



## Financial Markets Law Committee (“FMLC”)

### Asset Management Scoping Forum

Date: Thursday 29 November 2018

Time: 1.30pm to 3.00pm

Location: Akin Gump Strauss Hauer & Feld LLP, Ten Bishops Square, Eighth Floor, London, E1 6EG

#### **In Attendance:**

Ezra Zahabi (Chair)	Akin Gump Strauss Hauer & Feld LLP
Matthew Baker	Bryan Cave Leighton Paisner LLP
Philip Bartram	Travers Smith LLP
Gregg Beechey	Fried, Frank, Harris, Shriver & Jacobson (London) LLP
Iain Cullen	Simmons & Simmons LLP
Jonathan Gilmour	Travers Smith LLP
Kirsten Lapham	Ropes & Gray International LLP
Jon May	Marshall Wace LLP.
Neil Robson	Katten Muchin Rosenman UK LLP
Virgilio Diniz	FMLC
Thomas Willett	FMLC

#### **Guest Speaker**

Chris Ormond	Bryan Cave Leighton Paisner LLP
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#### **Regrets:**

Christopher Dearie	MJ Hudson
David Gasperow	Orbis Investment Advisory Limited
Monica Gogna	Dechert LLP
Matthew Huggett	Allen & Overy LLP
Owen Lysak	Clifford Chance LLP
Martin Parkes	BlackRock Investment Management (UK) Limited
Palvi Shah	J.P. Morgan Asset Management
Sam Wilson	Fried, Frank, Harris, Shriver & Jacobson (London) LLP

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## Minutes:

### 1. Introductions

1.1. Ezra Zahabi opened the meeting.

### 2. Administration: Scoping Exercise – Lifecycle of a Project and confirmation of the 2019 Forward Schedule (Virgilio Diniz)<sup>1</sup>

2.1. Virgilio Diniz described to the members how new issues of legal uncertainty on which the FMLC can undertake work are raised. He elaborated on the Committee's process of adopting new projects, how working groups operate, the publication drafting process and the profile of past FMLC publications.

2.2. Attendees did not raise any issues in relation to the draft Forward Schedule of meetings for 2019. These meetings dates were therefore confirmed.

### 3. Scope of the “user” definition under the Benchmarks Regulation (Ezra Zahabi)

3.1. Ms Zahabi introduced concerns with the “user” definition under Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure performance of investment funds (the “**Benchmarks Regulation**”). She queried whether an asset manager acting as agent on behalf on an investment vehicle entering into a derivative contract should be considered to be “using a benchmark” within the meaning of Article 3 of the Benchmarks Regulation.

3.2. Ms Zahabi explained that it is unclear whether a person “using a benchmark” under Article 3(7)(b) should include an asset manager acting as agent, or, whether the person “using a benchmark” should be understood as the counterparty to a derivative contract in line with Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories (the “**European Market Infrastructure Regulation**” or “**EMIR**”). She highlighted that a narrow reading would suggest that the restrictions would principally apply to credit institutions and investment firms with proprietary trading operations, as most asset managers' own account trading activities are limited. If the intention of the regulation was to limit the application to only entities dealing on their own account, this might have been

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<sup>1</sup> Please see Appendix I below.

specified; the European Securities and Markets Authority (“ESMA”) Questions and Answers (5.2), however, refers to “parties” to a derivative transaction.<sup>2</sup>

3.3. A narrow reading would also indicate that the BMR would generally only apply to an external manager where it measures its performance for the purpose of either tracking the return of the benchmark or defining the asset allocation of the portfolio or computing performance fees payable by it.

3.4. Forum members agreed to recommend that the Committee consider further work on this issue.

#### 4. **Scope of the “institutional investor” definition under the Securitisation Regulation (Ezra Zahabi)**

4.1. Ms Zahabi introduced an issue of uncertainty concerning the scope of the “institutional investor” definition under Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the “**Securitisation Regulation**”). She explained that given the way “institutional investor” is defined under Article 2(12) and the due-diligence requirements for institutional investors set out under Article 5, it is unclear whether the definition of an “institutional investor” is intended to extend to non-E.E.A. asset managers who have registered under Article 42 of Directive 2011/61/EU of the European Parliament and of the Council on Alternative Investment Fund Managers (the “**AIFMD**”) in one or more E.E.A. member states to market investment funds in accordance with the applicable private placement rules. If the definition did extent to non-E.E.A. managers, Ms Zahabi observed that this would introduce a material degree of extra-territoriality to the legislation.

