BREXIT briefing session

'READY STEADY GO' BRIEFING

18 March 2019

pwc

Agenda

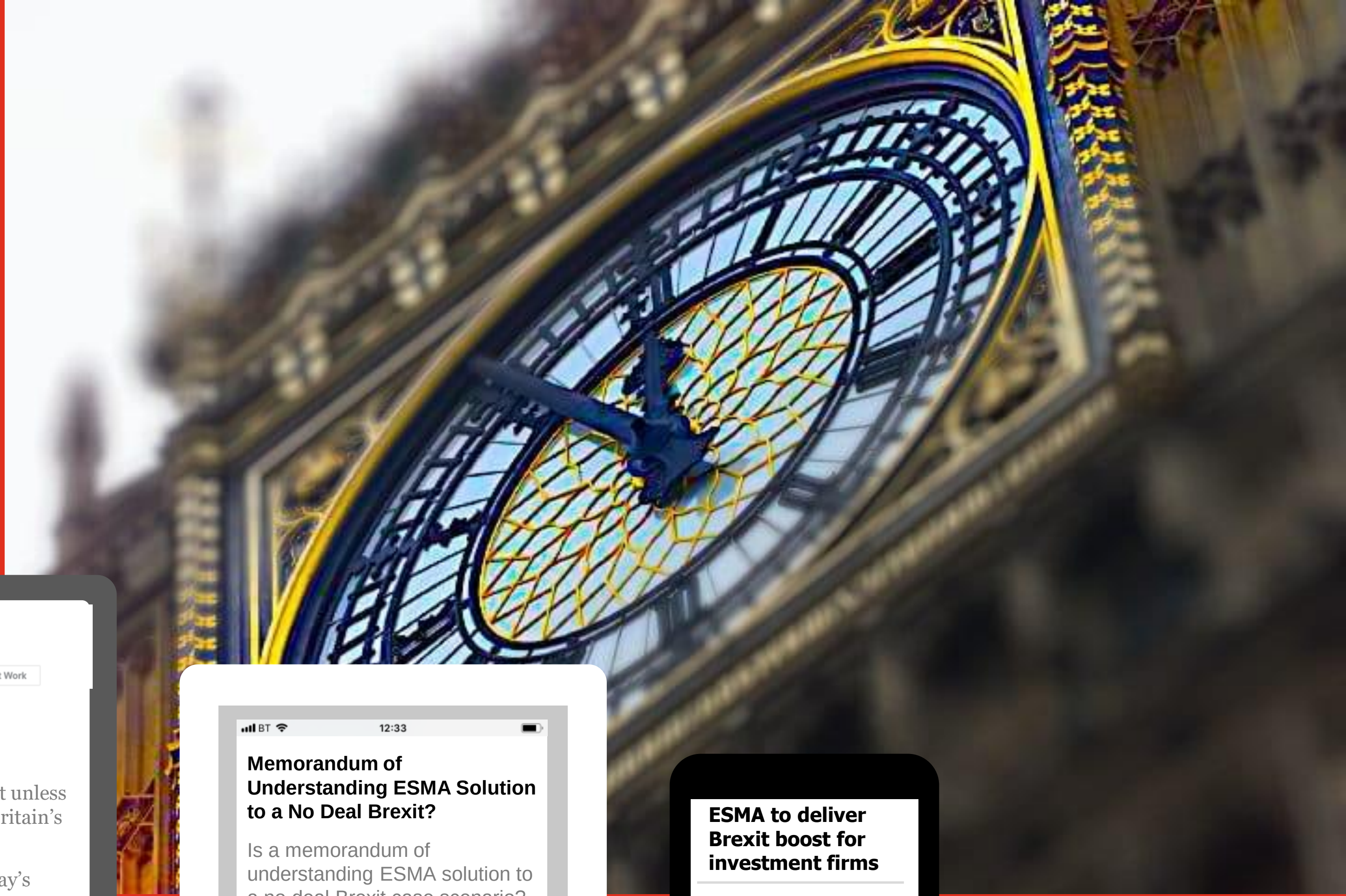
Time	
16:30 – 17:00	**Welcome and what's going on !?!** Executive Briefing on current state of affairs and outlook on post-BREXIT
17:00 – 17:30	**Products, services & TPR** o Temporary Permission Regime: what products to register and distribution insights o What changes to consider in the investment policy of Funds? How are MiFID services from/to UK impacted?
17:30 – 18:00	**Taxes** o How to assess and mitigate corporate tax impacts? o Management of staff transfers and personal tax consequences. o Changes to business set-up and transfer pricing.
18:00 – 18:30	**Delegation & Trading** o Which delegations are 'safe' and which are 'at risk'? o Any impacts on UK benchmarks and stock exchanges? o How to deal with collateral and securities lending agent business?
As from 18:30	*Networking cocktail*

1

Welcome and what’s going on!?!

What's happening in case of **hard Brexit** or **delay**?

Probability has increased over past weeks alongside preparations and statements of ESMA/other EU bodies as well as national regulators



REUTERS World Business Markets Politics TV

Brexit | The Z Factor | Imprisoned In Myanmar | CES | Breakingviews | Future of Money | World At Work

May's ultimatum to rebels: Long delay to Brexit unless you vote for my deal

Prime Minister Theresa May's deputy warned lawmakers on Friday that unless they approved her Brexit divorce deal after two crushing defeats then Britain's exit from the European Union could face a long delay

The United Kingdom's divorce from the EU has sown chaos through May's premiership and the Brexit finale is still uncertain with options including a long delay, exiting with May's deal, a disorderly exit without a deal or even another referendum.

The British parliament voted overwhelmingly on Thursday to seek a delay to the March 29 exit date enshrined in law...

