

BREXIT: GUIDANCE FOR FUND DIRECTORS - WHAT TO KNOW AND WHAT TO ASK

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Investment Management Alert

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On June 23, 2016, the UK held a referendum in which 52 percent of voters elected to leave the European Union (EU). While there is a great deal of uncertainty about the EU withdrawal process that will remain unresolved for a considerable period, a fund's directors have duties of oversight and responsible inquiry regarding matters relating to the fund. This alert will guide fund directors of both privately and publicly offered funds organized in various jurisdictions as they assess the immediate impact of the Brexit vote and identify questions for their fund's management and service providers.

BREXIT'S IMMEDIATE IMPACT:

Directors will benefit from learning about specific industries and asset classes already affected by the Brexit vote and from asking fund management to determine whether their fund's investment strategy, liquidity characteristics, or risk management processes should be adjusted.

1. Directors of funds with an investment strategy focused on the UK may wish to actively focus on any possible negative short-term impacts on performance and other portfolio characteristics, such as illiquidity. For example, in the immediate aftermath of the Brexit vote, certain open-ended UK property funds that had invested heavily in commercial property imposed limits or suspensions on redemptions.
2. Funds with significant investment exposure in continental Europe may also find short-term impacts, particularly in industries tied to trade with the UK. Directors may wish to review their fund's investment strategy and portfolio with fund management to assess any such issues.
3. Directors may consider the possibility that a fund's disclosures to investors may need to be revised or supplemented. Certain funds have begun to make changes to their prospectus risk disclosures to highlight special risks associated with Brexit.
4. Directors may benefit from receiving updates from management as to changes in counterparty credit or risk profiles for entities with whom the fund transacts in reliance on the creditworthiness of the counterparty (e.g., derivatives counterparties). For more information on this topic, see our [previous alert](#) about Brexit's impact on asset managers that trade derivatives.
5. Directors may also inquire about currency hedging strategies, the effectiveness of such strategies, and the fund's flexibility to engage in such activity given the wide fluctuations in the market.
6. Directors may seek confirmation that valuation procedures and sources for UK-related issuers continue to be appropriate, particularly for assets that are more difficult to value and may now be less liquid.

BREXIT'S LONGER TERM IMPACT:

Although Article 50 of the Lisbon Treaty contemplates a 24-month timeline for the UK's exit, the UK may agree to exit earlier (or possibly later) depending on how negotiations progress. Information about agreements between the UK and the EU will likely become available or known prior to the UK's official exit. As a result, it is important that fund directors ensure that they have open communication lines with fund management as new developments take shape.

Special Considerations:

1. The "Big Picture" - Fund directors will benefit from receiving analysis about post-vote developments and what these suggest regarding Britain's future trade relationship with the EU and the U.S. and how this may affect the fund's strategy.
2. For funds that rely on passporting, Directors may consider the implications of the potential end of passporting and whether the fund can still provide services and rely on marketing throughout Europe in the wake of Brexit. See the [K&L Gates Brexit flowchart](#) for more information if your fund has adopted a business model based on passporting to conduct EU-wide operations.
3. The UK's legal landscape is changing. The UK may choose not to adopt or maintain EU legislation that once bound it. Directors may inquire how this will affect their fund, especially if the UK enacts laws that contradict those of the EU.

Questions Fund Directors May Ask Fund Service Providers:

1. What do you see as being the key Brexit-related risks in your business?
2. How will Brexit affect the fund's pre-Brexit contractual obligations to comply with EU law, if any?
3. To what extent does your business rely upon the use of EU passporting privileges and are these important in the context of the services you provide to the fund?
4. Do you have any EU personnel in the UK, or UK personnel in the EU, who could be affected by any restrictions on the free movement of labor post-Brexit? To what extent do you see this as a significant problem for your business?
5. What, if any, new Brexit-related tax issues might affect the fund?

By taking an active role in communications with fund management and other stakeholders and maintaining an overall familiarity with Brexit developments, fund directors can better position themselves to respond to fund needs as they arise.

BREXIT RESOURCES

For access to Brexit resources, [click here](#).

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