



Brexit – What might this mean for UK financial services?

Following the shock referendum result on Friday 24 June 2016 the economy is left wondering what comes next.

It is now difficult to predict with any level of certainty how Brexit will impact Business. Economic forecasts currently remain unclear as they are based on assumptions. Largely this is due to the fact that it remains subject to at least two years' negotiation what form the UK's relationship with the EU and other global trading partners will take. Any final agreement requires a qualified majority of the EU Council and a majority vote of the EU Parliament. While the UK controls the start of the negotiation period, once notice is served there is a significant risk that the UK runs out of time to put in place a well-considered model or has no model at all.

In this briefing note we set out a summary of some of the possible consequences that our clients as

regulated firms or service providers to regulated firms must start to consider.

What regulations will now apply

Now that the UK has voted to leave the European Union the Prime Minister will have to invoke Article 50 of the Lisbon Treaty for the first time in EU history, thus beginning the formal process of withdrawal. Until this time and until the two year (or longer) negotiation process has been completed the UK will still remain a part of the EU. As such UK regulated firms should continue to follow the existing regulations that they were subject to pre Friday's vote.

For incoming new regulations driven by European directives, such as the Market Abuse Directive and MiFID II UK firms must continue to plan for the implementation deadlines. Whilst it is likely that the UK will wish to continue to operate with common standards this approach does not guarantee that rules will not be subject to change post EU exit. In the meantime, firms still have a regulatory obligation to comply in the interim periods running up to any form of post-Brexit change even if the final position is uncertain at the time of implementation.

On Friday the FCA released the following statement on their website:

"The FCA is in very close contact with the firms we supervise as well as the Treasury, the Bank of England and other UK authorities, and we are monitoring developments in the financial markets.

Much financial regulation currently applicable in the UK derives from EU legislation. This regulation will remain applicable until any changes are made, which will be a matter for Government and Parliament.

Firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still

to come into effect.

Consumers' rights and protections, including any derived from EU legislation, are unaffected by the result of the referendum and will remain unchanged unless and until the Government changes the applicable legislation.

The longer term impacts of the decision to leave the EU on the overall regulatory framework for the UK will depend, in part, on the relationship that the UK seeks with the EU in the future. We will work closely with the Government as it confirms the arrangements for the UK's future relationship with the EU."

Will regulations need to change?

The UK has played a primary role for 40 years as the driving force behind the establishment of the EU financial services regulatory framework. Consequently, a high degree of similarity and consistency exists between the EU and the UK when it comes to such regulation and, in so far as the UK retains domestic regimes based on the EU regimes, it is expected (despite the lack of certainty on the timing for this) that the EU Commission will reach a conclusion of equivalence to EU requirements with respect to much of the UK financial services regime once post-Brexit the UK becomes a third country. Notwithstanding this, there is a possibility that UK asset and fund managers may face additional licensing and regulatory requirements to service their EU clients in areas where the EU Commission does not make an equivalence determination.

The significant point of tension from a regulatory standpoint post-Brexit will be the inability of the UK to continue to successfully drive and influence EU regulation as it has always done in the past, and the move from a single regulatory regime to a dual regime. Whilst not immediately obvious this could ultimately have an impact on the UK's global competitiveness and investor confidence. As one potential (albeit small) upside, a leave vote may enable the UK to "disregard" provisions under EU directives relating to financial services that are contrary to UK policy and administratively burdensome. Nevertheless, it

is expected that there will have to be some "repatriation" of EU laws regardless of the post-Brexit model agreed on in order to ensure that the UK can maintain equivalency as a third country.

On a slightly separate note, a key consideration for our clients will be the increased burden and cost they are likely to face when it comes to regulation over the coming months and years. Whilst it is expected that a common standard will be maintained any consultations or new/updated regulations will require resource for review and implementation. Regardless of the level of change this will be particularly painful for firms given that the last few years have involved intense periods of wholesale regulatory change and most firms were hoping to move to a steadier state over the coming years.

A key risk to financial services

A key risk to financial services is the loss of various passporting regimes for corporate (as well as retail) banking, and investment banking under MiFID II and CRDIV.

The loss or limitation of managing and marketing passporting rights into the EU is also a high impact risk for asset and fund management firms.

Asset and fund managers

The impact of Brexit on fund managers would depend on the extent to which they are UK, EU or non-EU focused and the types of products they offer to investors.

Notwithstanding the potential for immediate impact regarding fire sell-offs if the market reacts negatively, there is likely to be a more future dated consequence for asset and fund managers who have UK managed funds (whether AIFs or UCITS) offered into the EU and, in the case of UCITS, the rest of the World, and EU funds (whether AIFs or UCITS) managed in the UK and offered into the EU. This final impact is likely to be some time away until at

least development of the post Brexit model is well progressed.

Central to what lies ahead is whether access to EU financial markets and financial services will be preserved for UK asset and fund managers.

