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Christopher discusses the potential impact of Brexit on private equity funds, including changes to fund structures and the implications for US fund managers:

How do you see Brexit generally impacting private equity funds and their managers, general partners, and limited partners, or other investors?

The impact depends to a large extent on whether there is a "soft Brexit" or a "hard Brexit." In a soft Brexit, the UK and EU would reach a comprehensive agreement as to the terms on which the UK will leave the EU and, in particular, that agreement would provide for the UK to continue to participate in the EU single market for financial services (which implies the continued application of relevant EU financial services legislation in the UK). In a hard Brexit, the UK leaves the EU without having reached an agreement as to the terms on which it can access the EU single market.

Immediately following the June 23, 2016 referendum in which voters chose, by a margin of 52% to 48%, to have the UK leave the EU, the financial markets across the globe, which had not expected this result, reacted strongly. The value of the pound depreciated 11% against the dollar and yen and 6% against the euro, and major share indices across the UK and Europe experienced significant volatility and ultimately ended the day 5% to 11% down from the previous day's close. UK and EU financial services stocks suffered particularly badly. For example the value of the UK's Lloyds Banking Group fell by over 20%. By mid-July 2016, many of these losses were regained, although the value of the pound continued to decline to 30-year lows.

This volatility makes it likely that, in the short term, the UK will suffer an economic downturn and perhaps a recession in the months following the Brexit referendum. The possibility of, and any effects from, a downturn or recession will likely be exacerbated because of uncertainty regarding the nature of the UK's future relationship with the EU, and, in particular, its ability to access the EU single market. This uncertainty may have a negative impact on investor confidence and may make it harder for managers to raise capital in the UK.

However, the devaluation in the pound has created value opportunities. For investors from outside the UK, shares and other assets are now effectively 10% to 15% cheaper than they were prior to the referendum, and there is evidence of some funds taking advantage of that fact.

In the longer term, investors will have to take a view as to whether those who campaigned for the UK to leave the EU were right to argue that leaving would decouple the UK economy from a stagnating economy in the EU and allow it to pursue free trade opportunities around the globe, which would in turn lead to long-term growth. The terms of the relationship negotiated between the UK and EU, if any, will affect that view.

We do not anticipate any specific changes to fund terms as a result of Brexit. However, a number of open-ended UK real estate funds suspended redemptions in the immediate aftermath of the referendum result and the Financial Conduct Authority (FCA), the UK regulator, issued guidance stating that UK-regulated managers have a duty to ensure "that assets are valued fairly and accurately and to ensure that any subscriptions or redemptions of units take place at a fair price" during times of market volatility. We therefore anticipate that fund valuation, redemption, and suspension terms will come under even greater scrutiny from investors and regulators.

Will Brexit change fund structures? Will it make countries such as Ireland or Luxembourg more attractive for certain fund entities?

This will very much depend on whether there is a soft Brexit or a hard Brexit. For example, the Alternative Investment Fund Managers Directive (AIFMD) includes a "passport" mechanism that enables an EU-domiciled and authorized manager to market any EU-domiciled fund that it manages to professional investors across the EU, subject only to compliance with the requirements of AIFMD.

If there is a hard Brexit, UK-domiciled managers will not be able to rely on the AIFMD passport to market their EU-domiciled funds. Certain managers, particularly those who are highly dependent on raising capital in the remaining EU member states, may consider restructuring their management and fund entities so as to ensure continued access to these markets on a passported basis. These managers may, for example, consider establishing fund

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management entities in an EU member state (Frankfurt, Paris, Dublin, and Luxembourg are destinations likely to be considered) to ensure continued access.

What are the practical implications of Brexit for US private equity and hedge fund managers and for the funds that they manage?

Other than the market volatility referred to above, and potentially increased investor redemptions from certain funds, particularly real estate funds, there are few immediate short-term implications of Brexit for US managers. The UK remains a member of the EU, and EU legislation relevant to those managers, including AIFMD, the Undertakings for Collective Investment in Transferable Securities Directive (UCITS), the Markets in Financial Instruments Directive (MiFID), and the Short Selling Regulation and the Market Abuse Regulation, continues to be implemented in and have an effect in the UK.

It will only be possible to fully assess the longer-term implications of Brexit for the asset management industry when there is some clarity as to the nature of the future relationship between the UK and the EU.

If there is a hard Brexit, the implications for managers domiciled in the UK that provide services in Europe on a cross-border basis will certainly be significant. The implications for US managers will depend on whether they:

- Have established a subsidiary in the UK.
- Market their funds in the UK and/or the remaining EU member states.
- Are invested in UK and EU companies.

