



22 December 2020

Brexit: Implications of Expiry of Transition Period for Funds and Management Companies

In a [statement](#) published on 21 December 2020, ESMA has urged all market participants to ensure that they have taken “*all necessary actions in due time to remain operational and compliant with EU law on 1 January 2021*”.

In this briefing, we consider some matters for consideration by funds and fund management companies arising from the expiry of the transition period set down in the Withdrawal Agreement between the UK and the European Union which is scheduled for 23.00 (GMT) on 31 December 2020 (the “**Expiry of the Transition Period**”).

UCITS-specific considerations

(i) *Promotion of UCITS within the European Union*

Under Article 3(b) of the UCITS Directive, a collective investment scheme must be promoted to the public within the European Union in order to constitute a UCITS fund. As a result, it would appear that any new UCITS established after the Expiry of the Transition Period cannot solely market its shares to UK investors and some form of promotion of such UCITS must be undertaken in an EU member state.

(ii) *Management of UK UCITS by an Irish management company*

An Irish management company will not be able to continue to manage UK domiciled UCITS funds without extending its licence to allow it to act as an AIFM given the re-categorisation of UK UCITS funds as alternative investment funds on Expiry of the Transition Period.

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(iii) Investment in UK UCITS

On Expiry of the Transition Period, UK UCITS will be re-categorised as alternative investment funds under EU law (“AIFs”). The Central Bank of Ireland (the “**Central Bank**”) previously confirmed that for the time period in which it is considering whether investment in UK UCITS is suitable for Irish UCITS funds and RIAIF funds, such investments will continue to be considered eligible investments. This position may therefore be subject to further change. However, in the case of UCITS funds, any investment in UK AIFs must fall within the aggregate limit of 30% for investment in all AIFs.

(iv) Investment in UK Credit Institutions

Under domestic rules governing UCITS funds, UCITS funds may only place monies on deposits with certain categories of credit institutions. Although UK credit institutions will constitute non-EEA third country credit institutions and no equivalence decision is in place, they will remain eligible for investment by Irish UCITS on the basis that the UK is a signatory to the Basle Capital Convergence Agreement of July 1988.

(v) Eligible OTC counterparties

The Central Bank has confirmed in a 2019 [Notice of Intention](#) that while it considers whether or not UK investment firms should be a category of eligible financial derivative counterparty for Irish UCITS or RIAIF funds, it will not treat such counterparties as ineligible. This position is subject to change depending on the conclusions of the Central Bank.

(vi) Marketing of Irish UCITS in the UK UCITS

UCITS umbrella funds which have entered the UK’s Temporary Permissions Regime (the “**TPR**”) by 31 December 2020 can continue to market to UK investors in accordance with the requirements of the TPR. They will also be permitted to add any new sub-funds which are authorised after the Expiry of the Transition Period to the TPR should they wish to market such additional sub-funds to UK investors.

UCITS schemes or existing UCITS sub-funds which have not entered the TPR regime before 31 December 2020 or UCITS umbrella funds established after that date may be required to wait for the introduction of the proposed “Overseas Fund Regime” in order to be able to register to market their shares in the UK¹. Further information is available in our recent [client briefing](#).

AIFMD-specific considerations

(i) Use of a UK AIFM by an Irish QIAIF

Irish QIAIF funds may continue to use a UK AIFM after the Expiry of the Transition Period, provided that the QIAIF and the UK AIFM comply with the provisions of the AIF Rulebook that apply in the case of QIAIFs with registered AIFMs. The Central Bank has confirmed that such QIAIF are subject to the full AIFMD depositary regime, including the AIFMD depositary liability provisions.

¹ While full FCA recognition under section 272 of the Financial Services and Markets Act is possible, it is acknowledged as impractical and unworkable and is not considered to be a feasible route to the UK market.

The Central Bank has written to all Irish QIAIFs which have notified it of their intention to continue to use a UK AIFM after Expiry of the Transition Period, setting out the new conditions of authorisation applicable to such QIAIF.