4.2. Members noted that the Alternative Investment Management Association (“**AIMA**”) have submitted a query to ESMA on this and agreed to keep a watching brief for any developments.

#### 5. **FCA consultation paper on illiquid assets and open-ended funds (Chris Ormond)**

5.1. Chris Ormond delivered to the participants an overview of the Financial Conduct Authority (“**FCA**”) consultation on illiquid assets and open-ended funds.<sup>3</sup> Taking into account findings from its February 2017 discussion paper on this topic (DP 17/1), the July 2017

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<sup>2</sup> ESMA, (2018), Questions and Answers On the Benchmarks Regulation, available at: [https://www.esma.europa.eu/sites/default/files/library/esma70-145-114\\_qas\\_on\\_bmr.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-145-114_qas_on_bmr.pdf).

<sup>3</sup> FCA, (2018), Consultation on illiquid assets and open-ended fund and feedback to Discussion Paper DP17/1, available at: <https://www.fca.org.uk/publication/consultation/cp18-27.pdf>.

outcomes of its analysis of the 2016 property fund suspensions and new recommendations from the International Organisation of Securities Commissions (“**IOSCO**”), the FCA concluded that a major overhaul of the regulatory framework was not needed. However, it considers that improvements should be made in the use of suspensions and other liquidity management tools, contingency planning, oversight arrangements and disclosure to retail clients. Ms Ormond explained that the focus of the proposed changes is on the Non-UCITS Retail Scheme (“**NURS**”) that invest in illiquid assets, but also impact authorised funds generally and will be of interest to those working in the unregulated open-ended funds space where there is a potential knock-on effect.

5.2. Ms Ormond mentioned that the proposals are framed as lessons learnt following the Brexit vote in June 2016, when several NURs were forced to suspend redemptions to deal with the high volume of requests, as investors were concerned with the outlook for U.K. real estate and tried to withdraw their money at short notice. The overall aim is to increase retail investors’ understanding and confidence in authorised fund managers’ (“**AFMs**”) management of liquidity risk in open-ended funds holding illiquid assets.

5.3. Next, Ms Ormond provided an overview of the proposed changes being consulted on which fall under three broad areas:

- i. suspension of dealing in units in cases of material uncertainty about the valuation of at least 20% of the scheme property;
- ii. improving the quality of liquidity risk management; and
- iii. increased disclosure for funds investing in inherently illiquid assets.

5.4. Members agreed that these proposals were welcomed as they constitute an evolution rather than a dramatic intervention. Some criticisms, however, were highlighted including the prolonged period of uncertainty and turmoil around Brexit preparations and implementation, as well as increased power of valuers in determining material uncertainty.

## **6. Any other business**

6.1. No other business was raised.

# Lifecycle of a Project

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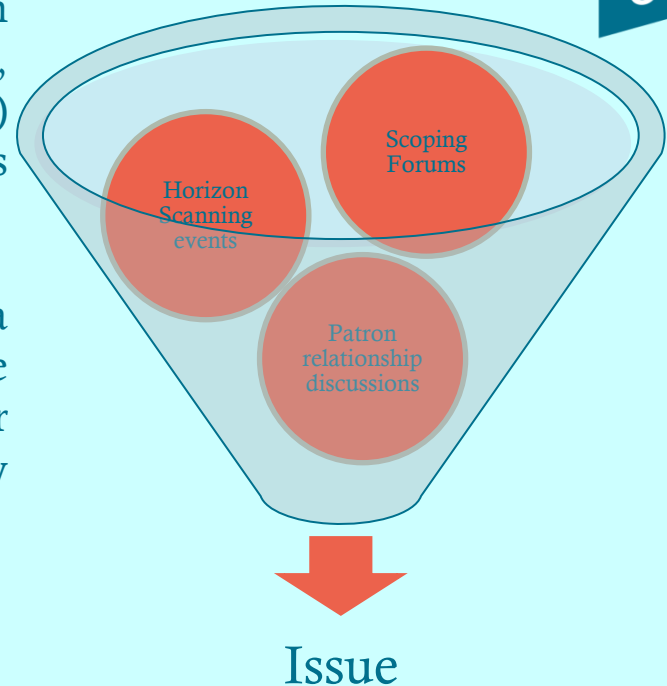


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# How an issue of legal uncertainty is raised

- New issues of legal uncertainty on which the FMLC can undertake work are raised in Scoping Forum meetings, bilateral radar meetings with Joanna Perkins (FMLC CEO) and during monthly Patron relationship calls with members of the Secretariat.
- Once an issue is raised, the Secretariat usually asks for a briefing note to be prepared by the person(s) making the recommendation. This is then put before the Committee for their consideration. (The FMLC Secretariat will normally offer formatting and other assistance in preparing the brief.)