BT 12:33

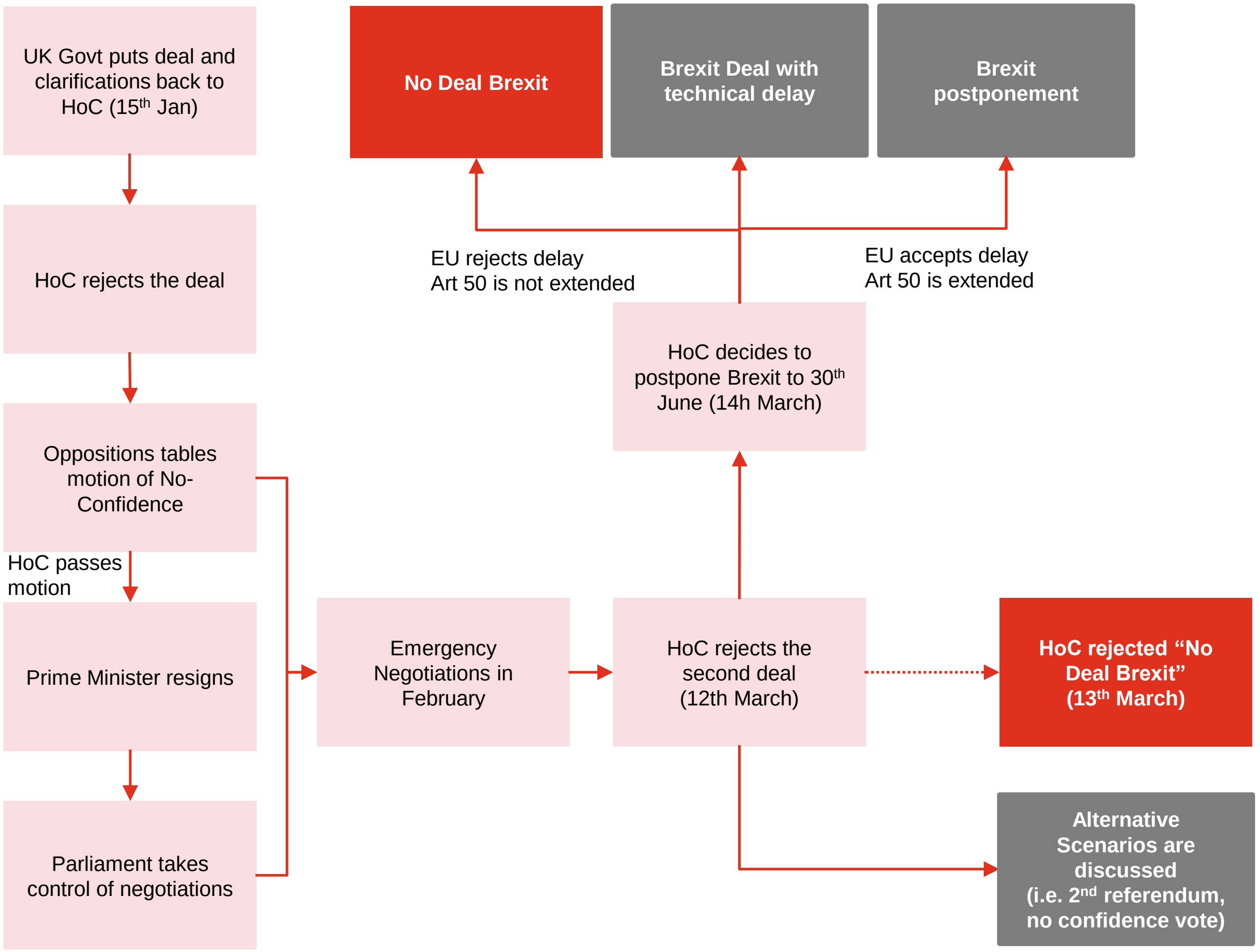
Memorandum of Understanding ESMA Solution to a No Deal Brexit?

Is a memorandum of understanding ESMA solution to a no deal Brexit case scenario? This seems to be the case from a recent speech held by Steven Maijoor, Chair of ESMA, when detailing some of the imminent steps to be taken at global European and EU 27 level in order to prepare to deal with a hard Brexit case scenario.

ESMA to deliver Brexit boost for investment firms

Investment fund managers will welcome news that a European watchdog is close to completing a major exercise aimed at minimising Brexit-related disruption to their business operations...

Prudent outcome assumptions: ‘No deal’ or ‘postponement’



What are the scenarios?

Base Case No Deal vs. Postponement

The Base Case and the postponement scenarios will result in slightly different outcomes.

The key differentiating factor which emerges from the Brexit negotiation is relating to the **degree of delegation**.

ESMA already initiated a systematic analysis of the **potential impact of a no-deal Brexit** for European securities markets. Mitigations of potential impacts are currently anticipated by national regulators.

	No Deal - Base Case	Postponement (Deal?)
When UK leaves EU?	**March 2019**	**June 2019 or longer**
Do we rely on transition?	**No transition period**	
Possibility to Delegate?	✓	✓

What are the key impact areas?

	No Deal - Base Case	Postponement (Deal?)
Client	⦿	⦿
Product	⦿	⦿
Infrastructure	⦿	⦿
Portfolio Management		
Marketing & Sales	⦿	⦿
Market Infrastructure / Processing		⦿ (?)

⦿ Impacted area

ESMA has initiated a systematic analysis of the potential impacts of a no-deal Brexit for European securities markets

UK Central Securities Depository recognition

- ESMA recognition of the UK Central Securities Depository in the event of a no-deal Brexit
- CSD established in the United Kingdom (UK) – Euroclear UK and Ireland Limited – will be recognized as a third country CSD to provide its services in the European Union
- The recognition decision would **take effect on the date following Brexit date**, **under a no-deal Brexit scenario**

Valid 24 months

MoU with FCA

- Exchange of information in relation to the supervision of credit rating agencies (CRAs) and trade repositories (TRs)
- Multilateral MoU (MMoU) on information exchange between individual regulators and the FCA, on market surveillance, investment services and asset management activities
- The MoUs will therefore only **take effect in the event of a no-deal Brexit** scenario

Use of UK data in ESMA databases

- UK Financial Conduct Authority (FCA) will stop sending data to ESMA and will no longer have access to ESMA's IT applications and databases
- Reference data submitted by UK trading venues and systematic internalisers (SIs) to FIRDS will be terminated **taking effect on 30 March 2019**

Central Clearing Arrangements

- Ensure continued access to UK CCPs for EU clearing members and trading venues **as of 30 March 2019**, should all the conditions in EMIR, including any conditions set out in the equivalence decision, be fulfilled
- **Novation facility** of certain over-the-counter derivatives contracts, where a contract is transferred from a UK to an EU27 counterparty

Valid 12 months

Application of MiFID II/MiFIR and BMR provisions

- Application of key MiFID II and the BRM provisions on **29 March 2019** in case of no-deal Brexit:
  - Trading obligation for derivatives
  - ESMA opinions on country trading venues for the purpose of post-trade transparency and position limits
  - Post-trade transparency for OTC transactions
  - BMR ESMA register of administrators and 3rd country benchmarks

2

Products, services & TPR

Will you be affected by BREXIT?

