

The End of the Brexit Transition Period: Compliance Requirements for UK Investment Managers and Advisers

On 24 December 2020, the government of the United Kingdom (UK) and the European Union (EU) reached a Trade and Cooperation Agreement¹ (the "Agreement") in advance of the end of the Brexit transition period (11:00 p.m. GMT on 31 December 2020).²

While the Agreement does not provide a solution for the provision of financial services between the UK and the EU, the Joint Declaration³ confirms that the UK and the EU will agree a framework for regulatory cooperation by March 2021 in order to facilitate mutual equivalence decisions in the future.⁴ The final agreement on financial services seems, therefore, subject to further separate negotiations.

We set out below an overview of the relevant considerations for alternative investment managers in light of the Agreement and the UK Financial Conduct Authority's (FCA) expectations following the end of the Brexit transition period.

1. Key implications for investment managers

- The Agreement provides little specific information regarding the future arrangements with respect to financial services (including the investment management sector) from January 2021.
- The Agreement will be separately negotiated with respect to financial services, with the parties having committed to reaching agreement on a Memorandum of Understanding (MoU), which provides the foundation for equivalency decisions, by March 2021 (subject to extension).
- This effectively means a "hard Brexit" for financial services, at least until the outcome of the further negotiations, and requires managers to understand the regulatory treatment in each EU member state in the interim period.
- Accordingly, EU "passporting" rights under the Alternative Investment Fund Managers Directive (AIFMD) with respect to the marketing of funds or provision of fund management services, and under the Markets in Financial Instruments Directive (MiFID) with respect to the provision of cross-border investment services and activities (including marketing), are no longer available for UK firms.

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- Permissibility of the provision of cross-border investment services activity and delegation arrangements by, or to, UK firms must be confirmed on a case-by-case basis for each EU jurisdiction.
- As there are currently limited "equivalence" decisions under the EU regulatory framework, compliance with overlapping regulatory requirements may be required. For example, entering into derivative transactions with EU counterparties requires compliance both with the UK and EU regulatory requirements⁵; UK firms are required to comply with the share trading obligation with respect to shares admitted to trading on UK regulated markets⁶, while EU counterparties are restricted from trading on UK exchanges with respect to shares admitted to trading on EU regulated markets.

2. FCA Brexit Guidance and Expectations

- The FCA published final onshoring instruments, related guidance and the Temporary Transitional Power (TTP) directions that apply in the UK from the end of the Brexit transition period.⁷
- The TTP is the power granted to the FCA by Part 7 of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019⁸ to delay or phase-in regulatory requirements where they change because of Brexit or where they apply to a firm for the first time following the Brexit onshoring process.⁹
- The FCA published a statement on its expectations of UK firms with respect to their Brexit preparedness, systems and operational changes, and clients.¹⁰

3. FCA TTP directions

- The FCA expects UK firms to follow the TTP directions where applicable.¹¹
- The FCA has "applied the TTP on a broad basis from the end of the transition period until 31 March 2022."¹² Therefore, "firms and other regulated persons do not generally need to prepare now to meet the changes to their UK regulatory obligations brought about by onshoring"¹³, but are instead expected to "use the duration of the TTP period to prepare for full compliance with the onshored UK regime **by 31 March 2022**."¹⁴

The FCA has issued the following TTP directions:

- **Main/Standstill Directions:**¹⁵ Firms must either comply with regulatory obligations that applied before the end of the transition period (i.e., 11:00 p.m. on 31 December 2020) **or** with the onshored regulatory obligations during the TTP period.
- The Main Directions include Annexes and explanatory guidance¹⁶ on how the Brexit Statutory Instruments and technical standards, which onshored EU law, and the updated FCA Handbook should be read.
- **Prudential Direction:**¹⁷ Firms must continue to comply with their pre-Brexit obligations covered by the Prudential Direction (i.e., as they stood before the end of the transition period) until 31 March 2022.
- The Prudential Direction includes an Annex and explanatory guidance on how the Brexit Statutory Instruments and technical standards, which onshored EU law, and the updated FCA Handbook should be read.¹⁸

