Keeping up with Brexit for Asset and Wealth Managers

February 2019

pwc

Introduction

Welcome to Keeping up with Brexit, a special edition newsletter, bringing together our latest analyses of key Brexit issues concerning the Asset and Wealth Management ('AWM') industry.

Brexit Day of 29 March 2019 is fast approaching and the second meaningful vote now won't take place until 12 March. Following a number of recent political events – the rejection of the Withdrawal Agreement, resignations within the two major British parties - businesses are encouraged to ratchet up their contingency plans in case a deal between the UK and the EU is not reached.

1. FAQs for AWMs

In an update to our FAQs two-pager for the AWM sector following recent events in the House of Commons and the agreement between ESMA and the FCA on numerous MOUs designed to manage disruptions in the event of a 'no deal' Brexit, we take you through what the possible outcomes from the changing state-of-play of Brexit could mean for you and your business.

Have you thought about the latest developments on Brexit and how these could impact your business?

2. Equivalence vs Passporting

This is a helpful comparative analysis of passporting arrangements available by virtue of EU/EEA membership versus equivalence arrangements for third countries (i.e. those outside the EU/EEA single market). We outline how the UK could obtain and maintain equivalence following Brexit and its shortcomings – particularly for UCITS.

Have you considered how a loss of passporting arrangements could require you to move functions to other territories and the indirect impacts (e.g. transfer pricing) it could bring?

3. Temporary Permissions Regime ('TPR')

During preparations for a 'no deal' withdrawal from the EU, the UK has introduced the TPR to permit EU/EEA firms operating under passporting arrangements in the UK to continue to do so provided certain administrative processes are followed. We take you through the TPR, FAQs on the regime and possible impacts for UK reporting funds.

Do you have funds in EU/EEA states, whose managers rely on passporting arrangements to provide services within the UK? If so, have you applied for entry into the TPR?

4. Impact of Brexit on fund products

In this piece, we consider the potential tax impact for funds in a 'no deal' scenario after 29 March. In addition to identifying potential withholding tax leakage for funds no longer being treated as domiciled in the EU/EEA or operating under an EU/EEA regulatory framework, our article looks at knock-on impacts on double tax treaties and investment mandates.

Have you thought about the impact that Brexit could have on your fund's performance due to possible WHT leakage?

We hope that you find this newsletter helpful and, as always, your usual PwC contact, or one of our colleagues listed on the contacts page, will be more than happy to discuss the finer details of any topics that grab your attention.

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FAQs for Asset and Wealth Managers

On Tuesday 29 January, there were several votes within the House of Commons on amendments to the Government's approach to the UK's arrangements for withdrawing from the EU. In the run up to the votes, there was significant media coverage of those tabled by Sir Graham Brady and Yvette Cooper.

The Brady amendment, calling for the Government to seek 'alternative arrangements' to the Northern Irish backstop within the draft Withdrawal Agreement, passed while the Cooper amendment, which could have brought an extension to the two-year period of the Article 50 process, failed to gather the required support in the House of Commons. Meanwhile, Dame Caroline Spelman's non-binding amendment confirmed that a majority of the House of Commons do not support the UK leaving the EU without a Withdrawal Agreement in place.

Theresa May will return to the House of Commons for a second vote on the Withdrawal Agreement on 12 March. It remains to be seen how the recent resignations of Labour and Conservative MPs will change the dynamics but we have seen Labour change their policy to now support a second referendum. Whilst the parliamentary arithmetic has changed, it may take further resignations to increase likelihoods of a rejection of a revised WA or a general election.

Incidental to the events in the Palace of Westminster, on Friday 1 February the European Securities and Markets Authority ('ESMA') and the Financial Conduct Authority ('FCA') announced that they had agreed Memoranda of Understanding ('MoUs') on supervisory cooperation in the event of a 'no deal' Brexit, allowing the continuation of information exchange and delegation of portfolio management cross-border between the EU/EEA and the UK from 11pm on 29 March 2019.

What impact is there for AWMs following the votes in late January?

The default position under UK law and within the Treaty of the EU is that the UK will leave the bloc on 29 March 2019 unless a Withdrawal Agreement is agreed and ratified.

The 29 January votes have not materially progressed matters. Our view is that the risk of a 'no deal' Brexit is still high and that it is arguably a little higher given the rejection of amendments to delay the Article 50 process and the deferral of the second meaningful vote until 12 March.