Products	 EU funds investing into UK or distributed in UK are impacted by the **change in status of UK funds** as well as by the abolishment of **EU product passporting**	 EU funds **not invested in UK** or **not distributed to UK** are not impacted
Services	 EU funds receiving **cross-border services** from the UK are the impacted fund domiciles; in the case of segregated mandates EU clients receiving PM from UK entities are also impacted	 An EU fund or client receiving services **from the EU or Rest of World ("RoW") ex-UK** will not be impacted
Impact	**IMPACT ON PRODUCT AND SERVICE LEVEL**	**NOT IMPACTED**

What means a world where UK is treated as 3rd country for Fund products?

For UK UCITS MANAGEMENT COMPANY:

EU/EEA countries CLOSED

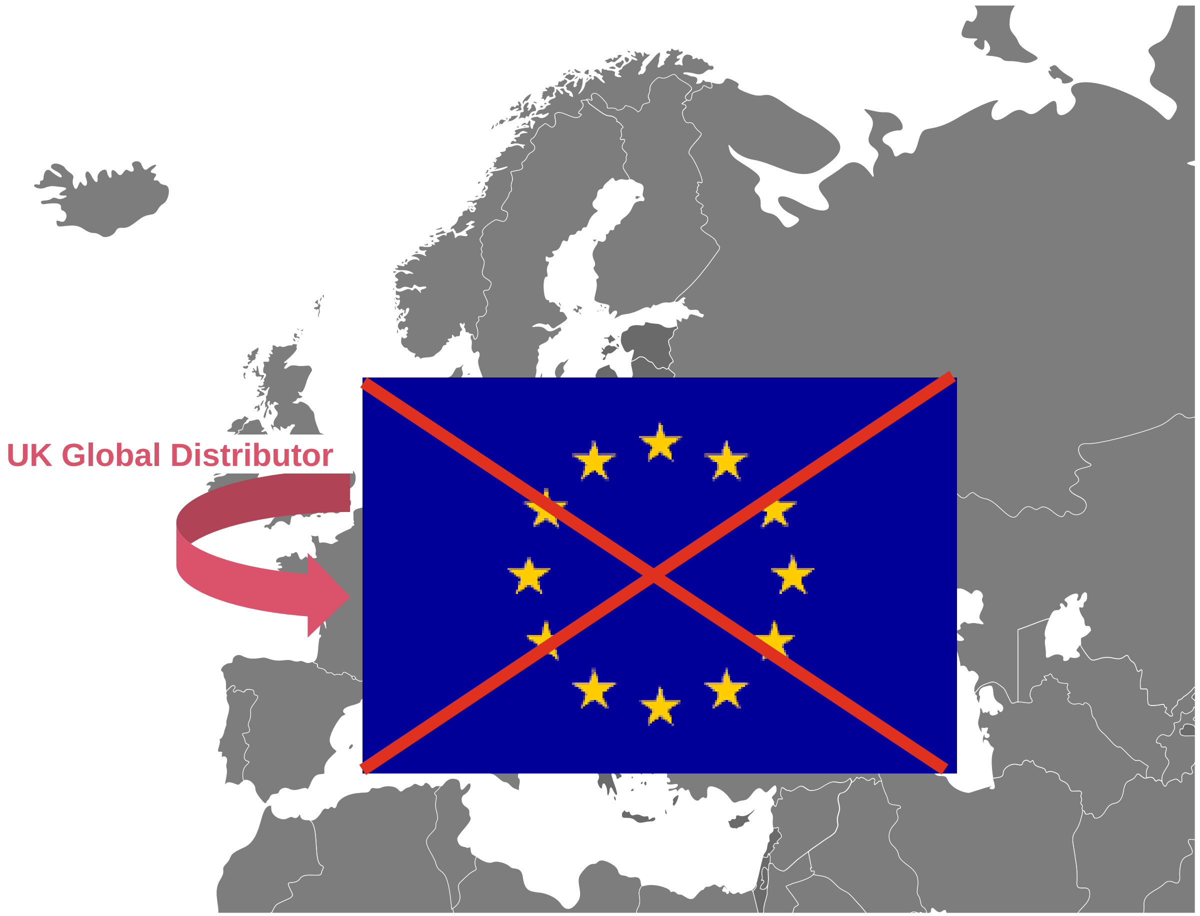
The UK ManCo will no longer be able to market its Funds in EU/EEA.

For UK GLOBAL DISTRIBUTORS:

EU/EEA countries CLOSED

The UK Global Distributor will no longer be able to market the Funds in EU/EEA.

This means that a LUX UCITS that has appointed a UK Global Distributor can no longer use this entity to be distributed in Europe!



What means a world where UK is treated as 3rd country for Fund products?

SEVERAL MARKETS CLOSED!

The UK (NON-EU) AIF with a UK (NON-EU) AIFM could not be distributed to professional investors in:

- **ITALY (closed market),**
- **SPAIN / PORTUGAL (equivalent to closed)**
- **GERMANY, AUSTRIA, LIECHTENSTEIN, FRANCE (market entry will be very complex)**

The retail market will be **closed to them in FRANCE and extremely difficult in the other countries**

