Brexit Law – your business, the EU and the way ahead

Brexit and financial services – welcome clarity from the UK regulators

April 2018

Executive summary

On 28 March 2018, the Bank of England (**BoE**), the Prudential Regulation Authority (**PRA**) and the Financial Conduct Authority (**FCA**) confirmed that, in light of the political agreement on transitional arrangements, it is reasonable for firms currently carrying on regulated activities in the UK by reason of passporting rights or the EU framework for central counterparties (**CCPs**), to plan on the basis that they will be able to continue undertaking these activities during the implementation period in much the same way as now.

In addition, the BoE also confirmed its approach to the authorisation and supervision of international banks, insurers and CCPs post-Brexit.

Background

Transitional arrangements

At an EU Council summit on 23 March 2018, the EU27 leaders endorsed a 21‑month transition period between March 2019 and the end of 2020 and adopted the negotiating guidelines on the future EU-UK relationship. The terms of the transition agreement mean that the UK will no longer be an EU Member State from 23 March 2019 but will continue to be treated as if it (broadly) were until the end of the transition period on 31 December 2020. Our [bulletin](http://www.allenovery.com/Brexit-Law/brexit-law-the-way-ahead-macro/Documents/Brexit__The_proposed_transitional_arrangements_-_do_they_provide_certainty_.PDF) summarises the key terms of the transitional arrangements, but the intention is for EU law to continue to apply to the UK during the period and for it to have the same legal effect as it does within EU Member States. The UK would cease to have voting rights and/or the ability to participate in EU institutions as of March 2019, although it would have some limited rights of consultation in relation to new European legislation.

In relation to financial services, this would mean that firms would continue to benefit from passporting between the UK and EEA during the implementation period. Obligations derived from EU law would continue to apply and firms must continue with implementation plans for EU legislation that is still to come into effect before the end of December 2020. Consumer rights and protections derived from EU law would also continue to apply.

Whilst the EU27 Member Sates have endorsed the proposals, the terms will not become legally binding until the entire draft Withdrawal Agreement has been finalised and ratified by the European Parliament, the EU Council and the UK. Both the UK government and the European Commission negotiators are working towards finalising the terms of the draft Withdrawal Agreement by October 2018 and the process must be completed by 29 March 2019. Accordingly, even if the text is agreed at a political level by October 2018, the process of ratification could take several months, which means that legal certainty on transitional arrangements is unlikely before the end of 2018.

UK regulatory approach to preparations for EU withdrawal

On 20 December 2017, HM Treasury (**HMT**) and the UK authorities made a number of statements and published supporting documents setting out their proposed post-Brexit framework for financial services authorisation and supervision. The coordination was clearly intended to demonstrate to the EU and beyond the UK’s commitment to maintaining stability, certainty and transparency for international banks, insurers and CCPs operating in the UK.

In addition to the UK government confirming that it will ensure there is a legislative framework to minimise the potential for any cliff-edge at Brexit, the UK regulatory authorities announced that they were proactively revising their policies to reflect the implications of the likely loss of passporting for relevant firms and, in the context of branch authorisation and supervision, broadly reflecting the current approach to supervision of third country banks.

The proposed transitional arrangements – how have the UK regulators reacted?

The BoE’s confirmed approach

On 28 March 2018, the BoE [confirmed](https://www.bankofengland.co.uk/news/2018/march/update-on-the-regulatory-approach-to-preparations-for-eu-withdrawal?utm_source=Bank+of+England+updates&utm_campaign=1e9517753e-EMAIL_CAMPAIGN_2018_03_28&utm_medium=email&utm_term=0_556dbefcdc-1e9517753e-113455049) that, in light of the political agreement on transitional arrangements, it is “reasonable for firms currently carrying on regulated activities in the UK by means of passporting rights, or the EU framework for central counterparties, to plan that they will be able to continue undertaking these activities during the implementation period in much the same way as now”.

Given the scale of the authorisation challenge with only a year to go, the BoE has [written](https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2018/firms-preparations-for-the-uk-withdrawal-from-the-eu-update-march-2018.pdf?la=en&hash=FD310274EDB28E2A0440228F3DD928E4BB725457) to impacted firms to make clear that they may plan on the assumption that UK authorisation and recognition will only be needed by the end of the implementation period. The PRA has confirmed that it will continue to work closely with firms and will provide guidance on the timing of their applications in the light of firms’ individual circumstances, in the context of any relevant developments in the political process, and with a view to making the process run as smoothly as possible.

In relation to non-UK CCPs, the BoE’s [letter](https://www.bankofengland.co.uk/-/media/boe/files/letter/2018/ccps-preparation-for-the-uk-withdrawal-from-the-eu-update-march-2018.pdf?la=en&hash=E3B138932B00125C93C149D6A9321AC31FE9DF3F) confirmed that non-UK CCPs may plan on the assumption that recognition by the BoE will only be needed by the end of the implementation period. These CCPs are encouraged to continue engaging with the BoE on the recognition process but also to consider how best to make use of the additional time provided by the implementation period in their planning.