In the absence of a political breakthrough, AWMs in the UK and EU need to accelerate their 'no deal' contingency plans, even if it now looks like portfolio management in the UK can continue. For those who haven't started implementing 'no deal' actions, there are still steps that can be taken to minimise disruption. The longer it is left, the more difficult building and effecting these contingency plans will be.

How would an agreement affect AWMs?

Should the Government and EU negotiators arrive at an agreement that the House of Commons approves then it becomes very likely that the Withdrawal Agreement would be ratified on 12 March and a transitional period would be entered beyond 29 March 2019. This is anticipated to be helpful for AWMs as it could allow a continuation of services during that period – particularly with the retention of passporting arrangements between the UK and EU/EEA rather than equivalence for portfolio management delegation. Businesses within the industry will know they have at least until 31 December 2020 (with an option for this period to be extended by no more than one or two years) to reorganise their affairs for life after Brexit. It should be noted that even if a deal is agreed, a 'no deal' Brexit will still remain possible until it is ratified by both the UK and EU Parliaments.

If the Government eventually fails in its attempts to get the Withdrawal Agreement, amended or not, passed, there are a number of possible scenarios, including the UK leaving the EU without a deal, or another EU referendum (only possible if the Government is able to get legislation enacting it passed in a vote in the House of Commons).

Some of these options may involve delaying the official Brexit date of 29 March by a few months to allow time to renegotiate a deal. However, it is still uncertain whether the EU would grant an extension to Article 50 (to delay the leaving date) to allow the UK to have a second referendum. As a second referendum could take months, not days or weeks, to happen the UK runs the risk of leaving the EU without a deal on 29 March by default due to the extent of the internal political challenges.

With so many different potential outcomes, AWMs should be activating their 'no deal' plans now, while still preparing for both a deal and 'no deal' outcome.

Are AWMs able to rely on Article 50 being cancelled and the Brexit process being halted?

In short, no. The UK will leave the European Union on 29 March 2019 regardless of whether there is a deal with the EU. The Brexit process can only be halted if there is a change in UK law. The Court of Justice of the EU has ruled that the UK could cancel the Article 50 Brexit process without the permission of the EU27 members, but this would require a vote in the House of Commons, which is viewed as unlikely.

What timeframe are AWMs working to?

As noted above, our experience, and our Brexit survey results show that most AWMs have already been working to put contingency plans in place that assume there will be a 'no deal' Brexit and no transitional period, so are working towards 29 March 2019.

FAQs for AWMs (cont'd)

What does a 'no deal' Brexit mean for AWMs?

Please note the most likely implications of a 'no deal' Brexit for the following:

