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Group structures, rationalising legal entities and moving operations – addressing issues for asset managers and financial institutions in the context of Brexit

Brexit and passporting

Following the UK's referendum vote to leave the European Union, asset managers and financial institutions based in the UK should be considering the potential impact of Brexit on their businesses and, in particular, how they will maintain access to the Single Market in the event that Brexit results in the loss of passporting rights.

Whilst the future political and trade arrangements between the rest of the EU and the UK following Brexit remain wholly unclear, there is a significant risk of an outcome in which access to the Single Market is lost (although this would not be the case if the UK becomes an EEA Member once outside the EU).

Where access is lost, asset managers distributing UK funds under UCITS and/or AIFMD passporting arrangements, and financial institutions with a pan-European business headquartered in the UK and which rely on passporting to offer services across Europe, will need to move aspects of their business to Continental Europe to ensure continued access to passporting arrangements.

Financial institutions with branches in the UK which currently benefit from passporting in from another EEA State will need to consider how they will continue to operate in the UK post-Brexit. If they will be carrying out regulated activities in the UK post-Brexit, these groups will need to obtain the relevant regulatory permissions for the branch (if the FCA will grant these to a branch) or a new UK entity. This is also likely to require some intra-group reorganisation in order to move businesses within the group from the branch to the new UK entity and if necessary create additional UK entities.

Given the timescales involved in (i) obtaining the relevant regulatory permissions; and (ii) transferring businesses, these are issues which asset managers and financial institutions need to consider and start work on in the next three to six months.

Implementation planning

Broadly, any implementation plan will need to involve:

- identifying the preferred location to which the relevant business or functions will be transferred
- if necessary, establishing a legal entity in that jurisdiction
- applying to the relevant regulator for the relevant regulatory permissions
- due diligence on the transferring business or functions and identification of any excluded business activities
- legal documentation
- implementation of the transfer from a practical and legal perspective
- delegation of services or functions from the newly established entity back to the residual UK operation

Key steps and factors to consider in an implementation plan:-

- Preferred destination for transfer of business

  This may depend on a number of factors including:

  - location of existing operations in Continental Europe, scope of those operations and scope of existing regulatory permissions

- infrastructure, expertise and personnel in the potential locations
  - what is the current presence?
  - costs of staffing in the potential locations?
  - ease of recruiting in the potential locations?
  - availability of sufficient talented human capital in the potential location?
  - location of other similar businesses
  - technology and other infrastructure requirements such as premises
- employment protection legislation in existing and potential locations (this is particularly relevant to implementing any intragroup reorganisation and the costs thereof)
  - staff rights to transfer
  - consultation obligations?
  - cost/timing of carrying out redundancies?
  - union and collective bargaining issues
  - pensions
- operational costs in the potential locations
  - office and personnel costs?
  - local charges such as business rates?
- tax considerations of any new business structure, including analysis of corporate and VAT rates, personal taxation implications for individuals involved, availability of tax rulings and/or preferential arrangements, impact on wider group taxation arrangements and any impact on the UCITS and/or AIFs to be managed, e.g. residence or "investment manager exemption" issues
- business climate, reputation and attractiveness to foreign investment
- preferred regulator – regulation including, potentially, the approach taken by the regulator concerned to key considerations such as remuneration
- costs and timing of implementation including regulatory and tax consequences
- costs savings versus costs of implementing the reorganisation

- Application process and timing for and scope of the required regulatory permissions and regulator's approach to branches
- Whether business will be transferred or replicated or a combination of both – for example, post-Brexit, for an existing UK head quartered business if business is still carried on in the UK, it will not benefit from the passport so that appropriate permissions will need to be retained in the UK, as well as new permissions obtained within the EU
- Other potential benefits – for example, combining any restructuring with the creation of a single UCITS/AIFMD ManCo structure, rationalising group structures
- Transaction costs attaching to implementation, including from a tax perspective, staff transfer costs and impact of employment protection legislation
- Integration process and timing

- Preferred legal structure of the chosen entity
- Accounting implications

Our regulatory, tax and employment teams are able to guide you through the options.

Implementation options - legal structures for consideration

Set out below are some of the legal structures to be considered for the purposes of implementing a new corporate structure.

These structures can be used alone or in conjunction with each other to effect a group reorganisation to facilitate the required new post-Brexit operational structure.