(ii) Investment of more than 50% of net assets in UK domiciled funds

Under the AIF Rulebook, QIAIF are only permitted to invest more than 50% of net assets in any one underlying fund where that fund constitutes a “Category 1” fund or a “Category 2” fund².

On Expiry of the Transition Period, it would appear that UK UCITS will no longer constitute “Category 1” funds and neither UK UCITS nor UK AIFS will constitute “Category 2” funds unless a submission is made to the Central Bank which demonstrates to its satisfaction that the relevant UK fund complies in all material respects with the provisions applicable to Irish QIAIFs.

Clarity has been sought from the Central Bank on this specific point and we will keep clients updated on this.

(iii) Marketing of Irish AIFS established after Expiry of the Transition Period to UK investors

Irish AIFS established prior to the Expiry of the Transition Period which have entered the TPR will be able to continue to market to UK investors for the duration that the regime is in place.

However, the TPR regime is not available to any new Irish AIFS or new sub-funds of existing Irish AIF umbrella schemes established after the Expiry of the Transition Period. As a result, the only route to the UK market for such funds is under the UK National Private Regime, which is considered in more detail in our recent [client briefing](#).

(iv) Marketing requirements applicable to AIF marketed in Ireland by a UK AIFM

The Central Bank has advised Irish Funds that UK AIFMs which currently (i) market EU AIFS to professional investors in Ireland under the AIFMD passporting regime or (ii) market non-EU AIFS without a passport under Regulation 37 of the AIFM Regulations must complete the relevant NPPR application under Regulation 43 of the AIFM Regulations (the “**Regulation 43 Regime**”) which is accessible from the Central Bank’s [website](#) in order to be able to market such funds to Irish professional investors after Expiry of the Transition Period. Once a notification is made under the Regulation 43 Regime, the UK AIFM must then comply with the reporting obligations set down in Regulation 25 of the AIFM Regulations.

EU Money Market Funds

Article 12 of Regulation (EU) 2017/1131 (the “**MMFR**”) requires that deposits of EU money market funds (“**EU MMF**”) are only held with eligible credit institutions, which include (i) any credit institution with its registered office in an EU Member State or (ii) a credit institution with its registered office in a third country which is considered equivalent by the European Commission under the Capital Requirements Regulation. In the absence of any equivalence decision from the European

² Similar rules are applied to RIAIF funds which may only invest than 30% of net assets in any one underlying fund where that fund constitutes a “Category 1” fund or a “Category 2” fund

Commission in respect of UK credit institutions before the Expiry of the Transition Period, EU MMFs will not be permitted to invest in the deposits of UK credit institutions.

As managers of MMF will be aware, under Article 2 of the MMF Commission Delegated Regulation³, additional haircut requirements apply to reverse repurchase agreements which fall within the scope of Article 15(6) of the MMFR unless the counterparty to the transaction is an EU credit institution, investment firm or insurance undertaking or an entity authorised in a third country that has been deemed equivalent by the European Commission. Again, in the absence of any such equivalence decision before the Expiry of the Transition Period, haircuts must be applied to collateral received by EU MMF from a UK counterparty to an in-scope reverse repurchase agreement.

UK Investment Managers

ESMA has previously confirmed that the necessary Memorandum of Understanding is now in place between it and the FCA to allow Irish management companies (and other EU management companies) to continue to delegate investment management functions to UK regulated investment managers.

The Central Bank has confirmed that any new UK investment manager seeking clearance to act as investment manager to an Irish domiciled fund must undergo the Central Bank's full review process applicable to non-EU investment managers.

As readers will be aware, one of the conditions of clearance to act as investment manager to an Irish domiciled fund imposed by the Central Bank is an obligation to inform it of any change in regulatory status. We understand that the Central Bank therefore expects all UK regulated investment managers which currently act as such to Irish domiciled funds to notify it of the change of regulatory status on Expiry of the Transition Period.