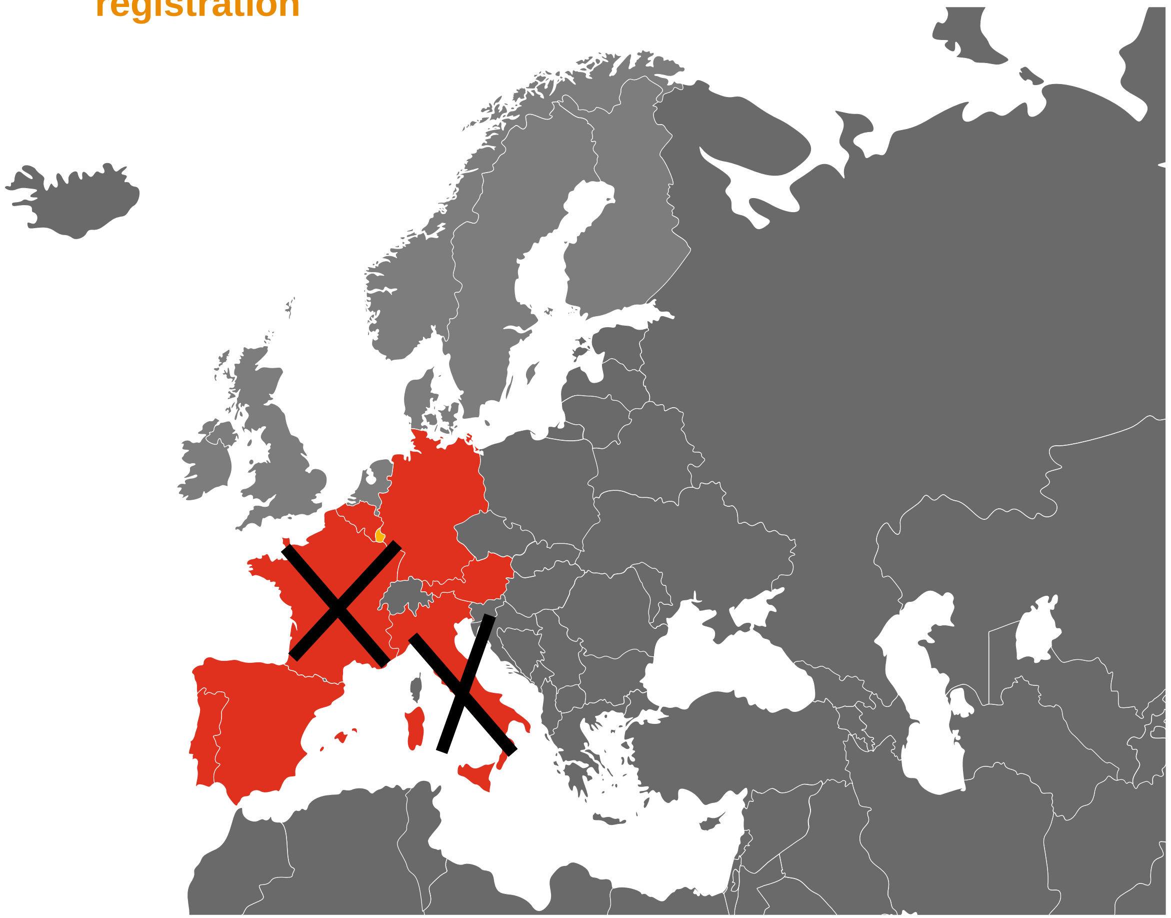
VERY LONG TIME TO MARKET!

TODAY…a UK UCITS needs **10 business days** to enter an EU/EEA market

As a NON-EU AIF, it can last **<u>6 months+ in several countries! (Finland, Germany…)</u>**

For UK UCITS:

No more passporting under UCITS or AIFMD! Will be subject to the National Private Placement Regime…several closed markets to professional or retail investors or highly complex registration



What means a world where UK is treated as 3rd country for Fund products?

For LUX UCITS / LUX AIF:

- **No more passporting under UCITS or AIFMD in the UK!**
- **Meaning subject <u>to national rules in the UK</u> to become authorised for distribution**
- **But possibility to maintain under current regime for an additional period (up to 3 years) applying to the Temporary Permissions Regime (TPR) !**
- Assess also impacts on distribution of Master / Feeder, for instance:
  - LUX UCITS Feeder in a UK UCITS Master (or the opposite) will no longer be possible (its distribution as well not).
  - LUX AIF Feeder in a UK (NON-EU) AIF Master: passporting AIFMD no more sufficient / need to register the Feeder for distribution under NPPR

Solutions for UCITS to maintain Fund distribution in UK?

01 Option 1 - Apply NOW for the TPR!

- ❖ **APPLY FOR "TEMPORARY PERMISSIONS REGIME" FOR FUNDS before the end of the deadline**
- ❖ **Enabling to maintain distribution (maximum up to 3 years)**
- ❖ Business as usual until the FCA provides a "landing slot" within which you need to apply for UK authorization / recognition

02 Option 2 – Apply as a UK Recognized Fund to target Retail and Professional UK investors

- ❖ Fund recognized under FSMA 272 can be marketed to all type of investors
- ❖ Notification procedures is quite cumbersome and approval can take up to 6 months

03 Option 3 – Register the LUX UCITS under National Private Placement Regime to target professional investors only

- ❖ Under NPPR, funds can only be marketed to professional investors (as defined in UK regulation)
- ❖ To track: whether the level of requirements will remain the same as under the current NPPR regime for NON EU AIF/AIFM distributed in the UK

WARNING ON TPR FOR FUND DISTRIBUTION:

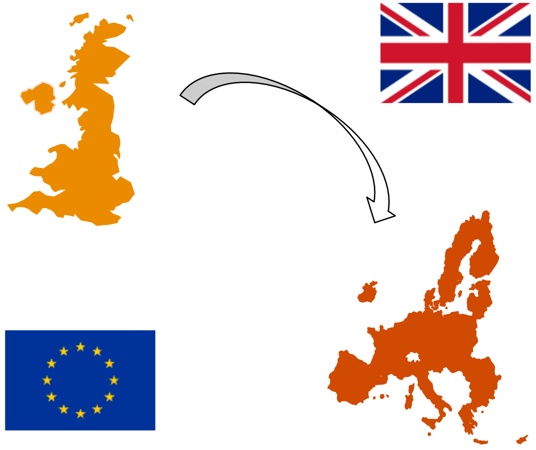
- If you did not apply before the deadline, the Lux UCITS/AIF will not be allowed for distribution in the UK and you will need to directly apply as **Recognised Scheme** to distribute to retail/professional investors.
- **Newly created sub-funds** will be able to benefit from TPR if the Umbrella Fund has applied for TPR before the deadline. But if the sub-funds were existing on the FCA registrar but did not initially apply under TPR before the deadline, **these sub-funds will not be able to benefit from TPR later on!**
- **This is therefore recommended to register all potential sub-funds within the UK FCA before the deadline and apply for TPR.**