Cross-border mergers

Until the UK actually leaves the EU, the cross-border merger process will continue to be available. This process allows two companies, each incorporated in a different EEA State, to merge, either:

- so that one of the entities ceases to exist and its business, assets, contracts, liabilities and staff transfer to the surviving entity; or
- so that both entities cease to exist and their businesses, assets, contacts, liabilities and staff transfer to a new entity.

For example, if the business of a single legal entity in the UK was to transfer completely to another entity in another EEA State, the cross-border merger could be used to effect that transfer. Alternatively, a cross-border merger could be used to effect part of a broader reorganisation with other elements (for example, using a business or asset transfer to move excluded business which will stay in the UK into another UK entity, followed by a cross-border merger or a demerger followed by a cross-border merger).

Business/Asset transfers

Asset transfers involve moving assets or certain assets of a business to another business. Business transfers involve a contractual transfer of all or part of a business from one entity to another. Staff engaged in the transferring business situated in the UK immediately before transfer will transfer automatically to the new Employer by virtue of to the Transfer of Undertakings (Protection of Employment) legislation (which is not expected to be repealed on Brexit). In principle, these transfers work on a cross-border basis.

For example, if a UK FCA regulated entity also carried on business in Germany using its passport, it could incorporate a subsidiary in Germany and use a business transfer to transfer the German business to that new entity. Or, a business/asset transfer could be used to transfer business from a UK branch of a bank incorporated and regulated in e.g. Germany, to a new UK subsidiary of that bank.

A business/asset transfer can form part of a hive down/hive up/hive across (see below).

Perfecting a business transfer can be complex and time consuming if it involves multiple contracts, particularly those where the counterparty has to consent to any assignment, or where a novation is required, as each of those counterparties would need to be approached and consent obtained either expressly or tacitly. However, given that any transfer will be within the same group it is reasonable to expect a process less complex than a transfer out of a group. Many assignment clauses in contracts permit assignments intra-group.

Hive downs and hive across transactions

These transactions involve the creation of a new legal entity and a business transfer into that new entity; the entity can then be transferred around a group if necessary.

Dividend in specie

Provided there are sufficient distributable reserves in the transferor (or the entity is unlimited), a dividend in specie or dividend in kind can be used to transfer a business or assets from a legal entity to its parent. For example, a UK entity having a parent in another EEA State could transfer non-UK business to that parent by dividending the business up to the parent. Such a transfer will need to be perfected, e.g. any land would need to be transferred using appropriate documentation complying with local legislation declaring a dividend to the parent, to be satisfied in kind by the transfer of the relevant assets/business.

Note that, if distributable reserves are not available, it may be possible to create them, for example by means of a capital reduction.

Liquidation

The business of a UK subsidiary can also be transferred to its parent pursuant to a liquidation of that subsidiary.

Demerger

Where a group carries on, in a single legal entity, a business which it intends to, in future, split across the UK and an EEA State, then a demerger is a process by which that business can be split so that it is carried out in two separate legal entities. A demerger can be effected in a number of different ways.

Three cornered demerger

This involves a UK company declaring a dividend to its parent which is satisfied by the transfer of a business (or shares in a subsidiary) to a newly incorporated company (NewCo) which has been incorporated as a subsidiary of the parent, in consideration for which the NewCo issues shares to the parent company, with both the company which declared the dividend and the NewCo becoming or being subsidiaries of the parent. So, for example, a UK financial institution carrying on business in France under the passport and which was a subsidiary of a US financial institution could dividend the French business into a French NewCo, resulting in the US entity having a UK and a French subsidiary. The laws of the relevant European jurisdiction (in this case France) will need to be observed – for example additional Formalities such as notarisations may be required.

Three cornered capital reduction

This involves a UK company reducing its capital, and instead of repaying cash to its shareholder(s) transferring the business (or shares) to be demerged to a NewCo which issues shares to those shareholder(s).

For example, in the above example the UK company would reduce its capital, and transfer the French business to the French NewCo which would issue further shares to the US parent.

Schemes of arrangement

A scheme of arrangement is a court-sanctioned arrangement between a UK company and its shareholder(s) which can be used to effect a demerger.

Section 110 liquidation scheme

This involves the liquidation of a UK company and the transfer of its assets to one or more newly formed companies (so, for example, a new UK entity and an entity incorporated in another EEA State). The liquidator accepts the shares in the NewCos as consideration for the transfer of the assets, and those shares go to the shareholder(s) of the company which is liquidated. In general, the NewCo would be created first and then the S110 Scheme implemented.

