regulation 59. In essence, it therefore gives EEA AIFMs a three year 'grace period' before they are treated in the same way as other third-country firms under UK law.

New EEA AIFs marketed in the UK after exit day

Both UK and EEA AIFMs marketing EEA AIFs into the UK post-Brexit and not as part of the TPR will need to notify the FCA under the current NPPR rules, as per other third-country AIFs.

Reporting on portfolio companies and asset-stripping provisions

UK AIFMs will only be required to report on portfolio companies and comply with the restrictions on asset stripping when they acquire control of a UK company, as opposed to an EU company.

Supervisory cooperation

Provisions in legislation relating to cooperation and information sharing have been removed. However, this will not preclude UK supervisors from sharing information with EU authorities where necessary.

The approach towards retained direct EU legislation

The SI seeks to amend UK domestic law that implements the AIFMD and accompanying regulations incorporated into UK law by the Withdrawal Act with the aim of ensuring the continued functioning of UK statute. In addition to the AIFMD SI, the UK regulators will update their rulebooks and policies to take account of and rectify any deficiencies resulting from the UK's withdrawal from the EU.

Legislation amended by the AIFMD SI[1]
Charities Act (Northern Ireland) 2008
Charities Act (2011)
Alternative Investment Fund Managers Regulations (2013) (UK AIFMD regulations)
Commission Delegated Regulation 231/2013
Commission Implementing Regulation 447/2013

Areas identified by industry as requiring further consideration

Although the intention of the SI is to onshore the AIFMD regime with as little change as possible to ensure the continued functioning of UK law, there are a number of issues arising as a result of Brexit that the industry has identified as potentially requiring further consideration.

EEA UCITS

The SI provides for the treatment of non-UK UCITS funds as AIFs, with such UCITS receiving temporary marketing rights under the UCITS SI. We have published a separate briefing on this SI, discussing some of the issues that arise from HM Treasury's approach to EEA UCITS going forward.

However, one particular concern is that historic UK investors into such funds would be prejudiced if (for example) an EEA UCITS can no longer be sold to retail investors following the end of the three-year transition period, and/or if it is not possible or convenient for an EEA UCITS manager to comply with the new UK AIFMD regime or obtain UK authorisation. This would be fixed by adding grandfathering provisions in the AIFMD SI or UCITS SI (as appropriate) to permit EEA UCITS managers to continue to interact with UK holders (eg deal with redemption requests, provide annual reports/updates, conduct corporate actions etc) following the end of the TPR.

Temporary permission regime

Proposed regulation 78A allows EEA AIFMs to benefit from transitional marketing rights to continue marketing EEA and UK AIFs into the UK post-Brexit, as if they still had the EU passport.

In relation to a UK AIFM with an EEA AIF currently marketed into the UK, that AIFM may be transferring the management of that AIF to an onshore management company for Brexit purposes. However, if that cannot be completed by exit day, then the AIF will not fall within the scope of the temporary permission regime.

New regulation 78B permits continued marketing by an EEA AIFM subject to certain conditions. These include a condition that, "immediately before exit day", "[it] was marketing" a particular AIF in the UK. This raises questions as to whether AIFMs with funds eligible to be marketed, but not in fact marketed, immediately before exit day fall outside the temporary permissions regime. It would be preferable if the word "immediately" was deleted.

Under new regulation 78B, an EEA AIFM would be treated as if it is an authorised person under FSMA. The implications of this are unclear (eg whether this requires compliance with home or host state rules) and also if certain other requirements under FSMA need to be excluded or modified as applied to these types of firms, such as the requirements as regards threshold conditions.

[1] **Retained direct EU legislation revoked by the AIFMD SI**: Commission Delegated Regulation (EU) 448/2015; Commission Delegated Regulation (EU) 2015/514

New funds and new sub-funds of umbrellas

Since a relevant AIF must be the subject of a filing with the FCA before exit day, the temporary permissions regime will not apply to new AIFs or new sub-funds of umbrella AIFs that may be launched after exit day or where a particular AIFM may wish to start marketing in the UK after exit day. In addition, it is not clear that new or further share classes of AIFs that were the subject of an FCA filing before exit day are within scope, although hopefully the FCA will clarify that this was the intention.

What does this mean for you?

The onshoring of the AIFMD regime has structural implications for EU27 AIFMs which manage UK funds or assets or which market funds into the UK, or vice versa, associated with the loss of passporting and recognition. Most firms are now well advanced with their planning. The SI affects the Brexit planning process as follows:

- the TPR affects Brexit planning with respect to the 'inward' (EEA to UK) activities undertaken by EEA AIFMs or with respect to EEA AIFs: firms undertaking such activities should update their Brexit contingency planning to take account of the availability of the TPR, and the obligations associated with temporary permission, noting the comments above on the various areas of uncertainty in the regime as currently contemplated
- in particular, AIFMs that wish to take advantage of the TPR should monitor FCA announcements as to the launch of the online notification process
- UK managers managing EEA AIFs cross border will need to factor the TPR requirements into their contingency plan if they are migrating the management of such AIFs to an EEA manager
- EEA UCITS managers and funds will need to consider the application of the TPR being introduced by the UCITS SI, and prepare for the application of the 'onshored' UK AIFMD regime to them in due course
- EEA AIFMs that wish to launch new EEA AIFs into the UK after exit day will need to get up to speed on the UK NPPR and prepare for compliance with the new 'onshored' AIFMD regime
- EEA and UK managers generally should consider the need to update fund documentation and marketing material to reflect the new regime and remove stale information – eg as regards the application of AIFMD and/or the UCITS Directive. They should also monitor FCA announcements as to their regulatory expectations on this front.

Next steps

- HM Treasury intends to put the SI before Parliament this autumn.
- FCA has begun to consult on its approach to the binding technical standards and on any amendments required to its rules relating to the FCA handbook.
- HM Treasury proposes to review the section 272 regime and separately consult on this but their timing is presently unclear.

Your Allen & Overy contacts

For further information please speak to your usual Allen & Overy contact.