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Post-Brexit Models under AIFMD

Since it came into effect in 2013, the Alternative Investment Fund Managers Directive (AIFMD) has had a profound impact on funds' risk management. It's seen the role of risk management expand to encompass every part of the value chain, from portfolio risk to operational risk and liquidity.

This has required a cultural shift. Managers have had to take an ex ante – rather than ex post – approach: embedding risk management firmly into portfolio decision-making at the outset, rather than simply measuring potential impacts of decisions that have already been made.

Now, with Brexit looming, AIFMD could be about to change everything for British alternatives managers once again.

Losing access

Under the directive, asset managers must have an EU presence to take advantage of the marketing passport that allows funds to be distributed freely across Europe. With many expecting a 'hard Brexit' in which the UK is no longer a member of the European Economic Area, expectations that passporting will be fully protected appear to be fading.[1]

According to European Securities and Markets Authority (ESMA), there are no significant obstacles impeding the application of the AIFMD passport for a number of non-EU jurisdictions, including Canada, Guernsey, Japan, Jersey and Switzerland.[2] It can only advise, however. Ultimately any decision will be made by the European Commission, Parliament and Council.

Should UK-registered alternative investment fund managers lose their passporting rights, they will effectively be in the same position as U.S. managers and others outside the EU. If they wish to market to investors within it, they must come to another arrangement.

Model opportunities

One option will be to set up a legal presence in a jurisdiction such as Luxembourg or Dublin. The requirements for adequate substance to prove genuine domicile are not light, however. UK managers already know the demands AIFMD puts on an organisation and may balk at the resources needed to locate core functions and skilled people outside the UK, as well as commit the minimum capital required.

It seems likely, therefore, that some will look to third-party management companies – as U.S. managers have done – rather than setting up their own operation in the country. Even if they ultimately want to set up their own operations, these could serve as a transitional arrangement. Outsourcing to meet the AIFMD requirements will enable them to enjoy continued access to the EU without immediately needing to deploy staff abroad in what is likely to be an uncertain post-Brexit period.

1 http://uk.reuters.com/article/us-britain-eu-banks-idUKKBN14W00A
2 https://www.esma.europa.eu/press-news/esma-news/esma-advises-extension-funds-passport-12-non-eu-countries

WHEN DO YOU BELIEVE BREXIT WILL IMPACT YOUR COMPLIANCE ARRANGEMENTS?

6.4%
Changes have already begun to be implemented

6.4%
Immediately (within 6 months)

22.4%
In the near term (7 months to 18 months from now)

26.3%
Long term (18 months or longer)

38.5%
Brexit will not have an impact on our compliance arrangements