# The brief

## FINANCIAL MARKETS LAW COMMITTEE (“FMLC”)



### Briefing Note: Issues of Legal Uncertainty on Brexit and Judicial Interpretation

#### 1. Introduction

1.1. Following the referendum in June 2016, in which the U.K. voted to withdraw from the European Union, the FMLC established a High Level Advisory Group (“HLAG”) of experts to give direction to the Committee’s work relating to Brexit. At a meeting of the HLAG in December 2017, members of HLAG recommended that the FMLC establish a Working Group to identify potential legal uncertainties arising from the interpretation by U.K. courts of autonomous E.U. legal concepts which appear in received E.U. legislation as it is incorporated into U.K. law

1.2. An overview of HM Government’s proposal to incorporate E.U. law into the U.K. and the various legal complexities relating to the interpretation of autonomous E.U. terms are set out below.

#### 2. The European Union (Withdrawal) Bill—and domestic preparations for Brexit so far

1.1. In the run up to the referendum, those who campaigned for withdrawal from the E.U. argued for an end to the principle of the supremacy of E.U. law and judgments of the European Court of Justice (“ECJ”). The European Union (Withdrawal) Bill (the “Withdrawal Bill”), introduced into the House of Commons on 13 July, aims to fulfil this purpose by: (i) repealing the European Communities Act 1972 on the day the U.K. leaves the E.U.; and (ii) incorporating E.U. law as it stands into domestic law. The Withdrawal Bill also provides guidelines for a new relationship between domestic law and U.K. law.

2.1. Clause 5 of the Withdrawal Bill states that the principle of the supremacy of E.U. law will not apply to any enactment or law passed or made on or after Exit Day (i.e., the term defined in the Withdrawal Bill as the day the U.K. leaves the E.U., except so far as relevant to the interpretation, disapplication or nullifying any enactment or law passed or made before exit day.<sup>1</sup> Clause 6, quoted below, provides guidance on the relationship between courts in the U.K. and the ECJ.

#### Interpretation of retained EU law

(1) A court or tribunal—

(a) is not bound by any principles laid down, or any decisions made, on or after exit day by the European Court, and

(b) cannot refer any matter to the European Court on or after exit day.

(2) A court or tribunal need not have regard to anything done on or after exit day by the European Court, another EU entity or the EU but *may do so if it considers it appropriate to do so* (emphasis added).

#### 3. Relevant Issues of Legal Uncertainty

3.1. As a consequence, where the meaning of an autonomous E.U. term or concept is defined before Exit Day, the U.K. will follow that interpretation. Where the meaning of terms, which may appear in the

incorporated *acquis* of E.U. law, is not fixed by Exit Day—or their interpretation is discussed and adjudicated upon by the ECJ post-Brexit—there remains ambiguity as to how U.K. courts should proceed. Following the publication of the Withdrawal Bill, the former President of the Supreme Court, Lord Neuberger, remarked in the media that judges would require guidance from HM Government on how U.K. courts should interpret European concepts and judgments post-Brexit.

3.2. Referring to this, members of the HLAG also highlighted the importance of interpretational equivalence between the U.K. and E.U. in preventing legal uncertainty in the context of negotiations for a future trade agreement, or in the event the U.K. applies for “equivalence” under the E.U.’s Third Country regimes, where regulatory coordination might be deemed important.

3.3. The questions before HM Government and U.K. judges (and for this Working Group to study and attempt to address) begin with a consideration of whether, and in what circumstances, U.K. courts might follow the ECJ’s judgments in so far as they settle, after Brexit, the meaning of terms in E.U. legislation previously received into U.K. law.

3.4. In the event that the U.K. courts choose not to abide by the ECJ’s interpretation, questions of legal complexity arise in relation to other aides to interpretation on which judges in the U.K. might rely. One such aide might be found, it has been suggested, in the Model Conventions and laws proposed and signed under the auspices of the United Nations. The Model Conventions are not, however, signed by a majority of E.U. Member States, which elicits further questions as to their authority and comprehensiveness.<sup>2</sup>

3.5. A final area of legal uncertainty which requires consideration is the basis for judicial interpretation in the event it is agreed that international conventions and existing aides do not provide sufficient guidance. In such a scenario, Lord Neuberger’s call on Parliament for direction becomes more relevant. The Working Group might wish to reflect upon the overarching principles which might facilitate Parliament’s determination of its guidance to judges on the interpretation of E.U. law and ECJ judgments post-Brexit.