What impact would a hard Brexit have on US fund managers?

The impact will depend on their nexus with the UK. If the US manager has a subsidiary operating in London or elsewhere in the UK, a hard Brexit would mean that subsidiary would not be able to automatically passport that entity's UK FCA authorization into the EU. In that circumstance, they must consider how important that passport is to their business and whether it is necessary to restructure. Likewise, if the US manager has an affiliate in another EU member state that uses a passport to access the UK market it will need to consider how this is addressed post-Brexit.

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If there is a soft Brexit and the agreement reached permits the UK to continue to participate in the EU single market, the relevant EU legislation, including AIFMD, UCITS, and MiFID, among others, will probably continue to apply in the UK in some form and the long-term implications of Brexit for the asset management industry may in fact be negligible.

This agreement would clearly be in the interests of the UK, and possibly in the interests of the EU and the global economy. It would accomplish the goals stated by German Chancellor Angela Merkel to minimize the "turbulence" and "successfully contend with this situation so each side can get the best out of the British position." However, such an agreement may not be politically achievable. There will be resistance in the UK, where at least part of the argument of the leave campaign was based on freeing the UK from the obligations of the EU single market, including making financial contributions to the EU and the implementation of EU legislation. There will also be resistance in other EU member states, some of which have expressed a desire to punish the UK for its decision to leave the EU.

However, the impact for US managers with no operations on the ground in London is likely to be less significant. AIFMD requires that a non-EU manager or an EU-domiciled manager of a non-EU fund that wants to market its funds to professional investors in an EU member state do so in accordance with a "national private placement regime." Although the national private placement regime must impose minimum investor and regulatory disclosure requirements, each EU member state is free to impose additional requirements or to prohibit marketing activity altogether.

AIFMD does include a mechanism that permits the passport to be extended to non-EU managers and to the EU-domiciled managers of non-EU funds. Although this mechanism has not yet been utilized, the European Securities and Markets Authority (ESMA) has recently advised the European Commission that there are no material obstacles that would prevent the passport being extended to managers and funds domiciled in Canada, Guernsey, Japan, Jersey, Switzerland, Hong Kong, and Singapore.

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ESMA's conclusions with respect to the US are more complex. ESMA found no significant obstacles regarding investor protection and the monitoring of systemic risk which would impede the extension of the AIFMD passport to the US. However, ESMA identified concerns that the US rules relating to the marketing of funds in the US by EU Alternative Investment Fund Managers (AIFMs) are less favorable than the rules that would apply to US AIFMs and Alternative Investment Funds accessing the EU if the passport is extended. ESMA consequently recommended that the EU should try to identify measures to address this disparity in treatment before extending the AIFMD passport to US managers.

Given the lengthy failed attempts over the last two decades to create reciprocal recognition arrangements between the US and EU over mutual funds governed by the Investment Company Act of 1940 and UCITS funds, it appears unlikely that US managers will be able to benefit from the AIFMD passport in the near term. US managers marketing in the EU will therefore have to continue to rely on the national private placement regime of each EU member state unless they establish an EU management entity and fund.

The UK currently takes a relatively light touch to private placements. Unlike some other major EU countries, it has not imposed additional obligations beyond the minimum transparency requirements of AIFMD. Although the UK will no longer be a member of the EU, it is unlikely that it will take any immediate steps to amend its AIFMD-based private placement regime for funds.

It is possible that because the UK will no longer participate in the EU legislative process, the AIFMD private placement regime and other aspects of financial services regulation may become more restrictive over time.

What should fund managers be doing now to begin to prepare for the UK exit from the EU?

Managers should, of course, closely follow the negotiations between the UK and the EU and consider how the likely terms of the UK's exit from the EU will affect their specific business. In particular, if they have a subsidiary or affiliate operating in the UK, they should assess whether that entity has exercised its passport rights, whether those passport rights are important to it, and whether it is likely to be able to continue to benefit from those passport rights or to otherwise access the European markets on alternative terms. Depending on the answers to those questions, it may be necessary to consider whether there are alternative fund and management structures that would provide them with these benefits post-Brexit. For example, it could be desirable to establish a fund or management entity, or both, in one of the remaining EU member states.

In terms of fund documentation, we expect the immediate focus to be on fund valuation, redemption, and suspension terms. Managers should also consider their risk exposure to Brexit and consider whether it is necessary to update their risk factors accordingly.

There is no doubt that Brexit will represent a significant change for the UK and the EU. Change brings both risk and opportunity, and managers should ensure that they are well placed to manage the former and take advantage of the latter.

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