Location of sales/ marketing team

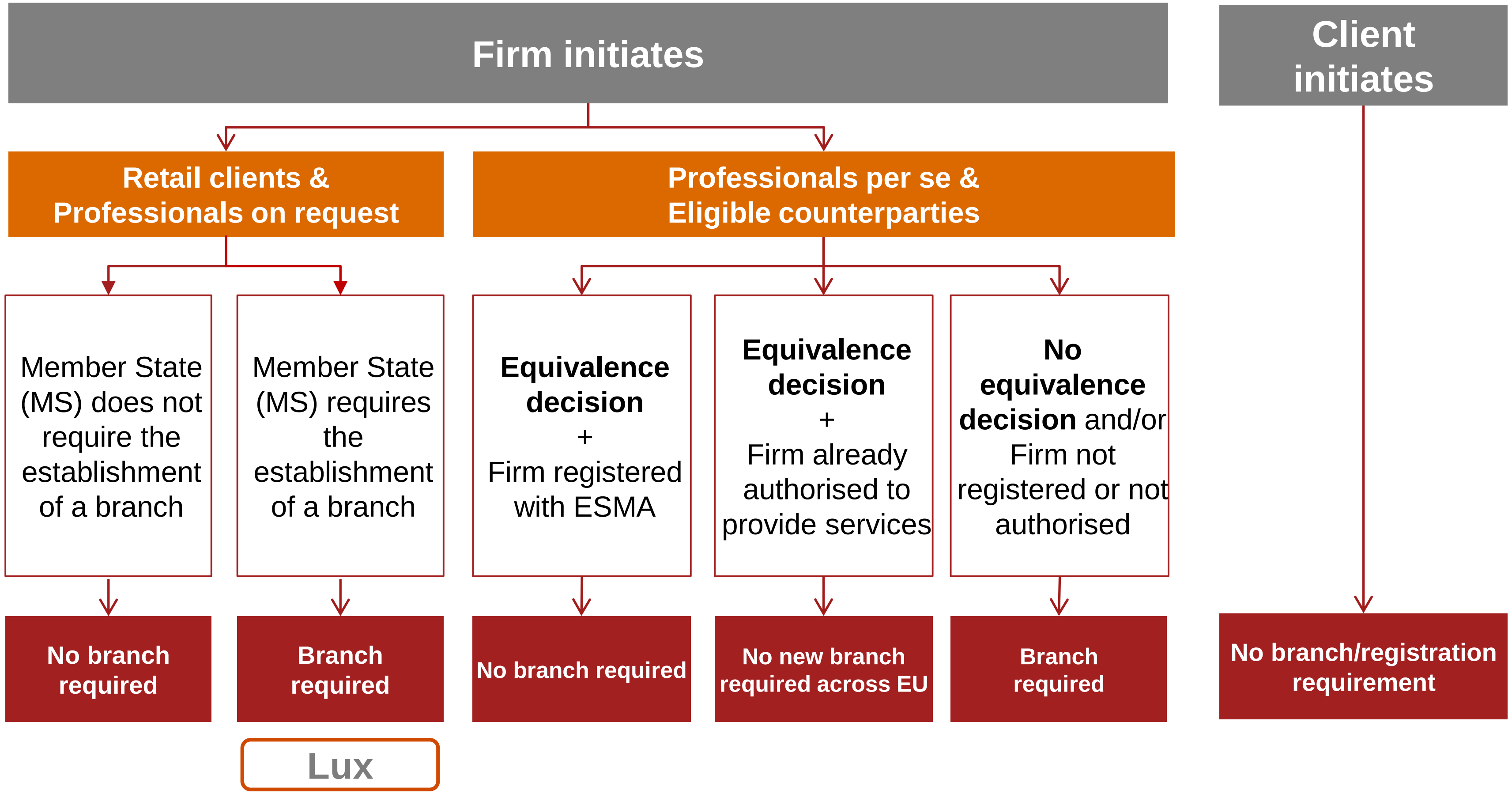
- **ManCo's need to assess and decide whether the teams are performing a MIFID activity**
- **Options to resolve include:**
  - Dual employment contracts with EU based MiFiD authorised entity.
  - Move people or activity to an EU based MiFiD entity.
  - UK Branch of EU MiFiD entity.
  - Sub marketing contract from EU firm to UK firm.
  - Use 3rd party ManCo with its permissions to provide regulatory umbrella.
  - Hope for UK to be recognised as MiFiD equivalent.
  - Limit activity to anything which falls short of MiFiD threshold.

What happens when UK becomes a 3rd country?

MiFID 3rd country regime to investment services restricts access to EU



- Based on MiFID passporting rights **today** UK EAM may actively serve EU clients.
- With loss of passporting in Brexit, these **passporting rights cease**



Provision of services by UK (3rd country) firms Branch or subsidiary?

Phase 1: Transitory regime

Luxembourg Bill 7401

Transitory measures granted to CAA & CSSF for

tied agent, branch and freedom to provide services

Up to 21 months equivalence as from no deal Brexit date

Scope:
Banks & Investment firms
UCITS & AIFM Manco
Insurance & reinsurance

for existing service & client relationships (or related to these)

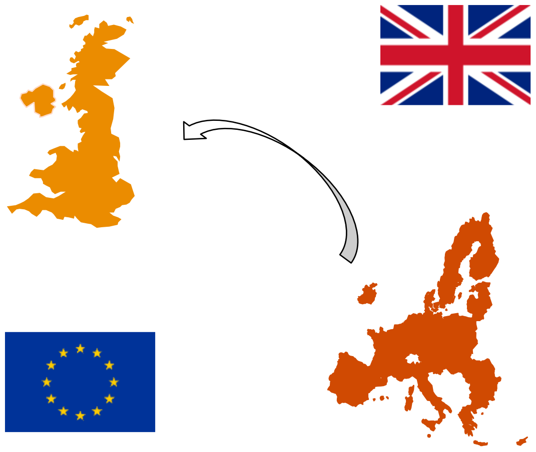
Phase 2: Post Transitory regime

	Subsidiary	Branch
Authorisation	**CSSF approval + ECB approval**	**CSSF approval**
Authorised activities	**All banking activities and investment services**	**Only banking activities authorised** by the relevant agreement of the head office
Passporting in EU	Possibility if **notification to CSSF**	**No passporting within EU**
Organisational set-up & regulatory requirements	**Same obligations** for a subsidiary and a branch regarding the main organisational and regulatory requirements	

MiFID II	Anti-money laundering	Risk management	Organisation
Controls framework	Compliance	Regulatory reporting	External audit
Risk exposure	Internal audit	Capital requirement	Banking secrecy

Solicitation of UK clients

Regulatory options in case of No deal Brexit



- ➢ Based on MiFID passporting rights **today** UK clients can be actively solicited from Luxembourg (e.g. phone call)
- ➢ With loss of passporting in Unorderly Brexit, these **passporting rights cease**

Phase 1: TPR

2019 2020 2021 2022

Objective:

- Temporary Permission Regime for EEA passporting firms to allow continued operations in the UK post-BREXIT
- **Valid: 3 years**

Regulatory environment:

- UK code of conduct rules will apply (same as if authorised within UK)

Notification:

- Need to notify the FCA of this intention prior to 29 March 2018 via FCA website
- **Inform CSSF**

Phase 2: Post TPR

With the end of the TPR, 3 options apply:

Option 1: Cease UK business

- Due to cost and complexity of undertaking, termination of business activities to UK

Option 2: Overseas Persons Exemption

- Existing UK exemption framework allowing firms established outside of the UK to provide limited services in the UK
- Much more restricted market access than passporting regime

Option 3: UK establishment

- Establishment of local subsidiary or branch (subject to UK laws) to continue servicing UK-based clients
- Considerations of FCA: (i) scope of business, (iii) operational structure, (iii) capital allocation, (iv) asset transfer, etc.