- **Share Trading Obligation (STO) Direction:**¹⁹ Article 23(1) of the Markets in Financial Instruments Regulation (MiFIR)²⁰ as onshored in the UK by the Markets in Financial Instruments (Amendment) (EU Exit) Regulations 2018 (as amended, “UK MiFIR”) requires a firm to trade in-scope shares on UK trading venues, systemic internalisers and equivalent third-country venues. However, the STO Direction effectively allows a firm to continue trading shares on EU trading venues and systemic internalisers without this constituting a breach of UK MiFIR. The FCA has not yet set a date of when this Direction will expire.
- The FCA also published an explanatory note on how the STO Direction applies.²¹
- **Derivatives Trading Obligation (DTO) Direction:**²² Article 28 of the UK MiFIR requires financial counterparties and nonfinancial counterparties to trade in-scope derivatives on UK trading venues and equivalent third-country venues when concluding relevant transactions.
- The DTO Direction modifies the UK DTO so that where firms subject to the UK DTO trade with, or on behalf of, EU clients that are subject to the EU DTO (e.g., a UK AIFM executing a transaction entered into by an EU AIF), they will be able to transact or execute those trades on an EU trading venue, provided certain conditions are met.²³

Exceptions to the TTP

- The TTP directions do not apply to all obligations that will change as a result of Brexit. Where the TTP does **not** apply, “firms will need to comply with the changed requirements from the end of the transition period” (i.e., immediately).²⁴ The FCA has published the “key requirements” where the TTP does not apply.²⁵
- The TTP does not apply to a number of requirements under the onshored UK regimes, which will continue to apply unamended, including:
 - MiFID II transaction reporting requirements.
 - EMIR reporting obligations.
 - SFTR reporting obligations.
 - MAR Suspicious Transaction and Order Reports (STORs).
 - STS notifications under the UK Securitisation Regulation.
 - Areas where HM Treasury has taken an equivalence decision in relation to European Economic Area (EEA) jurisdictions, in the area affected by such decision.
 - Changes related to a firm’s regulatory perimeter or financial promotions (i.e., those activities for which a firm needs authorisation, registration or approval from the FCA to carry out).

Other considerations

- **Applicable law**

The FCA expects UK firms to comply with English law, including with EU law as amended and retained in English law during the on-shoring process.²⁶ This includes compliance with the various Brexit Statutory Instruments that are now law and part of the UK’s regulatory regime.

- **End of the EU passport**

Following the end of the “EU passport”, the FCA expects “UK firms to take the steps available to them to ensure they act consistently with...local laws and expectations. The FCA is clear that firms’ decisions need to be guided by obtaining appropriate outcomes for their customers, wherever they are based.”²⁷

- **Systems and operational changes**

The FCA stated that its focus will be on the “strategic objective of ensuring markets function well.”²⁸ By this, the FCA means that it will “continue to monitor both primary market and associated secondary market activities closely, including for any misconduct by market participants, throughout this period during which some market volatility could arise.”²⁹

As priority areas, the FCA stated that it will monitor (as applicable) “order book reporting, suspicious order and transacting reporting, inside information disclosures, price movement monitoring, and reporting on net short positions and the FCA will use its powers to request information and make enquiries where behaviour that may be abusive or creating a disorderly market is identified.” The FCA also expects “market participants to be aware of the FCA’s significant detective capabilities” with respect to insider trading.³⁰

However, the FCA “recognises the challenges for firms in making the systems and operational changes required” and therefore intends taking “a pragmatic approach to any issues should they arise,” provided “firms can demonstrate that they have taken all reasonable steps to prepare.”³¹

- **Client disclosure requirements**

The FCA expects firms to have “put in place plans to ensure any possible disruption to UK financial services is minimised at the end of the transition period.”³² As part of these plans, firms are expected to contact their clients to inform them of any possible disruptions or changes due to Brexit, where these are unavoidable.

4. Sectoral considerations

AIFMD: Marketing

- UK AIFM marketing a non-EU AIF in the EU

A UK AIFM is now treated as a third country AIFM by the EU, and must therefore market a non-EU AIF in the EU under the national private placement of Article 42 AIFMD, where available.

- UK AIFM marketing an EU AIF in the UK and in the EU

A UK AIFM marketing an EU AIF (e.g., a Luxembourg or Irish fund) in the UK is now subject to the same requirements that apply when it markets a Cayman or other non-EU fund.

A UK AIFM is treated as a third country AIFM by the EU member states and, consequently, may only market an EU AIF in the EU under the national private placement regime of Article 42 AIFMD, where available.

AIFMD: Management activities

- UK AIFM managing a non-EU AIF

The rules applicable to a UK AIFM with respect to its activities of managing a non-EU AIF do not change.

- UK AIFM managing an EU AIF

A UK AIFM may no longer use the AIFMD management passport to manage EU AIFs from the UK, and will need to determine its right to manage an EU AIF in accordance with the local requirements in the jurisdiction of the EU AIF.

For example, the Luxembourg Commission de Surveillance du Secteur Financier (CSSF)³³ and the Central Bank of Ireland (CBI)³⁴ have published guidance on the circumstances in, and the conditions subject to which, a UK AIFM may continue to manage a Luxembourg or Irish AIF, respectively.

