The Brexit opportunity for Luxembourg and the Channel Islands

The alternatives sector should see growth in trusted domiciles as fund managers seek continuity, argue *Graham Perry-Dew*, *Julian Carey* and *Stuart Winter* of Vistra

Brexit will undoubtedly bring considerable opportunities over the next few years, though not without risk.

The opportunities are found in questions of domicile. The expectation is that the alternatives sector will continue growing significantly in Luxembourg and other trusted domiciles such as the Channel Islands. In preparation, many service providers are increasing their levels of investment in key domiciles to accommodate the up-turn in activity.

Access to EU markets for non-EU managers is a core problem faced by a significant proportion of clients; however, they can be supported through the third party Alternative Investment Fund Manager offering. In addition, the market is seeing an increase in UK-focused investment products being established in the UK, in a direct response to Brexit.

Overall, Brexit is encouraging further development of sector expertise in appropriate jurisdictions as functions and operations are expanded in these locations. The foreseeable risks lie around the Alternative Investment Fund Managers Directive regime and passporting. The overriding complication for the sector is the impact Brexit will have on the AIFMD regime.

There is a significant risk of a period of disruption and adjustment for clients as a new model is developed and implemented for the UK. The optimum outcome for the alternatives industry would be retention of UK membership of the European Economic Area, allowing retention of passporting rights, though this seems unlikely. The next best thing would be a UK-specific arrangement that achieves the same outcome. Otherwise the UK would need to access passporting rights as a "third country".

> "Managers need to take action to ensure they can continue with their marketing strategies for prospective EU investors"

It would be reasonable to expect a pragmatic solution that gives AIFMD passporting rights to the UK, but there may be a period of disruption before this. Many people are worried about the overall impact of Brexit on investment market performance in particular and on the economy more broadly.

With continued uncertainty around Brexit, managers need to take action to ensure they can continue with their marketing strategies for prospective EU investors.

Selecting the right jurisdiction in readiness for Brexit is going to be critical, not just for start-up managers but established managers in the UK who will need to ensure continued distribution to EU investors.

There are two likely options:

1. If a fund is completely outside the EU then marketing to investors using the national private placement regime of each target member state continues to be an effective solution. A manager can establish its own standalone operation in an EU jurisdiction. This option may be expensive and operationally difficult in terms of recruitment and retention of resource.

2. A manager may re-domicile its whole operation in the EU. This option may be expensive, operationally difficult and unsettling for existing investors. A manager may choose to engage a third-party EU based administrator. Changes to delegation rules may impact on the acceptability of these situations to local regulators. In such instances, managers will need to look to the support of global providers to ease the impact of Brexit on their businesses.

View from Luxembourg

Given the uncertainty created by Brexit, some fund promoters began considering Luxembourg as a more favorable fund domicile in 2016. As the Brexit scenario has unfolded they have also begun to look at AIFM/Management Company arrangements to future-proof and ensure continuity of distribution arrangements post March 2019.

To this end, certain promoters have already decided to establish AIFMs in Luxembourg, or, driven by economies of scale, are negotiating with third-party AIFMs to provide these services for existing and newly raised funds under a delegation model. Even post Brexit, the fund promoter will still be able to provide portfolio management from the UK or elsewhere.

From a Luxembourg perspective, when considering a soft Brexit, to a certain extent some of the impact is immediate. Promoters raising new funds already have to be sure they will be able to market their funds and operate effectively whatever the outcome. So business should continue along current lines, with Luxembourg continuing to attract new funds and grow AUM.

In the event of a hard Brexit then we envisage similar growth in fund numbers and AUM, but expect more AIFMs to be set up, and a small influx of personnel into Luxembourg, or third-party AIFMs appointed.

View from the Channel Islands

Guernsey and Jersey have always been outside the EU and their relationship is one of affiliation, via the UK, relating only to some specific trade. Financial services have been outside this relationship and hopes of being in the first round of "third country" jurisdictions able to passport into the EU via equivalence in regulation were dashed when the negotiations were abruptly terminated by the EU in response to the Brexit vote.

The Channel Islands, therefore, have continued to rely, and indeed thrive, on the private placement regimes of member states to market funds into these jurisdictions. Guernsey and Jersey's biggest relationship is, of course, with the UK which remains by far the most important jurisdiction for the islands. The Channel Islands, rather like the UK, are looking much further afield to the Far East and the United States.

Parry-Dew: Luxembourg will see immediate impact

Winter: future looks bright for Channel Islands

Carey: private placement is a cost-effective solution

Guernsey and Jersey as well-regulated jurisdictions can provide these rapidly growing markets with substance in which to domicile funds, and an attractive alternative to other domiciles.

The mainland EU jurisdictions have traditionally looked to Luxembourg and Dublin for their UCITS and AIFMD compliant funds. Global third-party administrators can make the best of both worlds by providing AIFMD compliant management and compliance services out of Luxembourg for non-EU managers who want to market into the EU outside of the private placement regime. Other jurisdictions, such as Guernsey or Jersey, can be used for less expensive and less restrictive non-EU funds focused on raising money from the rest of the world.

Culturally and linguistically, Luxembourg will always appeal as a tax-neutral domicile for German and French investment vehicles, but the dominance of the City of London is likely to continue post-Brexit. The stated intention of not including financial services as part of the Brexit settlement, whatever the outcome of negotiations, can only serve to strengthen the long-established bonds between London and the Channel Islands. UK alternative managers for whom access to EU markets remains important are either setting up their own offices in the EU or using service providers to set up EU-domiciled feeder vehicles or parallel investment vehicles with local AIFMD-compliant manager oversight, in conjunction with their Guernsey-domiciled funds.

It remains difficult to speculate about the impact of either a 'hard' or 'soft' Brexit on Guernsey and Jersey. Neither have ever been EU member states but the Channel Islands have historically, and continue, to attract EU fund managers and funds raising capital from the EU. The private placement regime continues to be a cost-effective and practical solution for which Channel Island administrators have developed a credible track record for delivery. The future therefore looks relatively promising for both Guernsey and Jersey post-Brexit. ■

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