- **UK funds marketed to EU investors** – Current EU passporting rights will end on 29 March 2019; EU investors may have to be transferred into EU domiciled funds (investor capital gains tax and portfolio tax implications arising from such fund reorganisations will need to be managed). Alternatively, some jurisdictions may implement temporary permissions regimes (as discussed below) or some marketing to professional investors may be possible in some countries under domestic regulatory provisions known as National Private Placement Regimes ('NPPRs').
- **EU funds marketed to UK investors** – Existing funds will need to enter the Temporary Permissions Regime ('TPR') by 29 March 2019, but this will not be an option for new funds launched after that date (other than sub-funds with an umbrella UCITS fund inside the TPR). New launches will have to rely on the NPPRs if they are aimed at professional investors, or Section 272 of the Financial Services and Markets Act ('FSMA') in the case of retail products.
- **UK AIFMs, UCITS, ManCos and MiFID firms with EU funds and investors** – With the agreement between the FCA and ESMA on MoUs relating to portfolio management delegation taking effect, potential disruption caused by a 'no deal' Brexit is mitigated. For areas in which coverage is not granted by the ESMA and the FCA's agreement and given the limited time now available, managers may need to appoint a third-party ManCo, AIFM or super ManCo in the EU27 to ensure no break in service after 29 March 2019; in the longer term, they may choose to establish their own ManCo, AIFM or super ManCo in the EU27. Assuming the FCA signs MOUs with its opposite numbers in EU member states, firms will be allowed to delegate portfolio management back to the UK provided they comply with the substance requirements in the member state in question. Naturally, any reorganisation of contracts, payment flows and changes of functions between jurisdictions could create a range of potential tax issues for the management group and these will need to be assessed and managed.
- **EU AIFMs, UCITS, ManCos and MiFID firms with UK funds and investors** – These firms must enter the TPR by 29 March 2019 and will need the appropriate regulatory permissions from their own member state; EU AIFMs would also need to rely on co-operation agreements for the exchange of information between their national regulators and the FCA. Note that the TPR is not available for new managers established after 29 March 2019, but the agreement between ESMA and the FCA may allow for portfolio management delegation to EU managers.
- **Immigration** – For people travelling from or leaving the UK, each country's immigration and visa requirements will need to be assessed, although there will be no material impact for individuals currently in the UK or arriving by 29 March 2019. Additionally, the Common Travel Area between the UK and the Republic of Ireland is expected to continue even in the event of a 'no deal' Brexit.
- **Social security** – Individuals in the UK working in other European locations will no longer be able to rely upon the European social security regulations, and we await clarification with regard to whether the pre-existing bilateral social security agreements will be available to help mitigate against social contributions in multiple jurisdictions.
- **Member States' 'no deal' scenario preparations** – Some Member States in the EU have approved specific domestic legislation or have made announcements that they intend to introduce measures to provide transitional relief in a 'no deal' scenario. For example:
  - Germany is looking to introduce transitional measures for UK banks, insurers and other financial market participants until the end of 2020 – 2021.
  - The Netherlands has submitted draft catch-all legislation to introduce measures in the event of a 'no deal' Brexit with unforeseen consequences.
  - Finland has introduced a draft proposal to create a new third country regime allowing UK firms to continue providing cross border investment services and ancillary services without establishing a branch.
  - Italy is looking to adopt an emergency decree in a 'no deal' scenario to introduce temporary measures to apply to financial institutions, MiFID firms, other financial intermediaries, insurance companies and pension funds, which will be permitted to continue operating in Italy for a transitional period.

In each case, there is considerable work to do to achieve these goals – and precious little time do to it. We are advising AWMs that are not already doing so to urgently activate their 'no deal' plans, while still preparing for both a deal and 'no deal' outcome. The time to act is now.

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Equivalence vs Passporting

What does it mean for asset management?

In the event of a 'no deal' Brexit, the UK would become a third country and UK financial services firms would lose their passport rights and access to the single market for financial services.

Following a 'no deal' Brexit, in order for UK firms to access the EU market and provide financial services, they would need to rely on third country equivalence provisions in the relevant EU acts. Some Member States have approved or have made announcements that they intend to introduce measures to provide transitional relief post-Brexit; these are however, interim in nature.

Only certain EU acts contain third country equivalence provisions, and in some acts these provisions are not switched on (e.g. under the AIFMD). In comparison to passport rights, equivalence offers piecemeal and limited access to the single market.

Furthermore, unlike passport rights, which are permanent, equivalence may be unilaterally withdrawn by the European Commission (the 'EC').

In order for UK firms to rely on third country equivalence provisions in the respective EU acts, certain conditions would need to be met. One of them is that the UK would need to apply for equivalence under each of the respective EU acts and equivalence would need to be granted by the EC.

Passport rights

EU passport rights allow financial services firms in Member States access to the single market for financial services. A financial services firm authorised by its domestic regulator can provide services or establish a branch in any other EU Member State without the need for any further authorisation or licence in that Member State.

Equivalence

There is no single concept of equivalence. It is only available where third country equivalence provisions are included in the respective EU acts. In many EU acts equivalence provisions do not exist and where they do exist, they are mainly technical, narrow in scope and do not provide passport-like access. Table A overleaf outlines a high level summary of passport rights and third party equivalence provisions under UCITS, AIFMD and MiFID.

How is equivalence determined?

Equivalence is determined by assessing if a third country's rules and supervisory mechanisms are equivalent to and achieve the same results as the EU regulatory regime. Assessment of equivalence is carried out by the EC taking into account technical advice from bodies such as ESMA.

In order for the UK to be granted equivalence by the EC, each of the UK regulatory regimes would need to achieve the same regulatory objective as the respective EU regime (that contains third country equivalence provisions). This would be based on the interpretation of EU bodies and not the FCA. At present, UK firms are subject to EU law, which is transposed into UK law and/or interpreted by the FCA.

