

Frequently Asked Questions - Implications of a Hard Brexit on the local asset management industry

Date: 17 May 2019

NOTE: This document is solely intended for its user's general guidance and should neither be considered nor construed as advice or in any way a commitment on the part of the MFSA. Should a conflict arise between this document and the applicable laws, regulations, rules or guidance notes issued by ESMA or the MFSA, the laws, regulations, rules or guidance notes shall prevail. This FAQ is intended to address the most common queries which are raised to the Authority by interested parties.

Table of Contents

GENERAL COMMENTS	3
1. CHANGES TO FUNDS' OFFERING DOCUMENTATION AND RELEVANT AGREEMENTS	4
2. BROKERAGE	4
3. MARKETING OF UK UCITS & UK AIFS IN MALTA.....	5
4. MARKETING OF MALTESE UCITS AND MALTESE AIFS IN THE UK	6
5. UK MANAGEMENT COMPANIES (UCITS MANCOS OR AIFMS) MANAGING MT COLLECTIVE INVESTMENT SCHEMES	7
6. DELEGATION OF INVESTMENT MANAGEMENT	7
7. DEPOSITARY DELEGATION	8
8. UCITS ASSET ELIGIBILITY	9
9. PROFESSIONAL INVESTOR FUNDS.....	10

General Comments

This FAQ aims to provide answers to queries that the Authority has been receiving regarding the implications of a no-deal Brexit¹ scenario (also referred to as Hard Brexit) on the Maltese asset management industry. In certain instances, an equivalence status is applicable in particular scenarios as permitted by the European Union ('EU') directives and regulations.

The Authority's position as outlined in this FAQ may be subject to change in the light of any guidance and direction that may be issued in the future by the European Commission or European Securities and Markets Authority ('ESMA') and/or other European Union institutions as the case may be.

In case of any queries in relation to this Q&A and to Brexit generally, these should be addressed the Brexit Team within MFSA on brexit@mfsa.com.mt.

Reference should also be made to the circulars that the Authority has issued in the past with respect to Brexit, as well to those that may be issued in future.

¹ The withdrawal of the United Kingdom from the European Union without an agreement.

1. Changes to Funds' Offering Documentation and Relevant Agreements

Will collective investment schemes having UK service providers need to amend their offering documentation and relevant agreements?

Yes. Service agreements between funds and their service providers, as well as offering documentation, need to be updated in order to reflect any changes resulting from Brexit.

Collective investment schemes licensed in Malta are reminded that, if they have not already done so, they must review their offering documentation and agreements with service providers as may be necessary and as soon as possible. Approval for changes in offering documentation should reach the Authorisation (ausecurities@mfsa.com.mt) as soon as possible and in any event by not later than 31 July 2019.

2. Brokerage Services

Can a UK licensed investment firm continue providing brokerage services to a Maltese licensed Fund and/or Maltese licensed Fund Manager post-Brexit?

The provision of brokerage activities² is governed by MiFID II³, AIFMD⁴ and EMIR⁵.

In relation to activities within scope of Section B of Annex I of MiFID II, the provision of such services on a cross-border basis from the UK to a Maltese licensed fund/ fund manager, following Brexit, depends on whether the UK will be treated as an equivalent EU/EEA jurisdiction. However, with a Hard Brexit, UK entities will lose their passporting rights and **the impact of Brexit will depend on the nature of the broker's services.**

UK firms providing brokerage services to Maltese clients under the MiFID definition will no longer fall within scope of MiFID post Hard Brexit. Article 42 of MiFID II and Regulation 8 of the Investment Services Act (Provision of Investment Services and Activities by Third-Country Firms) Regulations, 2017 permit the provision of services at the exclusive initiative of the client in an EU Member State. Therefore, if the brokerage services are initiated by and at the request of a Maltese fund/ fund manager, (hence falling under the notion of reverse solicitation) there should be no impact on the provision of brokerage services by UK entities post a Hard Brexit. The brokerage services would be provided to the Maltese client by and from a UK entity–

² i) custody i.e. safekeeping and administration of financial instruments for the account of funds; ii) financing (margin lending, securities financing and derivative facilities); iii) foreign exchange; iv) acting as clearing member; v) execution of orders, including settlement; vi) risk management and back-office services

³ Directive 2014/65/EU

⁴ Directive 2011/61/EU

⁵ Regulation (EU) No 648/2012

hence provision of services will not be done in Malta. Nevertheless, industry players are reminded to review carefully ESMA's Q&A on ['Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics'](#) in relation to the topic of reverse solicitation.

It is also pertinent to note that following Brexit, UK firms providing brokerage services to Maltese clients may do so in terms of Article 39 of MiFID II and Regulation 3 of the Investment Services Act (Provision of Investment Services and Activities by Third-Country Firms) Regulations, 2017. These Regulations allow third country firms to provide investment services or perform investment activities to professional clients (or to retail clients) by establishing a branch in Malta. This is subject to satisfying a number of conditions.