Given the political uncertainty that remains in relation to the successful progress of the UK-EU27 negotiations and the likelihood that the article 50 withdrawal agreement may not be ratified prior to March 2019, it is helpful to note that the BoE refers to the Government’s commitment to bring forward legislation to create a temporary permission regime and confirms that that would be used as the back-stop should one be needed.

The FCA’s confirmed approach

The FCA [confirmed](https://www.fca.org.uk/news/statements/fca-statement-eu-withdrawal-following-march-european-council) that firms and funds would continue to benefit from passporting between the UK and EEA during the implementation period and that, in light of the UK Government’s commitment to providing for a temporary permission regime as a backstop, firms and funds would not need to apply for authorisation at this stage. Subject to the Government’s legislation setting up the regime, the FCA’s expectation is that firms and funds that will be solo-regulated by the FCA will need to notify it of their desire to benefit from the regime. Notification will not require submission of an application for authorisation and the FCA will set out further details on these proposals later in the year. On 9 March 2018, the FCA launched a [survey](https://www.fca.org.uk/eu-withdrawal/survey-eea-inbound-passported-firms) to collect information from EEA firms and funds who would like to participate in the regime, and the FCA have encouraged firms to complete this.

The FCA also confirmed that it continues to work with HM Treasury and the BoE/PRA to ensure the UK’s legal and regulatory framework functions on EU withdrawal in any scenario. This includes ensuring that the FCA Handbook functions effectively following the end of the transitional period. The regulator plans to set out further details in due course.

International banks and insurers: the PRA’s approach to UK branch authorisation and supervision

International banks

In addition to the announcements regarding the transitional arrangements, and following the December 2017 consultation, the PRA has published Policy Statements [3/18](https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2018/ps318.pdf?la=en&hash=E83AC495359333506CF4AC036784D793CEC06888) and Supervisory Statement [1/18](https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2018/ss118.pdf?la=en&hash=84C0A0ECDD64B6C75C96A3C368F6EE05086274E3). The PRA confirmed that it has not made any material changes to the proposals as set out in [CP29/17](https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2017/cp2917.pdf?la=en&hash=A9AA5B71CDC39F1EBEAEA1A989B14C38B50734A7). The regulator has made a number of minor amendments to the draft supervisory statement in light of the feedback received to add further clarity. These clarifications are explained below but it is worth noting that because the PRA views these as insignificant, it has not updated the cost benefit analysis from CP 29/17.

Supervisory Statement 1/18 will expand on the PRA’s [approach](https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/banking-approach-2016.pdf?la=en&hash=67655137353DEB7FFF88F5726EE81FE2F8B750F7) to banking supervision and will replace SS10/4 ‘Supervising international banks: the PRA’s approach to supervision’.

Approach to significant retail activities

The PRA has reiterated that its underlying policy on retail bank branching into the UK from third countries remains substantially unchanged from SS10/14. In relation to the number of customers, SS1/18 now clarifies that the indicative number of customer accounts taken into consideration as a maximum level for branch retail activity is that number used for transactional purposes. The starting point for a ‘transactional account’ is one from which withdrawals have been made nine or more times within a three‑month period, but the PRA may additionally consider other factors. The PRA will continue to take a pragmatic, judgement-based view as to whether the accounts are transactional in practice.

Some respondents sought clarification on the scope of FSCS coverage as regards the GBP500 million total potential liability. The PRA confirmed that the GBP500m potential FSCS liability relates to covered deposits as defined in the Depositor Protection Part of the PRA Rulebook and that this clarification has been added at paragraph 4.5 of SS /18.

Equivalence of the home state supervisor’s (HSS) regulatory regime / Supervisory cooperation

In response to queries, the PRA has not significantly changed the supervisory statement, but has simply confirmed in PS 3/18 that the starting point for the PRA’s authorisation of a branch in the UK is the equivalence of the HSS regulatory regime to the UK regulatory framework, and the level of supervisory cooperation with the HSS. These are based on international standards and supplemented with other sources as necessary, as well as the PRA’s own experiences of its interactions with HSS in order to deliver appropriate outcomes that meet the PRA’s objectives. SS1/18 states that the PRA will consider the nature of the firm’s UK activities and its systemic importance to the UK economy when determining whether the HSS regime is of sufficient equivalence. It goes on to confirm that the frequency of review is determined by the number, size and systemic importance of the firms. The fact that the PRA authorises one firm from a particular home state to operate in the UK as a branch will not automatically mean that it will be prepared to authorise other firms from that home state to operate as branches in the UK. The more systemically important a third country branch is to the UK, the stronger the supervisory cooperation will need to be.