#### 4. Working Group—Brief

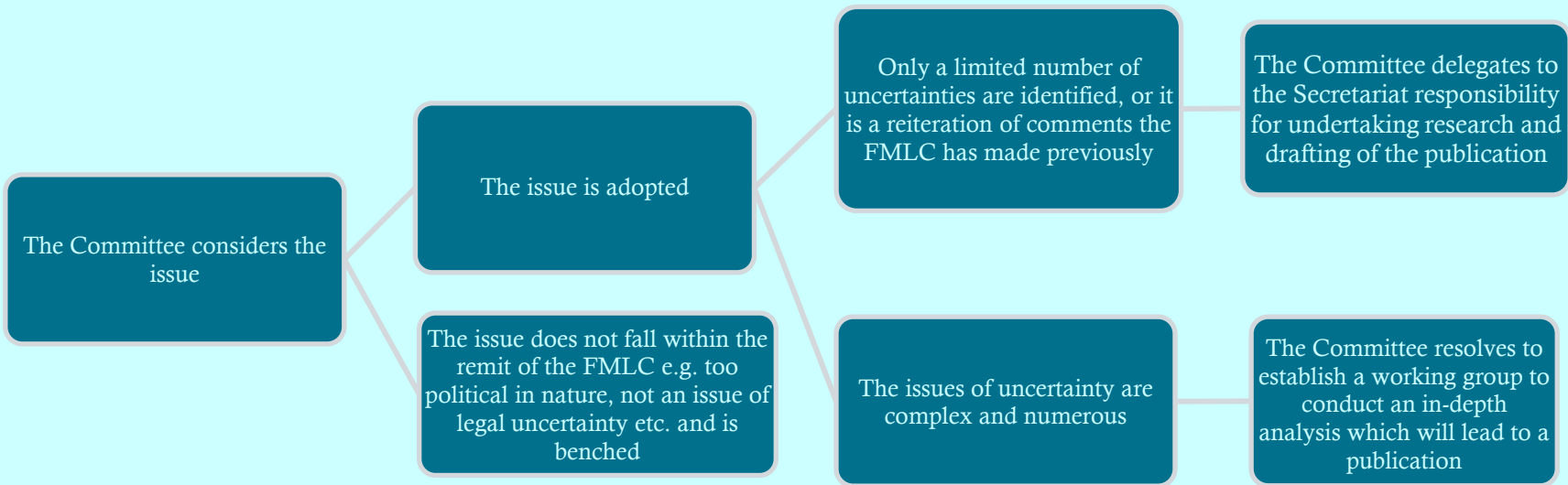
4.1. The Working Group is invited to examine in general the legal issues surrounding the judicial interpretation of autonomous legal terms post-Brexit and to document the results of their inquiry into a paper. As a guide, the paper should address the subject according to the following outline: (i) summary and introduction; (ii) legislative background; (iii) legal issue analysis; (iv) market impact or potential impact of the issue(s); (v) proposed solutions and mitigants; and (vi) conclusion.

4.2. More detail about drafting a paper for the FMLC can be found in the FMLC Contributors’ Guidelines.

<sup>1</sup> See clauses 5(1) and (2) of the Withdrawal Bill.

<sup>2</sup> The FMLC has previously considered, for instance, the efficacy of the UNCITRAL Model Law on Cross-Border Insolvency (1997) in the recognition of cross-border insolvency proceedings post-Brexit. This Working Group’s research would expand upon such work.

# The issue is presented to the Committee





# Working Group membership, conduct of business

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- Members of the relevant Scoping Fora as well as academics, experts and other FMLC stakeholders are invited to join working groups.
- Working groups are convened under Terms of Reference, including conduct of business guidelines. These include the following:
  1. participation is limited to one member per organisation;
  2. alternates are not permitted to attend meetings; and
  3. working group meetings are to be attended in person, where possible. Dial-in details are only provided to members who are permanently based abroad.

# Working Group meetings

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- Working groups typically meet between two and five times to identify relevant issues of legal uncertainty, make decisions as to any work product (i.e., a paper or a letter), and review draft contributions. Working group members volunteer to draft sections of the paper.
- The Secretariat will support the Chair and the working group during meetings and manage Group-related communications. The Secretariat will help draft and circulate meeting agenda and related documents and take minutes.
- On completion of a publication, the Working Group is likely to shut down.