There is no requirement under the AIFMD for prime brokers, as delegates of depositaries, to be based in the EU hence no impact as a result of a Hard Brexit is being foreseen.

Nevertheless, industry players are reminded of the requirements in terms of Article 20 of the AIFM Regulations (**'Due diligence in the selection and appointment of counterparties and prime brokers'**).

3. Marketing of UK UCITS & UK AIFs in Malta

- a. How will the marketing initiatives of UK UCITS and/or UK AIFs in Malta be impacted by a Hard Brexit?

UK UCITS and UK AIFs would become non-EU AIFs following a Hard Brexit and therefore they will not be able to continue benefitting from the passporting rights under Chapter XI of the UCITS Directive⁶ and Article 32 of the AIFMD respectively.

These funds would be permitted to be marketed into Malta under the National **Private Placement Regime ('NPPR')** which is governed by the Investment Services Act (Alternative Investment Fund Manager) (Third Country) Regulations (Malta AIFM Third Country Regulations) and subject to the notification procedures in accordance with Article 42 of the AIFMD, should they opt to continue offering their units to Maltese investors.

As per current procedure, the full notification fee applies to such funds. Moreover, the following notification documents would need to be submitted:

- Art 42 Notification Form;
- Offering Memorandum of the AIF;
- Proof of payment of the applicable notification fee;
- Copy of the most recent audited financial statements in respect of the AIF;

⁶ Directive 2009/65/EC

- Details in relation to the arrangements established by the Manager to prevent units of the AIF from being marketed to retail investors; and
- Proof of authorisation / registration of AIFM.

Marketing to retail investors pursuant to the NPPR is only allowed if a specific authorisation to market to retail investors is obtained from the MFSA. Vide the following subsidiary legislation, thereafter referred to as 'Third Country Regulations':

- <https://www.mfsa.com.mt/wp-content/uploads/2019/01/LN-116of2013-ISA-AIFM-Third-County-Regs-2013.pdf>
- <http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lp&itemid=25225&l=1>
- <http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lp&itemid=25226&l=1>

Whilst the local NPPR will continue to apply to these funds as hitherto, any active marketing of such funds in Malta would only be allowed if the applicable procedures emanating from the Third Country Regulations have been followed.

UK AIFMs currently passporting under Article 36 of the AIFMD will be required to submit a notification to the MFSA informing the Authority of their intention to continue marketing under Article 42 of the AIFMD. No further documentation in addition to that already submitted under Article 36 of the AIFMD would be required.

- b. How will UK EuVECA, UK EuSEF and UK ELTIF marketing in Malta be impacted by a Hard Brexit?

UK EuVECA, UK EuSEF, and UK ELTIF will need to abide by the notification procedures under the Third Country Regulations.

4. Marketing of Maltese UCITS and Maltese AIFs in the UK

How will the marketing of Maltese UCITS and/or Maltese AIFs in the UK be impacted by a Hard Brexit?

As part of the temporary permission regime granted by the FCA and as communicated in our circular dated 11 January 2019⁷, a MT UCITS/ MT UCITS ManCo which already passport into the UK had to follow the notification procedure which was available until 28 March 2019.

For new MT UCITS opting to offer their units to UK investors, it is suggested that the MT UCITS seeks guidance from the FCA in the UK.

⁷https://www.mfsa.com.mt/wp-content/uploads/2019/01/20190111_Circular_TPRbrexit.pdf

5. UK management companies (UCITS ManCos or AIFMs) managing MT collective investment schemes

- a. How will a Maltese AIF managed by a UK AIFM be impacted by a Hard Brexit?

In view of the fact that Article 37 of the AIFMD has not yet come into force in Malta, MT AIFs managed by UK AIFMs have three options:

- i) Appoint an EU AIFM;
- ii) MT AIF converts to an MT **Professional Investor Fund ('PIF')**; or
- iii) MT AIF converts into a self-managed AIF.

The current MT AIFs would need to take the above actions prior to the expiration date of the temporary national measures to be granted by Malta.

- b. How will a Maltese UCITS managed by a UK UCITS ManCo be impacted by a Hard Brexit?

MT UCITS managed by UK UCITS ManCo would either need to be converted into a self-managed MT UCITS or appoint an EU UCITS ManCo.

The current MT UCITS will need to consider the above actions within the period set out in the proposed temporary permission to be granted by MFS

6. Delegation of investment management

- a. What is the impact of a Hard Brexit on Maltese UCITS ManCos delegating their investment management function to a UK licensed entity?

A MT UCITS ManCo can only delegate to the UK MiFID firms if co-operation between the MFS

The delegation of the portfolio management services should not be impacted by a Hard Brexit if these services are initiated by and at the request of a Maltese client, (hence falling under the notion of reverse solicitation). These services would be provided to the Maltese client by and from a UK entity– hence provision of services will not be done in Malta. Nevertheless, industry players are reminded to review

⁸ https://www.mfsa.com.mt/wp-content/uploads/2019/02/20190213_Circular_BrexitMOU_ESMA-FCA.pdf

carefully ESMA's Q&A on ['Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics'](#) in relation to the topic of reverse solicitation.