Spin-off by way of universal succession

Most continental jurisdictions allow a spin-off of a business into a new entity, resulting in the demerger of that business into that new entity, using the principle of universal succession to transfer all of the relevant assets and contracts (including staff employment contracts) by way of operation of law to the new entity. Although these forms of demerger are not available in English law, English law will recognise the concept of universal succession.

This process could be used as a pre-step to a cross-border merger into a UK entity, or the spin-off could involve an SE which could be redomiciled.

Part VII transfers under FSMA

Banking business can be transferred under Part VII of the Financial Services and Markets Act, which sets out a statutory scheme for the transfer of (i) banking business in whole or in part) carried on by an entity which is authorised to accept deposits by the FCA/PRA to another entity; or (ii) banking business carried on in the UK by an entity which is authorised by another EEA regulator to accept deposits, to a UK entity. Limb (ii) means that a Part VII transfer is especially applicable to transferring business from a branch registered in the UK to a new UK incorporated entity. It could also be used to effect a UK transfer from one entity to another as a precursor to a cross-border demerger or SE transfer. The process is court sanctioned and the court order will usually provide for a transfer of all relevant assets, contracts and liabilities, irrespective of whether there are any bars on assignment in the relevant contracts. This means the process has a significant advantage over business transfer processes.

Redomiciliation of a Societas Europaea

Although companies incorporated in the UK cannot be redomiciled (a process which is available in certain jurisdictions) a redomiciliation process is available for Societas Europaea such that the SE can move the location of its head office from one EEA State to another.

SEs or Societas Europaea are not common in the UK and it is unclear what the status of an SE with a UK head office would be post-Brexit. Any groups containing an SE registered in the UK should therefore consider redomiciliation of the SE or the implementation of one of the structures referred to above prior to Brexit.

Using and creating SE

SEs, although relatively uncommon, can also be used to effect internal reorganisations to move operations from the UK whilst it is still a EEA Member State in a number of ways:

- two SEs in different EEA Member States can be merged together (in a similar way to cross-border mergers – see above)
- an SE can be formed by (i) merging public companies from two or more EEA States; (ii) forming a holding company promoted by companies in two or more EEA States; and (iii) forming an SE subsidiary where it has at least two parents incorporated in different Member States converting a plc which has had a subsidiary in another Member State

- SE can then be converted into a public company if it has existed for two years/its first two sets of audited accounts have been approved
- redomiciliation of an SE from Member State to be UK could also be used as part of a reorganisation

Transfer of staff

Many financial institutions employ staff through service companies, meaning that staff can potentially be moved to a different office without a change of employer. There may also be scope for 'dual-hatting' where one member of staff provides services to more than one entity and has either a dual employment contract or a potential secondment in place.

Data protection

Brexit potentially creates a number of issues in relation to data protection. The first is the uncertainty as to what law will apply in the UK post-Brexit and whether the UK will adopt the more severe data protection requirements coming into force in Europe in 2015 or apply a lesser standard. Other issues include whether Brexit will create issues with transfer of data to the UK (if, as is assumed, it becomes a country outside the European Economic Area) and where multi-national companies will be regarded as having their "main establishment" for the purposes of the centralised enforcement regime coming into effect in 2018.

Whatever happens data protection is and will remain a high priority for corporate governance in the UK and Europe due to rapidly evolving regulations, and increasingly proactive regulatory investigations and enforcement actions. Our multi-disciplinary data protection team is able to offer a global solution to data protection challenges and guide you through the potential regulatory changes and resulting actions you must take to remain compliant.

How Simmons & Simmons can help

We are familiar with the potential issues which arise in deciding where and how to implement these changes, and with finding the solutions to the issues which arise in implementing new structures:

- regulation and compliance
- corporate aspects of the implementation of reorganisation structures
- employment issues including transfer of staff, redundancy and compliance with legislation
- tax impacts of the preferred structure and of the reorganisation and implementation process
- transfer of assets and contracts
- issues under AIFMD
- setting up master/feeder structures for UCITS and combining UCITS
- data protection

Further information and key contacts

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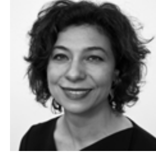

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