- UK firm acting as a delegate of an EU AIFM

UK firms may continue to provide portfolio management services as a delegate of an EU AIFM in accordance with existing provisions regarding delegation to third country entities. The Multilateral Memorandum of Understanding (MMoU) agreed between the FCA and each of the EEA regulators entered into force at the end of the transition period and satisfies the conditions for such delegation arrangements to continue.³⁵

However, the requirements applicable to the delegation of investment management activities by EU AIFMs to UK investment firms or other third country managers may change in the future as a result of the review of the AIFMD framework by the European Commission.³⁶

MiFID: Investment services and activities (including marketing)

- UK firm providing investment services to EU clients; undertaking investment activities in the EU

- A UK firm may no longer rely on the MiFID passport and must assess whether the nature of the services it provides or the activities it undertakes, would require licensing in the relevant EU jurisdiction by taking into account a range of factors.
- An understanding of the local interpretation of the MiFID rules, such as whether marketing is considered to constitute a MiFID investment service or activity, or restrictions on the use of tied agents, is essential, as the regulatory perimeter is not identical across the EU. For example, certain jurisdictions may not permit the use of third country tied-agents.

UCITS Directive

- Creation of a UK-specific UCITS regime

The EU UCITS framework has been onshored into English law by the Collective Investment Schemes (Amendment etc.) (EU Exit) Regulations 2019³⁷ (as amended, “UK UCITS”), which created a separate UK regime for “UK UCITS”.

- UK firm acting as a delegate of an EU Management Company of an EU UCITS

A UK firm may act as the delegated portfolio manager of an EU UCITS Management Company. No material disruption is expected with respect to these arrangements.

- UK firm marketing an EU UCITS

The marketing of an EU UCITS by a UK MiFID investment firm in the EU may, in some cases, be affected if such marketing is considered to be a MiFID investment activity as the UK MiFID investment firm may no longer rely on a MiFID passport.

- UK firm managing an EU UCITS

A UK firm may no longer act as the UCITS Management Company of an EU UCITS, as the UCITS Directive³⁸ does not permit a third country manager to act as the UCITS Management Company.

5. Status of “equivalence decisions” by the UK and EU

- **Equivalence decisions by the EU**

To date, the most operationally significant EU equivalence decision is an 18-month time-limited equivalence decision³⁹ (i.e., until 30 June 2022) under Article 25 of EMIR⁴⁰, on the legal and regulatory framework of central counterparties (CCPs) that are already established and authorised in the UK. ESMA subsequently recognised three UK CCPs as eligible to provide clearing services in the EU (e.g., to EU funds).⁴¹

- **Equivalence decisions by the UK**

The UK has established its own equivalence framework and on 9 November 2020 published a package of equivalence decisions for the EEA across a range of sectors under the onshored UK regimes.⁴² The UK equivalence decisions, combined with the FCA TTP directions (e.g., the Share Trading and the Derivatives Trading Obligation Directions discussed above), seek to allow for minimal disruption to UK firms’ normal trading activities.

The most notable UK decision relates to the equivalence of EEA regulated markets such that UK firms “may continue to treat derivatives traded on EEA regulated markets as exchange-traded derivatives rather than OTC derivatives.”⁴³

The decisions are in addition to the equivalence decisions taken by the EU before the end of the transition period in relation to non-EU jurisdictions, and which have been onshored in English law from the end of the transition period.

¹ Trade and Cooperation Agreement (including Annexes and Protocols) between the European Union and the European Atomic Energy Community, of the one part, and the United Kingdom of Great Britain and Northern Ireland, of the other part (See [here](#)). Other associated agreements and declarations made by the parties are: the Declarations; the Nuclear Cooperation Agreement; the Agreement on Security Procedures for Exchanging and Protecting Classified Information; and an Exchange of letters between the United Kingdom and the European Atomic Energy Community on provisional application of the Agreement for Cooperation on the Safe and Peaceful Uses of Nuclear Energy (See [here](#)).

² The UK formally left the EU on 31 January 2020 and a transition period immediately began, during which the EU and the UK have negotiated the details of their new relationship. The Agreement is the culmination of those negotiations and lays the foundations for the legal framework between the EU and the UK as two distinct but closely interlinked trading partners.

³ Declarations, Joint Declaration on Financial Services Regulatory Cooperation between the European Union and the United Kingdom, page 2 (See [here](#)).

⁴ The Joint Declaration on Financial Services Regulatory Cooperation between the European Union and the United Kingdom (page 2, [here](#)) provides that: "Both Parties will, by March 2021, agree a Memorandum of Understanding establishing the framework for this cooperation. The Parties will discuss, inter alia, how to move forward on both sides with equivalence determinations between the Union and United Kingdom, without prejudice to the unilateral and autonomous decision-making process of each side."