Any new arrangements would need to be notified to the MFSa by the MT UCITS ManCo through the Authorisation (ausecurities@mfsa.com.mt).

b. What is the impact of a Hard Brexit on Maltese AIFMs delegating their investment management function to a UK licensed entity?

The AIFMD permits delegation of management activities to non-EU managers, provided certain conditions are satisfied, i.e. notification to the regulator of the EU AIFM and EU AIF and an MMoU between the relevant competent authorities. An MMoU is already in place between the FCA and Members States competent authorities as explained in Q&A5a above. The supervisory approach in relation to such firms will be similar to those entities which are currently delegating to non-EU managers; for instance, delegation by EU AIFMs to US fund managers.

Therefore, in case of a Hard Brexit, MT AIFMs may still continue delegating parts of their management activities to UK firms, and therefore comply with the applicable regulatory requirements. Comments with respect to reverse solicitation apply as per Q&A5a above.

7. Depositary delegation

How will the delegation of the depositary services, in terms of UCITS Directive and AIFMD, be impacted by a Hard Brexit?

UCITS and AIFs need to have EU depositaries in the same jurisdiction where the funds are domiciled. However, such entities may delegate the provision of custody services to a third-party custodian (including one that is based in a third country – refer to Q&A1 above). This is not dependent on an equivalence determination being made, but would require an arrangement to be put in place allowing UK depositaries to continue to perform activities on a delegated basis.

Therefore, UK depositaries would be restricted from directly performing safekeeping and/or other depositary services in relation to EU UCITS and AIFs, but may continue acting as sub-custodians (on the basis of delegation).

8. UCITS Asset Eligibility

Examples of how a Hard Brexit scenario may impact asset eligibility criteria within a Maltese UCITS:

a. Eligible collective investment undertakings

Under Article 50(1)(e) of the UCITS Directive, a UCITS scheme may invest all or part of its assets in other UCITS. Post Brexit, where such investments are UK UCITS, they must be subject to a 30% cap as set out in Article 55 of the UCITS Directive.

Post Brexit investment in UK UCITS must not exceed the permitted limit applicable to investments in non-EU countries. Where necessary, positions should be rectified within the six month leeway set out for inadvertent breaches.

b. Eligible derivatives

Article 50(1)(g) of the UCITS Directive provides that counterparties to OTC derivative transactions are to belong to categories approved by NCAs. Post Brexit, a number of counterparties may no longer meet national eligibility criteria because they are not EEA credit institutions or EEA investment firms.

SLC 4.1(vii)(b) of the Investment Services Rules ('ISR') for UCITS states that:

Financial Derivative Instruments, including equivalent cash-settled instruments, dealt in on a regulated market referred to in paragraphs (i), (ii) and (iii) above; and/or Financial Derivative Instruments dealt in over-the-counter ("OTC-derivatives) provided that the counterparties to OTC-derivative transactions are institutions subject to prudential supervision, and belonging to the categories approved by the MFSA according to the criteria set out in SLC 5.23.

SLC 5.23 of the ISR for UCITS states that:

The Scheme shall only enter into transactions for direct investment in Financial Derivative Instruments or for efficient portfolio management/ hedging by means of Financial Derivative Instruments with counterparties who:

- i. are not the Manager or Custodian of the Scheme; and*
- ii. form part of a group whose head office or parent company is licensed, registered or based in Malta, any member of the OECD, the EU or the EEA and is subject to prudential supervision in accordance with provisions equivalent to Directive 93/6/EEC or Directives 73/239/EEC and 79/267/EEC as amended; and*
- iii. have a credit rating of at least A (Standards & Poor's) or A2 (Moody's) or such other rating acceptable to MFSA.*

Therefore, in case of a Hard Brexit, given that the UK will remain a member of the OECD, such exposures would still be compliant with provisions equivalent to Directive 93/6/EEC or Directives 73/239/EEC and 79/267/EEC as amended, and there should be no impact with respect to UK counterparties.

Moreover, ESMA has signed Memoranda of Understanding (MoUs) with the Bank of England (BoE) for the recognition of central counterparties (CCPs) and of central securities depositories (CSDs) established in UK, in case of a Hard Brexit scenario.

9. Professional Investor Funds

How will Maltese Professional Investor Funds ('PIF') managed by UK firms be impacted by a Hard Brexit?

The PIF regime is a local regime. In terms of Regulation 3(1)(h)(ii) of the Investment Service Act (Exemption) Regulations, a person resident outside Malta providing investment management services to a PIF, where the MFSA is satisfied that such person is of sufficient standing and repute, is exempted from the purposes of the requirement for a licence for investment services in terms of article 3 of the Investment Services Act. Therefore, PIFs managed by UK firms will not be impacted by Brexit.