UK resident Directors and Designated Persons of Irish management companies

The Central Bank previously confirmed in a [Notice of Intention](#) published in February 2019 that in the event of a hard Brexit, it would consider whether or not the UK is a jurisdiction which meets its "effective supervision" requirements and its "location rule". It also confirmed that pending such consideration, it did not propose adopting a default position, which would treat the UK as a jurisdiction which would not meet its effective supervision requirements.

However, this Notice of Intention must now be read in light of the Central Bank's correspondence to Irish Funds in which it indicated that it expected that a "clear and convincing preponderance of the [firm's] Designated Persons and management roles (including key roles) are performed within the jurisdiction [of Ireland]."

³ Commission Delegated Regulation (EU) 2018/990

Use of UK Central Counterparties

The European Commission confirmed in a decision published on 21 September 2020 that the UK's legal and regulatory supervision regime of UK CCPs is considered equivalent for a period of 18 months after the Expiry of the Transition Period (i.e. 30 June 2022) in order to give financial market participants 18 months to reduce their exposure to UK CCPs.

Following this, ICE Clear Europe Limited, LCH Limited and LME Clear Limited were granted temporary third-country recognition by ESMA until the same date⁴. These CCP can therefore continue to be used by EU firms until 30 June 2022.

Access to UK CSDs

ESMA has confirmed that it will grant temporary third-country recognition of Euroclear UK & Ireland Limited (which operates CREST, the settlement system used for Irish equities listed on Euronext Dublin and the London Stock Exchange) until 30 June 2021, the purpose of which is to allow EU issuers adequate time to transfer their securities to EU CSDs.

Reporting of trades to trade repositories under EMIR and SFTR

Under EMIR and SFTR, all in-scope derivative transactions and/or securities financing transactions must be reported to a trade repository registered with ESMA. On Expiry of the Transition Period, UK trade repositories will no longer appear on this ESMA register and as a result cannot be used to fulfill trade reporting obligations under EMIR or SFTR respectively. From that date, alternative EU trade repositories or non-EU trade repositories which appear on the relevant ESMA register must be used.⁵

Novation of OTC contracts from a UK counterparty to an EU counterparty

In draft reports published by the [EBA](#) and [ESMA](#) in November 2020, further extensions of relief on Brexit-related novations of certain OTC derivative legacy contracts with UK counterparties were announced. In particular, counterparties are provided a window of time within which they may novate contracts from a UK to an EU counterparty without triggering the EMIR bilateral margining requirements and the EMIR clearing obligations under certain conditions. This transitional relief seeks to ensure a level playing field between EU counterparties and the preservation of the regulatory and economic conditions under which the contracts were originally entered into. The measures are time limited and will expire 12 months from the date of application of the revised RTS. Both the ESA and ESMA expect to exercise regulatory forbearance and to apply the margin requirements and clearing requirements "*in a risk-based and proportionate manner*" until the proposed revisions enter into force. Further information on this is available in our recent [client briefing](#).

⁴ LME Clear Limited has been assessed by ESMA as a Tier 1 CCP; ICE Clear Limited has been assessed as a Tier 2 CCP and LCH Limited has been assessed as a Tier 2 CCP

⁵ For example, with effect from 23 December 2020, DTCC Data Repository (Ireland) PLC has been registered as a trade repository under EMIR and SFTR.

Share Trading Obligation

Where the assets of an Irish fund are managed by an EU regulated MiFID firm or a UK investment firm, consideration will need to be given to the ability of that fund manager to access shares necessary to implement the investment strategy while at the same time continuing to comply with its share trading obligations under MiFIR or the equivalent UK onshoring legislation respectively.

In this regard, ESMA has confirmed in a [statement](#) published in October 2020 that the trading of shares with a UK ISIN are not subject to the EU share-trading obligation (the “**STO**”). It also noted that shares with an EEA ISIN traded in GBP on a UK trading venue by EU investment firms will not be subject to the STO. All other shares with an EEA ISIN will continue to fall within the scope of the STO.