⁵ The EU has only made one time-limited equivalence decision under EMIR; See section on Equivalence decisions further below in this client alert.

⁶ However, see the "FCA TTP" section of this client alert for information on the Share Trading Obligation (STO) Direction.

⁷ FCA publishes final Brexit instruments and Temporary Transitional Power (TTP) directions, FCA website, 22 December 2020 (See [here](#)); Onshoring and the Temporary Transitional Power, FCA website, 31 December 2020 (See [here](#)); and Statement on use of the Temporary Transitional Power to modify the UK's derivatives trading obligation, FCA website, 31 December 2020 (See [here](#)).

⁸ See [here](#).

⁹ The "onshoring process" is the process of amending EU legislation and regulatory requirements so that they work in a UK-only context.

¹⁰ Brexit countdown for UK financial services sector, FCA website, 24 December 2020 (See [here](#)).

¹¹ The FCA has also issued TTP directions with respect to non-UK firms continuing their business in the UK but these directions are beyond the scope of this note.

¹² Onshoring and the Temporary Transitional Power, FCA website, 31 December 2020 (See [here](#)).

¹³ *Ibid.*

¹⁴ *Ibid.*

¹⁵ Main transitional directions, December 2020 (See [here](#)).

¹⁶ Annex A, Application of the standstill direction to amendments made in Statutory Instruments and Exit Instruments amending technical standards, December 2020 (See [here](#)); Annex B, Application of the standstill direction to amendments made in the FCA Handbook, December 2020 (See [here](#)); Explanatory note: Directions under Part 7 of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 (Transitional Powers of the Financial Regulators), December 2020 (See [here](#)).

¹⁷ FCA Prudential Transitional Direction (See [here](#)).

¹⁸ *Ibid.*

¹⁹ FCA Transitional Direction for the Share Trading Obligation, December 2020 (See [here](#)).

²⁰ Regulation (EU) No. 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No. 648/2012.

²¹ Explanatory note: FCA Transitional Direction for the Share Trading Obligation (a direction under Part 7 of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 (Transitional Powers of the Financial Regulators), December 2020 (See [here](#)).

²² FCA Transitional Direction for the Derivatives Trading Obligation, December 2020 (See [here](#)).

²³ The conditions are: "(a) firms take reasonable steps to be satisfied the client does not have arrangements in place to execute the trade on a trading venue to which both the UK and EU have granted equivalence; and (b) the EU venue has the necessary regulatory status to do business in the UK – such venues include those that are a Recognised Overseas Investment Exchange, have been granted the relevant temporary permission, or are certain that they benefit from the Overseas Person Exclusion." See [here](#).

²⁴ Brexit countdown for UK financial services sector, FCA website, 24 December 2020 (See [here](#)).

²⁵ Key requirements of firms, FCA website, 31 December 2020 (See [here](#)).

²⁶ Brexit countdown for UK financial services sector, FCA website, 24 December 2020 (See [here](#)).

²⁷ *Ibid.*

²⁸ *Ibid.*

²⁹ *Ibid.*

³⁰ *Ibid.*

³¹ *Ibid.*

³² *Ibid.*

³³ End of the transitional period on 31 December 2020 following the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union, Press Release 20/26, CSSF website, 7 December 2020 (See [here](#)).

³⁴ AIFMD, Questions and Answers, 35th Edition, 9 October 2020, Central Bank of Ireland (See [here](#)).

³⁵ MoUs with European authorities in the areas of securities, insurance and pensions, and banking, FCA website, 4 January 2021 (See [here](#)).

³⁶ Public Consultation: Financial services – review of EU rules on alternative investment fund managers, European Commission (See [here](#)).

³⁷ The Collective Investment Schemes (Amendment etc.) (EU Exit) Regulations 2019 (See [here](#)).

³⁸ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (See [here](#)).

³⁹ Commission Implementing Decision (EU) 2020/1308 of 21 September 2020 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council (See [here](#)).

⁴⁰ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (See [here](#)).

⁴¹ ESMA to Recognise Three UK CCPs from 1 January 2021, ESMA website (See [here](#)); the three CCPs are: ICE Clear Europe Limited, LCH Limited and LME Clear Limited.

⁴² Policy paper: HM Treasury equivalence decisions for the EEA States – 9 November 2020, HM Treasury (See [here](#)).

⁴³ *Ibid.*; The European Market Infrastructure Regulation (Article 2A) Equivalence Directions 2020, HM Treasury (See [here](#)).

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