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BRIEFING: *Luxembourg*

# Brexit

# Supervision of fund managers is about to get more complex

Theresa May says the UK will leave the single market, so how will this affect authorised UK AIFMs managing Luxembourg funds?

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Luxembourg is a major hub for private funds, particularly due to its extensive tax treaty network and the wide range of regulated and unregulated investment vehicles it offers. Retaining access to the management of Luxembourg alternative investment funds (AIF) and making sure they can be successfully marketed in the European Economic Area (EEA) on a level playing field with other market players is therefore key to UK alternative investment fund managers (AIFMs).

One of the main aspects of the British Prime Minister's 17 January speech was a commitment to exit the single market and negotiate a new Free Trade Agreement (FTA). The option for the UK to remain a member of the EEA through which it would retain access to the single market – the 'Norway option' – appears to have been ruled out.

**Lost your passport?**

The Alternative Investment Fund Managers Directive (AIFMD) created a passport for EEA AIFMs to manage and market to professional investors EEA AIFs across all EEA states. If the UK does not remain in the EEA, UK asset managers who qualify as authorised AIFMs ('full-scope AIFMs') would lose the benefit of the AIFMD passport, unless such passport is maintained through the FTA. It would therefore adversely impact UK full-scope AIFMs who are relying on the AIFMD passport to manage and distribute Luxembourg funds.

If UK full-scope AIFMs were to lose the benefit of the AIFMD passport they would in principle still be able to manage Luxembourg AIFs, except for those that must be managed by a full-scope AIFM such as reserved alternative investment funds (RAIF).

However, they would only be able to market such AIFs in other EEA countries in compliance with each country's national private placement regime (NPPR) provided that they comply with certain requirements, although these would be lighter than those that apply to full-scope AIFMs. This notably includes an obligation to issue an annual report for each AIF managed, complying with investor disclosure requirements and reporting obligations.

Individual NPPRs may impose additional burdensome regulatory requirements.

To retain the benefit of the AIFMD marketing passport UK AIFMs will need to manage Luxembourg AIFs through a full-scope AIFM located in the EEA, either by establishing a subsidiary or by using the services of a third-party AIFM and acting on the basis of an advisory or portfolio management mandate.

As an AIFM cannot fully delegate its management function the latter option implies that the third-party AIFM might interfere in the management of the AIF.

The AIFMD provides for a third-country passport regime that has not been implemented yet. Now that Theresa May has confirmed that she expects the UK to leave the single market it is likely that the timeline for the implementation of this regime and the extension of the benefit of the passport to the UK will be part of the negotiations. Most probably, a condition for the regime to be extended to the UK will be that the UK maintains the current AIFMD regime.

**State of reference**

If the third-country regime is implemented and extended to the UK in the wake of Brexit a UK AIFM could have the benefit of the marketing passport. It would have to be authorised by an EU member state of reference and would have to comply with substantially all of the AIFMD requirements. It would further have to maintain a legal representative in its member state of reference who should be the point of contact with the EEA regulators and who must verify AIFMD compliance.

A UK AIFM will not be entitled to choose its member state of reference. The member state of reference will be determined depending on where the AIFs managed by the AIFM are registered or authorised and where the AIF is effectively marketed. As a result, several member states may qualify as member states of reference and the AIFMD provides for a mechanism whereby the relevant competent authorities will jointly decide which will be the member state of reference.

The member state of reference of a UK AIFM managing a Luxembourg AIF might therefore not be Luxembourg, in which case that AIFM might be supervised by a less business-friendly regulator than the Luxembourg supervisory authority of the financial sector, the CSSF.

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