How long can equivalence take?

Obtaining equivalence is an uncertain process that can take a long time. Factors other than technical differences in laws/regulations (e.g. political reasons or reciprocity by the third country) could impact equivalence.

The process of obtaining European Market Infrastructure Regulation ('EMIR') equivalence for US central counterparties ('CCPs') took some four years. Given the close alignment of the UK regulatory regime to the EU regime, it is arguable that the process of obtaining equivalence for the UK regulatory regime may not be as long.

Can the equivalence decision be reversed?

Equivalence is made at a point in time and can be unilaterally withdrawn by the EC. This could make long-term planning based on equivalence hard.

If the UK is granted equivalence, maintaining it could be challenging as the UK may have to adopt future EU laws without having an influence in the design of such laws. Given UK laws are mostly aligned with EU laws, the UK may not be able to diverge from EU laws without the risk of losing equivalence.

Equivalence vs Passporting (cont'd)

Rights granted under EEA model?

An EEA member can rely on EU passport rights to access the single market for financial services if they accept and implement all relevant EU rules and regulations in relation to financial services, including any amendments.

EEA members have the opportunity to influence the shaping of EEA-relevant legislation, i.e. to participate in expert groups of the EC and submit comments on upcoming legislation. However, in terms of the final decision on the legislation on the EU side, they have little influence when compared to being a full EU member.

Member states' 'no deal' Brexit preparations

Some member states in the EU have approved specific domestic legislation, or have made announcements stating that they intend to introduce measures to provide transitional relief in a 'no deal' scenario. For example:

- Germany is looking to introduce transitional measures for UK banks, insurers and other financial market participants until the end of 2020 – 2021.
- The Netherlands has submitted draft catch-all legislation to introduce measures in the event of a 'no deal' Brexit with unforeseen consequences.
- Finland has introduced a draft proposal to create a new third country regime allowing UK firms to continue providing cross-border investment services and ancillary services without establishing a branch.
- Italy is looking to adopt an emergency decree in a 'no deal' scenario to introduce temporary measures to apply to financial institutions, MiFID firms, other financial intermediaries, insurance companies and pension funds, which will be permitted to continue operating in Italy for a transitional period.

Table A

	UCITS	AIFMD	MiFID II
UK access via EU passports	UK ManCos can manage UCITS across EU member states. UK ManCos can market UCITS to investors across the EU (including retail investors).	UK AIFMs can manage AIFs across EU member states. UK AIFMs can market AIFs to EU professional investors.	UK MiFID firms can provide investment services (e.g. investment advice, portfolio management etc.) across the EU either on a cross-border basis or by establishing a branch.
UK access via third country equivalence provisions	No equivalence regime in place.	Includes third country equivalence provisions that allow third country AIFMs to manage EU AIFs and market EU or non-EU AIFs in the EU (to professional investors), subject to compliance with certain conditions. However, these third country equivalence provisions are not switched on.	Includes third country equivalence provisions that allow investment firms to provide investment services to per se professional clients and eligible counterparties across the EU[1], subject to compliance with certain conditions. There is no need to establish a branch in the EU. However, these third country equivalence provisions are mostly untested.

[1] UK AIFMs and UCITS ManCos may not be able to benefit from MiFID II/MiFIR third country passporting, which may not be available to managers of collective investment undertakings.

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Temporary Permissions Regime

Summary

In a 'no deal' scenario, passporting arrangements for financial services firms and investment funds between the EU/EEA and the UK, which allowed for reciprocal market access, would no longer be available.

The UK Government, as part of its preparation for a 'no deal' Brexit scenario, introduced, in December 2017, a Temporary Permissions Regime ('TPR') with an aim to reduce the risks and disruption that would potentially occur if there were an abrupt loss of passporting, and to allow firms and funds to retain their contractual rights, fulfil their obligations and manage existing business. While in the TPR, EEA-domiciled investment funds can continue to be marketed in the UK to new and existing investors, and EEA firms can continue to provide financial services and activities in the UK.

The FCA, in October 2018, opened its consultation on how it expects the TPR to be implemented.

On 7 January 2019, the FCA opened the notification window for the TPR. The window closes at the end of 28 March 2019 after which the TPR would come into effect (provided it is a 'no deal' Brexit). In the event of the date when the UK leaves the EU being extended for any reason, then the window will be extended until the UK leaves the EU and the TPR would come into effect on the new date.