The FCA has [confirmed](#) that UK market participants will continue to be able to access any EU trading venue and systematic internaliser after the Expiry of the Transition Period provided that the venue has ensured that it has the relevant regulatory permissions.

Derivatives Trading Obligation

On 25 November 2020, ESMA published a [statement](#) on the impact of the Expiry of the Transition Period on the trading obligation for derivatives (the “**DTO**”) under MiFIR.

As readers will be aware, the DTO requires EU investment firms to conclude transactions in certain derivatives on (a) regulated markets within the meaning of MiFID II, (b) MTF within the meaning of MiFID II, (c) OTF within the meaning of MiFID II or (d) third country trading venues where they are located in jurisdictions in respect of which the European Commission has adopted an equivalence decision⁶.

However, where EU and UK counterparties, including branches, wish to trade with each other in in-scope derivatives on a cross-border basis, such counterparties will face conflicting requirements as to which exchanges/ platforms must be used for these trades.

In this Statement, ESMA notes that most UK trading venues that offer trading in derivatives subject to the DTO have established new trading venues in the EU. The Statement confirms that ESMA does not intend to issue a decision recognising the equivalence of the UK’s derivatives trading venues. As a result, ESMA expects EU investment firms to continue to comply with the DTO after the Expiry of the Transition Period, noting that it will keep the liquidity of such markets under review.

⁶ The derivatives which fall within the scope of the DTO are listed in the Annex to Commission Delegated Regulation (EU) No 2017/2417 and include (i) fixed-to-float interest rate swaps denominated in EUR, (ii) fixed to float interest rate swaps denominated in USD, (iii) fixed to float interest rate swaps denominated in GBP; and (iv) index credit default swaps

Use of benchmarks under the Benchmarks Regulation⁷

Following the Expiry of the Transition Period, UK administrators of benchmarks and third country benchmarks recognised or endorsed in the UK which currently appear on the ESMA register of administrators and third-country benchmarks will be removed from that register.

However, until 31 December 2021, EU management companies can continue to use benchmarks administered by UK administrators or benchmarks previously endorsed or recognised in the UK for the purposes set down in the Benchmark Regulation provided that the benchmark is already in use within the EU as a reference for financial instruments, financial contracts or for measuring the performance of investment funds.

From 1 January 2022, in the absence of an equivalence decision from the European Commission, UK administrators must be recognised or endorsed under the third country benchmark regime in order for their benchmarks to be able to be used by EU management companies for the purposes falling within the scope of the Benchmarks Regulation.

Use of Credit Rating Agencies

Following the Expiry of the Transition Period, the registration of UK credit rating agencies under the EU CRA Regulation will be withdrawn⁸. As a result, it will no longer be possible to use credit ratings published by UK credit rating agencies for EU regulatory purposes unless the relevant credit rating has been endorsed by an EU credit rating agency⁹.

Transfer of Personal Data

Any transfer of personal data by Irish domiciled funds and fund service providers to the United Kingdom must be effected in accordance with one of the safeguards available under Chapter V of the GDPR on Expiry of the Transition Period. Therefore, unless it is possible to rely on one of the other safeguards set down in the GDPR, if an Irish entity will, in fact, transfer personal data to one or more UK based entities after the Expiry of the Transition Period, it should take steps to put in place EU Commission approved Standard Contractual Clauses with any such UK entities.

If you require any further assistance with Brexit contingency arrangements or have any questions arising from this briefing, please contact your usual contact in the Dillon Eustace Asset Management and Investment Funds Team.

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⁷ Regulation (EU) 2016/1011. The relevant ESMA statement is available from https://www.esma.europa.eu/sites/default/files/library/esma80-187-610_bmr_brexit_public_statement_2020_q4.pdf

⁸ Regulation (EU) 1060/2009

⁹ Further information on the endorsement regime is available from https://www.esma.europa.eu/sites/default/files/library/esma_33-5-857_esma_public_statement_on_endorsement.pdf



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