Brexit: ‘Ready Steady Go’ checklist

For ManCos		
1	Assess impact of funds investment policy	☐
2	Identify options to distribute funds in the UK, considering target clients types (retail vs. professional)	☐
3	Register funds for TPR	☐
4	Anticipate repapering of fund prospectuses (investment restrictions & BREXIT warning) and investor documentation	☐

For MiFID services		
1	Assess business at risk with (Global) Distributors and External Asset Managers located in the UK	☐
2	Quantify services rendered to UK resident clients	☐
3	Consider need for TPR for MiFID services in UK and prepare for UK set-up	☐
4	Anticipate repapering of contractual rights of clients (i.e. information on the firm and services, safeguarding)	☐
5	Consider suitability process impacts when distributing UK funds as non-EU products (i.e. target market)	☐

3

Taxes

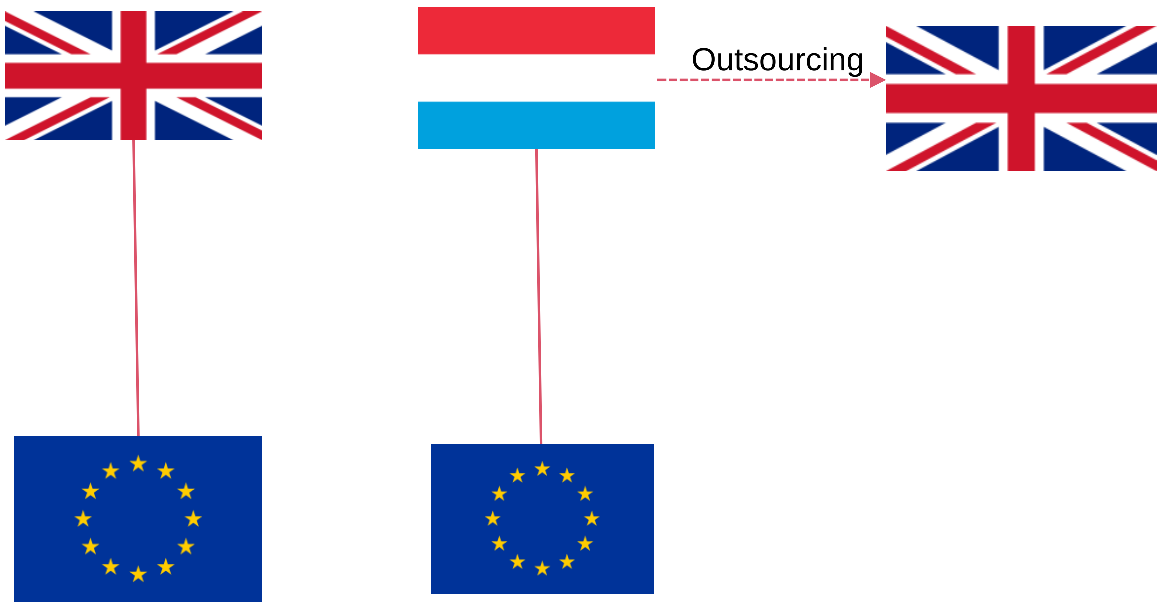
Preliminary tax remarks

Brexit's tax impacts will mainly be driven by the degree of necessary re-organization businesses will face to keep servicing their customers despite the lack of passporting.

In the financial services sector, the distribution functions of financial institutions have historically followed two paradigms:

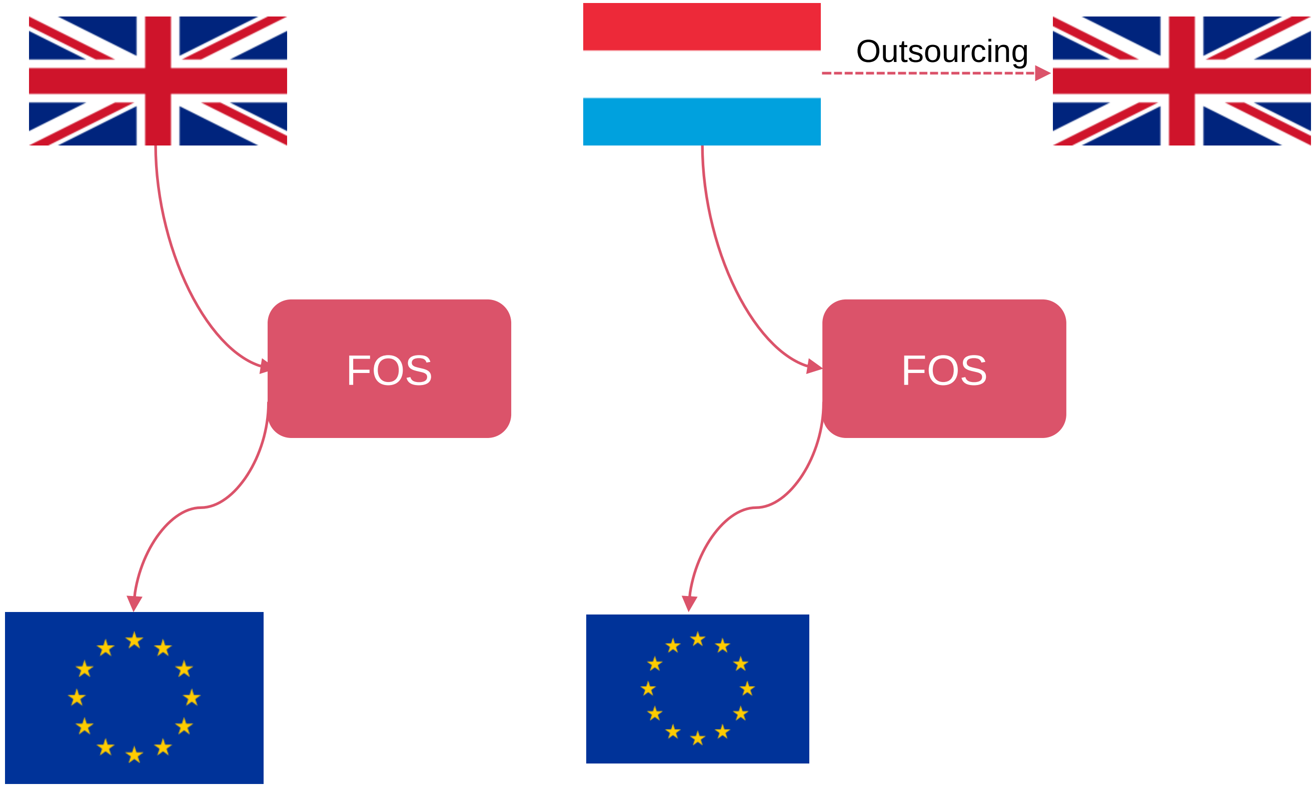
- A UK Hub with branches;
- A UK Hub distribution under FOS.