The TPR would allow relevant EEA firms and funds passporting into the UK to continue regulated business in the UK for a limited period (up to a maximum of three years) after 29 March 2019. The period will vary depending on when the EEA firms or investment funds are asked to submit their application or recognition in the UK. Preparing this application can be time consuming, and PwC has a team of dedicated professionals who can assist with managing this process.

TPR	Firms	Investment funds
Which entities can use the regime?	EU/EEA firms passporting into the UK under Schedule 3 of FSMA (by way of services or establishment passport). Treaty firms under Schedule 4 to FSMA.	EEA UCITS and EEA AIFs (including European social entrepreneurship funds ('EuSEFs'), European Venture Capital Funds ('EuVECA'), European Long-term Investment Funds ('ELTIFs') and Money Market Funds ('MMFs') marketed into the UK.
What is the notification process?	Firms would have to notify the FCA that they wish to use the TPR via the FCA Connect system. A firm can only submit one notification. The notification would need to be submitted before 29 March 2019. No fee will be charged to firms for notifying the FCA.	The fund managers would need to notify the FCA, via the FCA Connect system, of the list of the passported funds, including sub-funds, they wish to continue to market in the UK. Fund managers should ensure all funds and sub-funds are included before submitting the final notification. The notification would need to be submitted before 29 March 2019. No fee will be charged to the fund manager for notifying the FCA.
What happens after the notification has been submitted?	The FCA will allocate firms a three month application period or 'landing slot' within which firms would have to submit an application for UK authorisation (i.e. an application to be authorised for the investment services and activities they wish to undertake in the UK). Firms with top-up permissions will need to submit a Variation of Permission ('VoP') application. The first landing slot is expected to be October to December 2019 and the last to be January to March 2021. Given the short time frame until the first landing slot in October, firms should begin planning this application from April. If the FCA refuses the application or the firm does not make an application, the FCA can cancel the firm's temporary permission.	The FCA will allocate the fund manager a three month application period or 'landing slot' within which to apply for UK recognition of the investment fund/sub-fund or submit a notification. The first landing slot is expected to be October to December 2019 and the last to be January to March 2021. Given the short time frame until the first landing slot in October, funds should begin planning this application from April. If the FCA refuses the application or the fund manager does not apply, the FCA can cancel the fund manager's temporary permission.

Temporary Permissions Regime (cont'd)

TPR	Firms	Investment funds
Are there any restrictions?	If the firm wants to change the scope of its regulated activities, then this must be done through its application for authorisation or VoP application in the UK.	Whilst in the TPR, a fund manager cannot add new funds or sub-funds to umbrella funds (with the exception of new sub-funds with umbrella UCITS inside the TPR) or change or extend the category of customer to be marketed to.
What happens if timely notification to the FCA is not made?	Firms cannot benefit from the TPR and would have to stop providing financial services in the UK at 11pm on 29 March 2019. In order for a firm to provide financial services in the UK, the firm would have to submit an application for UK authorisation. Where the firm has top-up permissions, it would have to submit a VoP application. However, any needed approval would take time to process and the firm's application may not be successful or limitations may be placed on its permissions.	The fund cannot benefit from the TPR and the fund manager would have to stop marketing the fund in the UK at 11pm on 29 March 2019. The fund manager could reapply to market the fund outside of the TPR at a later date, either by being recognised under s.272 of FSMA or by registering for the fund to be marketed in the UK under the NPPR. However, any needed approval would take time to process and the fund may not be granted marketing permission, or may not be able to market to the same category of investors. Furthermore, not applying for the TPR could be evidence that the fund in question will not be a special investment fund for UK VAT purposes going forward. To the extent that a UK supplier is providing services in relation to any such fund, this could have an impact upon the VAT recovery position for that supplier, albeit the rules in this area remain complex.

Potential impact of TPR on UK reporting funds

Funds will be able to maintain their status as a reporting fund under the Offshore Fund Regime regardless of whether the fund enters the TPR. However, to the extent that you are currently marketing EEA funds (including, but not limited to those registered with HMRC as reporting funds) to UK investors then you may wish to enter into the TPR in order to continue marketing your funds in the UK after 29 March 2019. This requires you to notify the FCA (via the FCA Connect system) of your intention to rely on the TPR. The notification process is already open and will close before 29 March 2019. During the TPR, fund managers will be allocated a three month window within which to submit an application or notification for recognition of the fund in the UK.