# Review process and publication

- For publications drafted by the Secretariat, draft copies will be circulated to the individual(s) who raised the issue for comment and then to the Committee for their review before being finalised. In these cases, the Scoping Forum, as the Committee's pool of experts on the general area of financial services law, will be asked if they have any feedback.
- For working groups, members who committed to writing sections of a paper will send their drafts to the Secretariat, who will align it to FMLC house-style as defined in the contributors' guidelines and collate the sections into one document. Working group members will have the opportunity to comment on the draft publication before it is sent to the Committee.
- Once approved by the Committee, the publications will be uploaded to the [FMLC website](#) and circulated to relevant stakeholders and authorities.

The screenshot shows the FMLC Publications website. At the top, there is a header with the text "FMLC Publications" and a background image of a person writing. Below the header, there is a search bar with the text "Search by keyword or topic" and a button "Type and press enter". To the right of the search bar, there is a section titled "Search the FMLC archive using common tags" with a list of tags including years (2003-2017), "BENCHMARK REPORT", "BREXIT", "DIRECTORATE GENERAL INTERNAL MARKET AND SERVICES", "EMERGENCY POWERS", "EUROPEAN COMMISSION", "EUROPEAN SECURITIES AND MARKETS AUTHORITY", "FINTECH", "HM TREASURY", "ISSUE 56", "LETTER", "MAJOR OPERATIONAL DISRUPTION", "MINISTRY OF JUSTICE", "MR FAILL", "PRESENTATION", "REPORT", and "U.K. WITHDRAWAL FROM THE E.U.". Below the search bar, there is a section titled "Recent Publications" with three entries:

- **Letter to the Department for Exiting the European Union: Legal Uncertainties relating to Insurance Business: 12 July 2018**  
The FMLC has sent a letter detailing the issues of legal uncertainty which arise in relation to insurance business in the context of Brexit. The letter draws attention to the uncertainties in identifying whether and when an insurer is providing  
Brexit, Department for Exiting the European Union, establishment of an E.U. insurer in another member, Financial Conduct Authority, Insurance, Insurance Interpretive Communication 2000, Ministry of Justice, Part VII Transfers, U.K. Withdrawal from the E.U., 12 July 2018
- **Report: Establishment of an E.U. Insurer in Another Member State: 12 July 2018**  
As the U.K. and E.U. continue to negotiate their relationship in the context of the U.K.'s impending withdrawal from the E.U. ("Brexit") and as U.K. insurers with clients in the E.U. begin to plan for the possibility that no deal  
Brexit, Insurance, Insurance Interpretive Communication 2000, U.K. Withdrawal from the E.U., 12 July 2018
- **Report: Analysis of the Proposal to Amend Moratorium Powers: 13 April 2018**  
On 23 November 2016, the European Commission published a package of reforms proposing fundamental changes to E.U. legislation on bank resolution and bank capital. One proposed

# Examples of recent projects suggested by Scoping Fora



## Asset Management

- [Letter](#) to Financial Conduct Authority: Asset Management Review: February 2017

## Banking

- [Report](#): Analysis of the Proposal to Amend Moratorium Powers: April 2018

## Brexit Advisory Group

- [Letter](#) to Ministry of Justice: Clause 6 of the Withdrawal Bill: March 2018

## Finance and Technology

- [Report](#): Distributed Ledger Technology and Governing Law: March 2018

## Infrastructure

- [Report](#): EMIR: the European Commission's Legislative Proposal to Amend Procedures for recognition of Third Country Central Counterparties: July 2018

## Insurance

- [Report](#): Establishment of an E.U. Insurer in Another Member State: July 2018

## Sovereign Debt

- [Report](#): *Pari Passu* Clauses in Sovereign Debt Obligations: April 2015

# Achievements and impact



Professor Hugh Beale (University of Warwick) and Simon Firth (Linklaters LLP) gave evidence to the House of Lords E.U. Financial Affairs Sub-Committee on the topic of post-Brexit contractual continuity as an extension of work conducted by the FMLC Working Group on Brexit—Robustness of Financial Contracts.

In response to the FMLC paper exploring uncertainties as to the financial instruments that fall within the scope of MAR, the FMLC received a letter from the FCA stating that the paper was circulated to the FCA policy team who worked with ESMA to develop the MAR guidance materials. Subsequent ESMA Q&A's on MAR were updated to include questions on market soundings.

In response to the FMLC paper on issues of uncertainty arising from the European Commission's proposed directive and regulation on data protection, the FMLC was asked by the Commission to conduct further work. Subsequently, draft texts of the regulation were closely aligned with changes proposed by the FMLC.