Client Update
AIFMD Meets Brexit

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On Thursday, the UK public were called upon to answer the following question—"*Should the United Kingdom remain a member of the European Union or leave the European Union?*"

It goes without saying that the outcome of Thursday's referendum was unexpected (circa 52% voted to leave the European Union and 48% voted to remain in the European Union, based on a voter turnout of 71.8%). It also goes without saying that the consequences of the UK's eventual withdrawal from the European Union are unknown.

From a private investment funds regulatory perspective, Brexit is unlikely to lead to real change in the immediate future. It may be that in the longer term there will be relatively little that changes. It is the uncertainty that now exists, and that will continue to exist during the transitional period that will begin on the day that the United Kingdom exits the European Union and end on some unknown date thereafter, that will be destabilising for the UK funds industry and potentially damage the popularity of the United Kingdom as a fund manager jurisdiction of choice.

AIFMD: RECAP

The Alternative Investment Fund Managers Directive ("AIFMD") introduced, for the first time, EU-wide regulation of private investment fund managers. At its most basic, AIFMD draws a distinction between European 'alternative investment fund managers' and non-European 'alternative investment fund managers'.

In short, a European fund manager is subject to more extensive regulatory burdens than was the position pre-implementation of AIFMD, but obtains the significant benefit of an EU-wide 'marketing passport' that permits marketing of its European private investment funds to European professional investors.

Generally, a non-European fund manager that wishes actively to market its private investment funds to European investors is subject to a sub-set of the regulatory burdens borne by a European fund manager but currently does not have access to the 'marketing passport'. A non-European fund manager must look to the divergent national private placement regimes in the relevant European jurisdictions to determine how, and the extent to which, it can market to prospective investors in the particular jurisdiction.

HOW IS A UK FUND MANAGER TO BE CATEGORISED?

To state the obvious, a UK fund manager currently is categorised as a European 'alternative investment fund manager'. Under current law, a UK fund manager will still be categorised as a European 'alternative investment fund manager' until the United Kingdom's withdrawal from the European Union.

The status of a UK fund manager post-Brexit is unclear and will depend on the outcome of the negotiations amongst the United Kingdom and the other member states of the European Union. The paths forward (or backward, depending on your view) are set out below. Some of these paths may seem fanciful but, given the current state of the United Kingdom's European Union position, not impossible.

To the extent a new fund manager is looking to establish itself and would otherwise have focused on the United Kingdom as its base, it is likely that such a fund manager, at least in the short term, will now look first to another European jurisdiction like Luxembourg or Ireland.

The United Kingdom withdraws from the European Union but is a member of the European Economic Area. Such a relationship likely would closely mirror that which Norway currently enjoys with the European Union and accordingly a UK fund manager would retain the categorisation of European 'alternative investment fund manager'. As a member of the EEA, the United Kingdom would pay a fee to preserve its access to the single market and would continue to enjoy the benefits of free movement of goods, services, workers and capital. Given the importance that many of those who voted to leave the European Union seemed to place on giving the United Kingdom the power to restrict the free movement of workers into the United Kingdom, it seems unlikely this option will be pursued.

The United Kingdom exits the European Union and the European Economic Area and other arrangements are put in place amongst the United Kingdom and the members of the European Union. Subject to any grandfathering regime, a UK fund manager would be categorised as a non-European 'alternative investment fund manager'.

A non-European fund manager wishing to market a private investment fund in the European Union does not have access to the 'marketing passport'. AIFMD contemplates that non-European fund managers ultimately will have access to the 'marketing passport' prior to the mandatory withdrawal of the national private placement regimes at the end of 2019 (at the earliest) (such that the only way in which a fund manager actively may market its fund in the European Union is if that fund manager has access to the 'marketing passport').

On 30 June 2015, the European Securities and Markets Authority ("ESMA") announced that it would be undertaking a detailed assessment of 22 non-European jurisdictions for the purposes of determining whether it should recommend access to the 'marketing passport' for fund managers established in those non-European jurisdictions. ESMA has not given itself a firm deadline for completion of this assessment.

On 30 June 2016, ESMA is due to finalise its analysis of the United States, Hong Kong, Singapore, Japan, Canada, Isle of Man, the Cayman Islands, Bermuda and Australia. Given the detailed assessment process ESMA appears to be adopting and the pace to date at which it has undertaken this assessment, that date likely will pass before that analysis is concluded and it is difficult to estimate when this process will be complete. If the United Kingdom exits the European Union and the European Economic Area, presumably the United Kingdom will need to join the orderly queue of non-European jurisdictions for ESMA 'marketing passport' assessment.

Scotland becomes independent and remains in the European Union while England, Wales and Northern Ireland withdraw from the European Union. Query whether this results in an exodus of English fund managers to Scotland in order for those fund managers to secure the status of European 'alternative investment fund manager'.

The United Kingdom remains in the European Union. The referendum is not legally binding, although it is difficult currently to see a political way forward for the United Kingdom to remain in the European Union.

ANY DIRECT IMPACT ON US FUND MANAGERS?

There is unlikely to be any immediate direct impact on US fund managers (or other non-European fund managers) vis-à-vis AIFMD and Brexit.

It would be surprising if there was any short-term change in the process by which a US fund manager markets its private investment funds in the United Kingdom.

One of the issues constantly monitored and assessed by many US fund managers is whether it makes sense to establish a European 'alternative investment fund manager'. There are two related reasons for such consideration: (a) the difficulties associated with utilising the private placement regimes in particular European jurisdictions, and the fact that in some European jurisdictions there is no viable private placement regime, and (b) the recognition that even if, or when, the 'marketing passport' is extended to non-European fund managers, there is likely to be a period of uncertainty of application and approach such that moving ahead and establishing a European 'alternative investment fund manager' may seem the more palatable option. To the extent a US fund manager (or a fund manager in another non-European jurisdiction) decides to establish a European 'alternative investment fund manager' it is now unlikely that the jurisdiction of choice for such establishment will be the United Kingdom.

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Please do not hesitate to contact us with any questions.