Please note that as currently contemplated the TPR is restricted to existing funds that have notified the FCA before the UK leaves the EU. Any new umbrella funds or sub-funds launched after 29 March 2019 (other than sub-funds with umbrella UCITS inside the TPR) will not qualify for entry into the TPR. We anticipate that new share classes that are created after Brexit should be able to rely on the TPR if they are part of a sub-fund or umbrella fund that has already registered for the TPR.

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Impact of Brexit on fund products

Faced with uncertainty in their businesses as a result of Brexit, Asset & Wealth Managers ('AWMs') should consider the potential impact of the tax drag on their funds' investments. Have you considered how your fund may be impacted as a result of increased post-Brexit tax charges?

There are many ways in which the UK's departure from the EU has the potential to increase the level of taxes paid by funds on the returns on their investment portfolios. We consider below the impact under a 'no deal' Brexit scenario, whereby the UK leaves on 29 March 2019:

- **UK UCITS funds may suffer increased levels of withholding tax on their investments as they lose their UCITS status**: Many European jurisdictions (e.g. France, Spain) apply reduced rates of, or full exemptions from withholding tax on dividends paid to funds authorised as UCITS. UK funds currently authorised as UCITS will no longer be entitled to benefit from this treatment after the UK leaves the EU, unless an agreement is reached between the UK and the EU in this regard. Higher rates of withholding tax will apply, even where double tax treaties are in place.
- **UK UCITS funds could find that their EU withholding tax reclaims become more costly as they lose their UCITS status**: UCITS authorisation is not required for Fokus Bank reclaims, which are available for 'third country' funds, so, in theory, UK funds should continue to be able to make reclaims. However, in practice, as non-UCITS funds, such reclaims are likely to be administratively more burdensome as comparisons to domestic funds will be more complex.
- **UK funds (both UCITS and non-UCITS funds) may suffer increased levels of withholding tax on their investments as they are no longer considered EU recipients**: Aside from the provisions of double tax treaties mentioned above, certain jurisdictions have domestic tax provisions that allow reduced or eliminated withholding taxes on interest and dividend payments to recipients in EU or EEA territories. After 29 March 2019, UK funds (both regulated and unregulated) investing overseas that rely on such domestic provisions may face increased withholding taxes.
- **EU27 funds may suffer increased levels of withholding tax on their investments**: Many EU27 funds rely on the provisions of double tax treaties to reduce or eliminate taxes on their investment returns, either in the form of withholding taxes on dividend or interest payments or taxes on capital gains. In certain cases, the entitlement of investment funds to benefits under double tax treaties is dependent on a significant proportion of the investors in the fund being resident in the EU, based on applying a 'look through' approach to the fund itself. The UK's departure from the EU could potentially impact the ability of EU27 funds with UK investors to benefit from the provisions of such double tax treaties. Similarly, certain treaties allow benefits to apply to entities listed on EU stock exchanges. Without an agreement to the contrary, any EU27 funds relying on a UK stock exchange listing for the purpose of claiming tax treaty benefits could be negatively impacted. The establishment of UK domiciled funds for UK investors which could benefit from the UK's network of double tax treaties may alleviate this impact.
- **UK funds become less attractive to EU27 investors who invest via a tax wrapper or specific incentivised regimes**: A number of European jurisdictions have introduced tax regimes in recent years in order to stimulate investment by local investors (e.g. French PEA regime) or by overseas investors in their local markets (e.g. Italian tax reporting regime). While initial steps have been taken by some governments to limit the impact of the UK's departure from the EU on these regimes, their application could be significantly restricted without further action.
- **Practical impact on investment mandates:** Tax implications aside, Brexit also has the potential to impact investment behaviour more broadly. Where investment mandates dictate minimum thresholds of investment in EU instruments and derivatives, investment portfolios may need to be reconfigured in the event that the UK is no longer considered to be within the EU/EEA in this context. This could be of particular concern for pension funds and for UCITS funds investing in UK-domiciled funds, given these will no longer qualify as UCITS for investment restriction purposes, however other funds may also be impacted.

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