Although much has been uncertain since the result of the United Kingdom's referendum in June 2016, it is clear that the effects of Brexit will be felt beyond the UK and Europe. This raises potential concerns for the Cayman Islands, BVI and Bermuda, notwithstanding their full compliance with the OECD's transparency requirements.

Will Brexit have an impact on offshore financial services?

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Now that the United Kingdom has served notice to leave the European Union under Article 50 of the Lisbon Treaty, managers of offshore funds have a clearer timetable for when Brexit will happen, with the UK scheduled to leave the EU in March 2019. The terms of the UK's exit will be the subject of intense negotiations over the next two years, and are expected to be closely followed by investment managers, together with the rest of the financial services industry. Although much has been uncertain since the result of the United Kingdom's referendum in June 2016, it is clear that the effects of Brexit will be felt beyond the UK and Europe. This article discusses the potential impact that the UK's departure from the European Union (***EU***) may have on various of its Overseas Territories (such as the Cayman Islands, Bermuda and the BVI) and their financial services industries during the next two years of Brexit negotiations, and following the Brexit in 2019.

Will there be any impact on offshore jurisdictions during the Brexit negotiations?

UK Overseas Territories such as the Cayman Islands, Bermuda and the BVI are not members of the EU and for now, nothing has changed for these jurisdictions. Each has their own separate legal system and EU law does not apply directly to them. Although their status as Overseas Countries and Territories of the EU will technically change when the UK leaves the EU in 2019, we do not expect there to be any direct impact on these jurisdictions' existing legislation or stability as a result of the United Kingdom serving its Article 50 notice, during the next two years of Brexit negotiations or on Brexit.

Although Overseas Territories may not be expecting extensive direct effects of Brexit, we are monitoring potential indirect effects on these jurisdictions and their financial services industries. These may result from the UK's loss of influence over EU financial services legislation and policy now that negotiations for the UK's exit have begun, in particular in the next two years in relation to the "EU tax blacklist" and the ongoing review of third countries for the extension of passporting rights under the Alternative Investment Fund Managers Directive (***AIFMD***).

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The EU is currently in the process of creating its “common EU list of problematic tax jurisdictions” which it is expected to complete by the end of 2017, in the middle of Brexit negotiations. Blacklist exercises have traditionally focussed on tax co-operation and transparency, where the Overseas Territories continue to score very highly, and arguably higher than some EU jurisdictions. The political element is very high, however, and the lessened influence of the UK increases the likelihood that this exercise could become an attack on low tax rates. This raises potential concerns for the Cayman Islands, BVI and Bermuda, notwithstanding their full compliance with the OECD’s transparency requirements.

With the AIFMD passport, the European Securities and Markets Authority’s (***ESMA***) advice in Summer 2016 noted that there are no significant obstacles regarding competition and market disruption impeding the application of the AIFMD passport to the Cayman Islands and Bermuda, with ESMA delaying its definitive advice on both countries as they were in the process of implementing new AIFMD-like regulatory regimes and other legislative changes. ESMA has since confirmed that it is continuing its assessment of Bermuda and Cayman with a view to reaching a definitive conclusion on whether to extend the passport to these countries. As the passport is not yet available to any third country, it remains to be seen if or when the passport becomes a reality, whether it becomes a lower priority for ESMA during the Brexit negotiations and post-Brexit, and whether the national private placement regimes are simply left in place for marketing alternative investment funds, including those from the Cayman Islands, Bermuda and BVI, into Europe. Some commentators have suggested that ESMA may now delay any extension of the passport to third countries until the UK’s status post-Brexit has been settled, including whether it will enjoy any passporting rights under AIFMD and other financial services legislation.

One area where Brexit may have a direct impact, however, is on foreign policy, including economic and financial sanctions and restrictive measures. Although EU regulations are not implemented in Overseas Territories as they are outside the EU, currently the UK directly applies EU-origin sanctions to its Overseas Territories. Following Brexit, UK foreign policy can be expected over time to start to differ from the EU’s policy, including in the way it deals with countries currently subject to sanctions. How it will differ and any impact it may have on these jurisdictions remains speculation at this stage, although many are expecting the UK to ramp up its sanctions policy significantly post-Brexit.

Will offshore jurisdictions have any input into Brexit negotiations?

The UK has made it clear that it will be negotiating its exit terms from the EU and, although it is actively engaging with its Overseas Territories to understand their priorities and concerns, those offshore jurisdictions will not be directly involved in the Brexit negotiations. Since the referendum in June 2016, the Overseas Territories have been meeting regularly to discuss their priorities on Brexit, and also meeting with the UK Government to make their priorities and concerns known and taken into account. The UK Government’s recent White Paper noted that the unique relationships between the Overseas Territories and the EU will change and also that the UK Government will continue to involve these jurisdictions fully in their work, respecting their interests and engaging with them as the UK enters negotiations. Many of the Overseas Territories have also been running public consultations in their jurisdictions to understand the key concerns raised by Brexit, including for their financial services sectors given the importance of those industries in various of these jurisdictions.

What impact will there be on offshore financial services sectors post-Brexit?

As the final terms of the UK's exit deal from the EU will not be known until the end of the negotiations in 2019, the impact on financial services in the UK and any indirect impact on the financial services industries in specific Overseas Territories, also cannot be known at this stage. We expect that the relationship between the UK and its Overseas Territories and Crown Dependencies (such as Jersey and Guernsey) will not change, and that the relationship between those Overseas Territories with strong financial services sectors will remain strong following Brexit. The BVI's Premier, Dr Orlando Smith, recently reiterated the Overseas Territories' commitment to working with the UK to help achieve its goal of a "Global Britain" post-Brexit.

What post-Brexit plans are managers of offshore funds making?

Since the referendum, there has been a lot of discussion about how UK based investment managers will operate post-Brexit, although up until now many managers have been starting to review their options, while holding off putting any firm plans in place. This approach was due to the uncertainties over timing, the terms of the final exit deal and how it will actually affect financial services firms operating in and from the UK in practice. As with other business sectors, many managers are considering plans for a hard Brexit, with the UK outside the EU Single Market and EU passporting rights to operate around the EU from London no longer available, so that if a bespoke deal for financial services is negotiated by the UK Government this will be a bonus.

Now that Article 50 notice has been served, we expect that the two-year deadline ending in March 2019 will bring contingency planning by London based managers of offshore funds into more focus. A continued wait-and-see approach and flexibility are still likely to be needed however, given that the final exit terms will only be known later in the negotiation process, including whether they will include transitional arrangements to ease changes in gradually. There also remains a strong sentiment that managers will find solutions that will avoid having to move operations and staff out of London.

Although we do not expect Brexit to have much direct impact on the financial services industries in the Cayman Islands, the BVI and Bermuda, we are continuing to monitor developments closely and advise clients on how they may be affected.

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