It is possible that firms could lose out on the marketing and management passport benefits that they can currently benefit from. Therefore, the biggest impact will be for firms who rely on a passport to conduct their business, for example if they rely on a passport to market and distribute their funds on a pan-European basis, or to provide managed account and investor advisory services on a cross-border basis

A UCITS fund must be EU domiciled and managed by an EU management company. After Brexit, funds established as UCITS in the UK would no longer fall within the scope of the UCITS Directive, and would therefore be unable to use the passport provisions which allow UCITS funds established in one Member State to be managed and marketed in other Member States. As a consequence, asset managers for whom passports are integral to their business model will need to change the way in which they manage and market their funds. If the fund remains in the UK, it is likely that the UK regulator would regard the fund for UK regulatory purposes as a type of non-UCITS retail fund, which would be categorised as an 'alternative investment fund' (AIF) under AIFMD. Similarly, the EU would treat the UK fund as a non-EU AIF. This means that UK UCITS would have to comply with the AIFMD regime and could only be marketed into the EU under the Article 42 AIFMD national private placement regimes for marketing to professional investors (and any national restrictions on marketing to retail investors). Some EU Member States, such as Italy, have not implemented an AIFMD private placement regime and in others, such as Germany, the conditions for the AIFMD regimes are very restrictive. Similarly, assuming the UK does not change its rules, EU UCITS could only be marketed in the UK under the UK national private placement regime. This would require

compliance with the UK's financial promotion restrictions and would restrict marketing to retail investors.

For alternative investment funds, the exit of the UK from the EU would mean that UK full scope AIFMs would no longer be full scope EU authorised AIFMs and so would lose the use of the pan-European marketing (and management of AIFs established in other EU member states) passport under AIFMD. Instead, they would have to comply with the AIFMD national private placement regimes for marketing into EU jurisdictions. In a similar way, the exit of the UK from the EU will also affect EU AIFMs when marketing into the UK. Compliance with the AIFMD transparency and reporting requirements would still be necessary however. The possibility of a third country passport under AIFMD for non-EU financial institutions and approved by ESMA may reduce the impact on UK AIFMs post-Brexit, but this remains an area subject to discussion.

Given the level of uncertainty and potential for change we expect that Depositories, Trustees, Transfer Agents and Outsource Providers will also feel a lot of extra pressure given the requirement to understand and facilitate the model changes their clients might propose and also the requirement to understand how compliance will be achieved going forward.

Banking and investment services

For purely UK-focused firms (both UK entities and UK branches of foreign entities), there are unlikely to be material impacts. For firms which use the passport (for cross border activities), the key issue will be whether that system continues. If the passport lapses, it would be necessary to consider how business model and group structures would need to change. This is of particular concern in the context of banking activities because CRDIV does not contemplate a framework for third country access. The need for an EU subsidiary that could provide banking services into the remainder of Europe under the passport system would become fundamentally important in this scenario.

Similarly, for EU firms that wish to provide banking services into the UK, it would be necessary to consider establishing a UK subsidiary. This will be a key concern for Banks that may have relocated their UK client base into a European Headquartered Bank over the past few years (which has been a general strategic move that we have seen).

Derivatives

In 2009, the G20 made a commitment to reform the derivatives markets globally. Given the UK's role in this commitment and the size of its derivatives market, the idea that the authorities would seek to deregulate that market is an almost untenable notion. The global reforms that have taken place and which are still being finalised in key locations mean that the UK would almost certainly continue to apply mandatory clearing, minimum margin requirements and reporting to a centralised trade repository whether it was in the EU or not. The primary open question is how the UK might seek to do this going forward. Either way this will therefore require some form of operational change initiative on a regulatory reform that is still a recent memory for most firms.

One immediate impact on the derivatives market may be the need for close margin monitoring and a review over the enforceability of contracts given the likely volatility of the markets now and in the coming months.

For most of our clients given that market standard derivative contracts are under English Law we do not believe these should require re-papering.

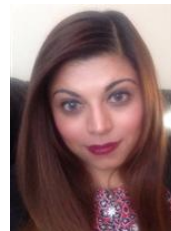
Market infrastructure

Post the financial crisis changes to market infrastructure has assisted with establishing investor confidence. If Brexit means that the benefits of MiFID and EMIR are no longer available, firms operating UK based trading venues or clearing or settlement systems would need to consider how they can continue

to service EU-based firms or link up with EU-based market infrastructure. Given how fundamentally important the financial market infrastructure is to both the reputation and the operation of UK capital markets, it is expected that the UK Government will focus efforts on ensuring that EU firms continue to be given access however, this remains subject to discussions which will unfold in due course.

Contact us

Should you wish to discuss any of our services or make any further enquiry please reply to this email at mail@rosediem.com or; contact Rosediem's Managing Director, Nisha Madhvani.



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