Hub with branches: main tax consequences



- ❖ Key regulatory functions do not always align with key tax practices (functions entitled to attract a substantial share of the profits);
- ❖ The majority of the profit remains taxed in the UK or at the level of the branches (or both).
- ❖ UK exit tax considerations;
- ❖ Transition between UK VAT rules to Lux VAT rules create unexpected treatments and potential opportunities:
  - ➢ Possibility to apply VAT or direct tax local group vs impact of ECJ Skandia case;
  - ➢ Possibility that the transfer will be eligible for a TOGC VAT exemption.
- ❖ Social security uncertainties;
- ❖ Immigration regulations to be complied with;
- ❖ Governance.

Transfer of HUB under FOS: main tax consequences



- UK Exit tax → Luxembourg tax consequences;
- TOGC qualification VAT? Does the transfer need to happen at once or can it be occurring overtime?
- Personal tax issues: expatriate regime eligibility, transfer of pension scheme, group incentives, multi countries taxation;
- If a Brexit-triggered business re-organization is progressive, how would that impact the tax allocation between Lux and UK?
- Transfer pricing arrangements and their documentations;
- Governance.

Additional tax developments increase the complexity of the Brexit exercise

Progressive implementation of extra-abuse rules (ATAD 1 & ATAD 2) could impact the global structure, E.G.

- financing of EU operation or EU structure of participation
- Impacts of ATAD 2 rules for US players.

New Luxembourg government

- new attractive rules: expert regime, future of warrants scheme, TP rules…

Progressive implementation of Base Erosion and Profit Shifting OECD program

- should lead to the transfer of the taxation of part of the profits into the distribution country (action 7 BEPS), taxation on digitalization (action 1 BEPS)…

Conclusion

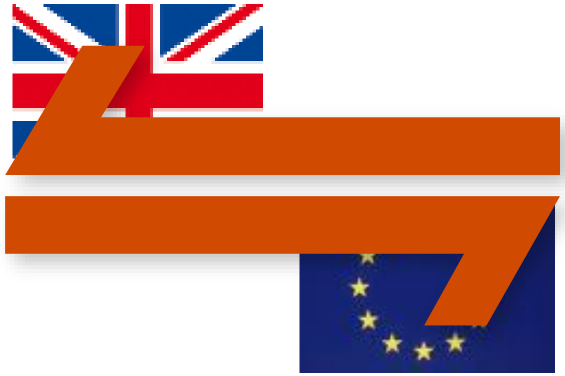
- Tax consequences of Brexit will be finalised in 2-5 years. Management of the transition:
  - Multipolar world ➔ increasing complexity;
  - Discrepancies of the evolution of UK and EU tax regime in the future.
- Business restructuring (Chapter. IX OECD Transfer Pricing Guidelines);
- Brexit is a perfect opportunity for businesses to map out their strategies for the medium to long run:
  - Where should they be located?
  - Which customers should they be serving?
  - How do they optimize their value chain?
  - Regulatory environment considerations
- Two-way traffic: a number of non-EU firms have chosen to expand their UK footprints while EU firms have been applying for the temporary permission regime;
- Time for action?

4

Delegation & Trading

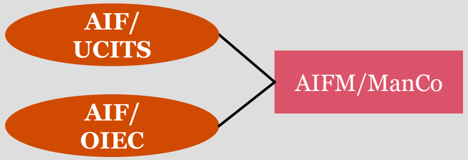
Delegation post-BREXIT
Sub-delegation or EU entity possible

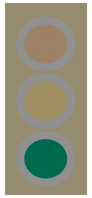
From EU to UK



From UK to EU

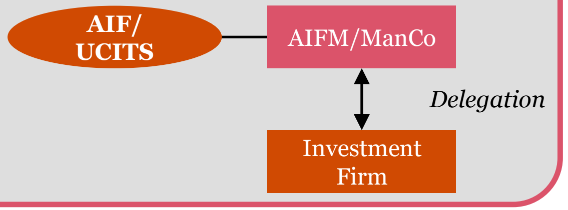
Equivalence regime

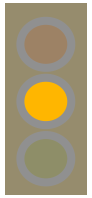




- Agreement on equivalence
- Similar to current passporting regime
- Potentially not for all products

Sub-delegation

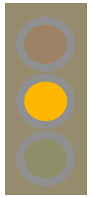




- Limited for services to professionals
- Due diligence and contractual enforcement of EU rules

MOUs allow for continued delegation to the UK for PM

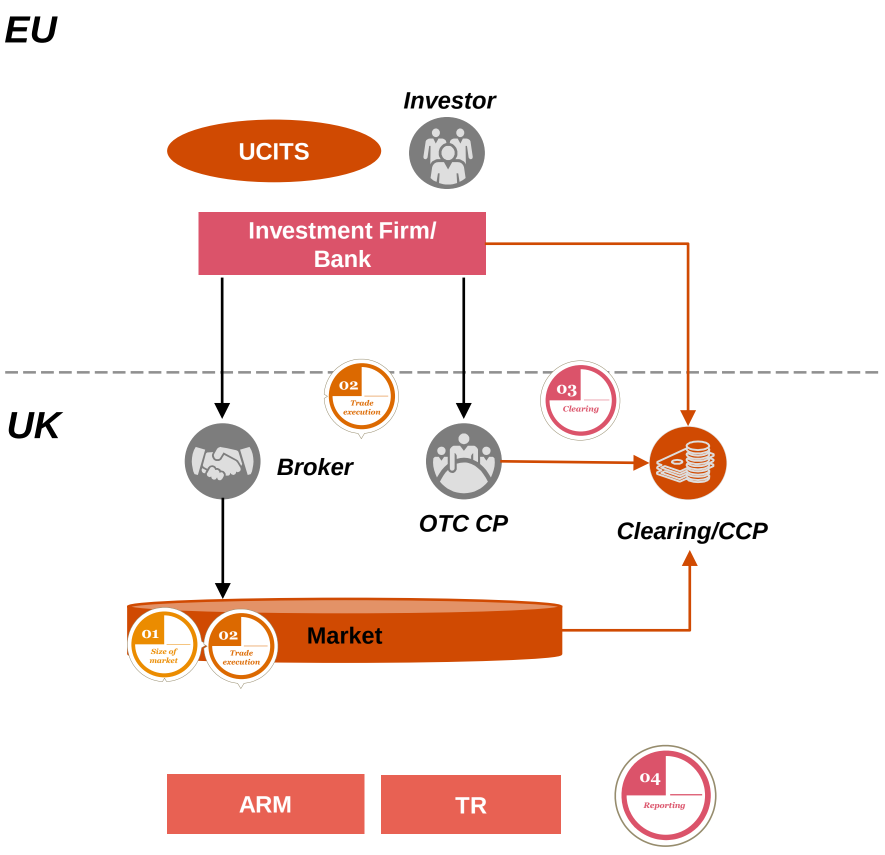
Branch model

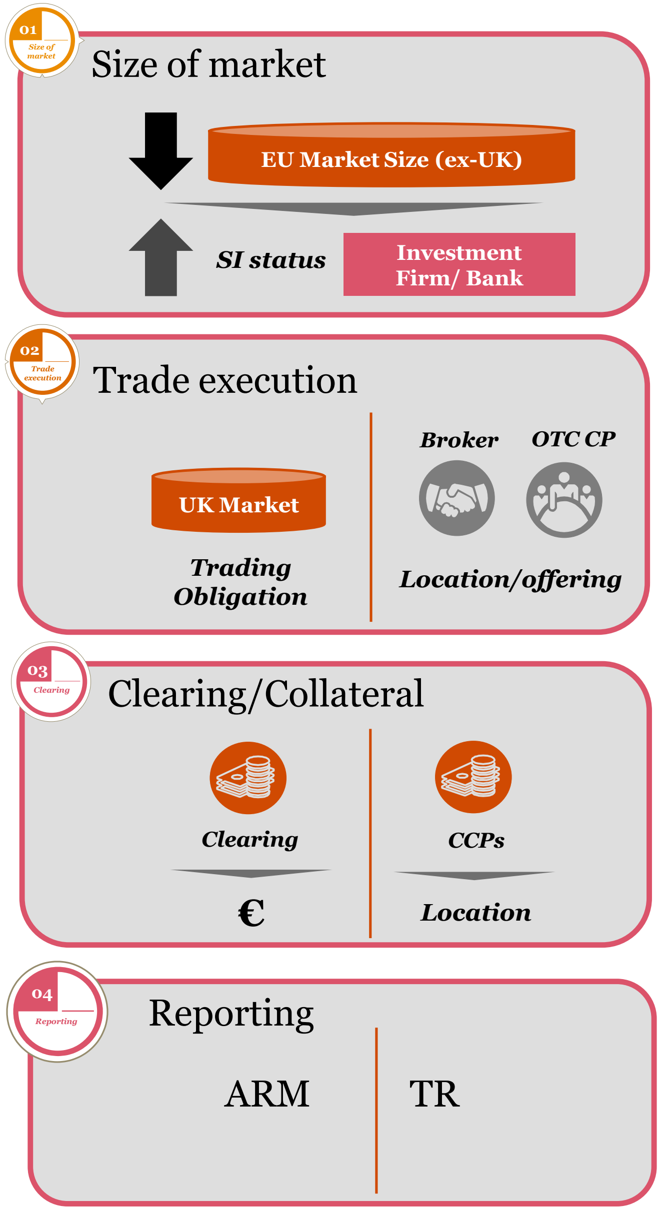


- Subject to member state application
- Prudential rules and EU law apply indirectly to non-EU firm

Major market re-shuffle in case of non-equivalence

Current state





Decrease of EU market size (e.g. bonds or fx) results in more IF/banks becoming SI - SI threshold in relation to market size

⇨ Increase on transparency and impact on liquidity

Trade flow for equities & derivatives (e.g. IRS/CDS) can change, if UK trading venues are not deemed equivalent or brokers/OTC CP decide to reposition business

⇨ Impact on liquidity

Potential change of location of clearing (e.g. EUR) and for CCPs - if UK non-equivalent; no collaterisation exemption for intragroup OTCs - if UK non-equivalent

⇨ Impact on collateral/cost and liquidity

Continuity of ARM services / use of registered EU-established TR or a recognised third-country TR

Brexit: 'Ready Steady Go' checklist

Delegation		
1	Assess sub-delegation model and need for new PM entity	☐
2	Reinforce oversight duties on sub-delegation when using UK entities (3rd country scrutiny)	☐
3	Review (sub-)delegation agreements and operating memoranda	☐

Trading		
1	Review clearing set up and collateral arrangements	☐
2	Assess impact of best execution policy when using UK counterparts	☐
3	Consider impacts on MiFID II calculations (i.e. SI reporting)	☐
4	Amend regulatory reporting (MiFIR, EMIR) due to changes on financial instruments' scope	☐
5	Secure transaction reporting by UK TR AND registered EU-established TR or a recognised third-country TR	☐

5

Conclusions

If moving people or businesses, what are the questions to ask?

Regulatory

- Does the new location have the required licenses to perform portfolio management?
- What is the lead time for licence applications to the relevant jurisdiction?
- What are the other related substance requirements in the new jurisdiction? E.g. Risk/Compliance support

HR/People

- Does the relocating individual have the appropriate right to work in each location they are visiting?
- Where will the individual be resident for tax purposes both under domestic legislation and double taxation agreements where relevant?
- What are the labour law considerations?

Infrastructure

- Will you lease the space or will you work from serviced offices?
- Do you have the appropriate IT infrastructure that will be required?
- Will the new location allow for segregation of functions if required?

Tax

- Do your relocations or changes to entities performing the PM function result in any exit charges?
- What is the impact to the transfer pricing framework?
- How does this change affect your group's VAT profile?

Multiple EU locations split by nature of business

Prepare for No Deal and have Day 2 in mind

Key activities

No Deal Readiness

- Review of your Base Case Brexit TOM and project progress for the key functions:
  - Product
  - Portfolio Management
  - Trading execution
  - Marketing

  along the dimensions: Client, People, Data, Technology, Contract & Policies
- Identify key risks / issues of Base Case TOM and project as well as must-haves for Day 1

Day 2 Preparation

For No Deal and/or end of transition

- Day 1: Re-prioritise / re-scope actions and planning incl. must-haves to optimise readiness for Day 1 and reduce risk exposure
- Day 2: Preparation and planning for Day 2 to deploy strategic Brexit TOM (changes and enhancements to tactical Day 1 solution) as well as closing out de-prioritised actions and low risk items

Outputs

No Deal - Heatmap for Key Functions

No Deal - Risk and Issues Catalogue

Day 1 - Action Plan

Day 2 - Roadmap

‘Order please’… Thank you

pwc.com