Approach to systemic wholesale branches

As part of the consultation process, there were a number of responses questioning the triggering criteria for a systemic branch. For example, respondents questioned how the PRA would calculate the GBP15 billion of total gross assets as a threshold trigger for systemic status, including how the PRA will take into account firms’ booking arrangements. The PRA stated that the GBP15bn metric is a starting point; it is not an automatic threshold. This number is an indicative guide to the PRA’s approach to a firm, while the final decision will be based on the PRA’s overall judgement of the firm on a case-by-case basis. The PRA will take all relevant assets into account for the purpose of the GBP15bn metric, including intragroup assets and assets originated by the branch but booked outside the UK. As a starting point the PRA will assess this by looking at the information provided at the time of authorisation or reported by the firm in the Branch Return.

SS1/18 now also provides greater clarity on the timing and process for a branch becoming subject to additional requirements or being required to subsidiarise.

Assurance over the resolution arrangements

In response to requests for clarity on how SS1/18 would affect third country branch resolution, the PRA reiterated that the BoE has set out its approach to resolution in ‘The Bank of England’s Approach to Resolution’ and that approach is unaffected by PS 3/18 and SS 1/18 on branching policy. In addition, following queries regarding whether the potential branch subsidiarisation would automatically lead to a multiple point of entry approach to resolution – the PRA confirmed that the approach to resolution would continue to be assessed on a case-by-case basis.

Other responses - scope

The scope of firms for which SS1/18 is relevant has been amended to clarify that SS1/18 is relevant to all PRA-authorised banks and designated investment firms not incorporated in the UK *which form part of a non-UK headquartered group and which are* operating in the UK through a branch, as well as any such firm looking to apply for PRA authorisation *in the future*.

Application

The new approach comes into effect from 29 March 2018. For EEA firms currently branching into the UK under ‘passporting’ arrangements and intending to apply for PRA authorisation in order to continue operating in the UK after the UK’s withdrawal from the EU, this approach will be relevant to authorisations for this purpose.

The PRA also states that, on the basis of existing business and structures and the current degree of supervisability, it does not expect the new approach to affect any of the non-EEA international banks currently authorised to operate in the UK through branches.

International insurers

Following the December 2017 consultation, the PRA has published Policy Statement 4/18 (**PS4/18**) and Supervisory Statement 2/18 (**SS2/18**) on the PRA’s approach to branch authorisation and supervision for international insurers. Based on the responses received as part of the consultation process, the PRA has made one material change and, for the purposes of clarity, a few minor amendments, to the draft supervisory statement. The change and the clarifications are explained below. It is worth noting that Supervisory Statement 44/15 ‘Solvency II: third country insurance and reinsurance branches’ continues to apply.

Approach to FSCS-protected liabilities threshold

As part of the consultation process, some respondents proposed that the level of FSCS-protected liabilities threshold should be increased from the proposed GBP200 million to GBP500m to align the threshold level with the PRA’s approach in banking branch policy. While the PRA did not consider a direct comparison with banking branch policy to be appropriate, the regulator has increased the threshold to GBP500m, taking into account the capacity in the insurance industry to absorb levies and the potential impact on the firms. The PRA has reiterated that the level of FSCS-protected liabilities is a strong indicator of the impact of the failure of a branch to both policyholders and the FSCS levy payers.

Most respondents asked for clarity on the PRA’s definition of ‘FSCS-protected liabilities’. The PRA has now clarified that ‘FSCS-protected liabilities’ means an estimate of the aggregate gross amount of liabilities calculated by reference to protected contracts of insurance of policyholders who are eligible for FSCS protection (i.e. eligible claimants). Paragraph 2.7 of SS2/18 sets out further clarifications on the calculation of the threshold.

In response to queries as to how the PRA proposed to assess the amount of FSCS-protected liabilities, the PRA has emphasised this would involve consideration of a range of factors, including the medium-term strategy, business plan and forecasts of the branch business.

The PRA has clarified that while the threshold applies to all third country branches, it may be possible for the level of FSCS-protected liabilities for pure reinsurance branches to be zero.

Other responses

Some respondents also queried whether the PRA would agree to a time period to allow firms to restructure and subsidiarise in cases where the PRA concluded that operating through a subsidiary was more appropriate than operating through a branch. The PRA has acknowledged the need for firms to plan and prepare and has confirmed that it will consider with firms a reasonable time period to restructure. In agreeing a time period, the PRA will take into account the operational steps involved and the risks to the PRA’s approach.

Some respondents asked for additional clarity on the impact of the UK leaving the EU. The PRA has confirmed that the policy will be kept under review to assess if any changes would be required due to changes in the UK financial system and regulatory framework, including those arising once new arrangements with the EU take effect.

Application

The new approach came into effect on 29 March 2018. For EEA firms currently branching into the UK under ‘passporting’ arrangements and intending to apply for the PRA authorisation in order to continue operating in the UK after the UK’s withdrawal from the EU, this approach will be relevant to authorisations for this purpose. The regulator has further confirmed that the new SS2/18 does not apply to Swiss General Insurers, as defined in the PRA Rulebook, to which different requirements apply pursuant to the Swiss Treaty Agreement (No. 91/370/EEC).

Practical impact

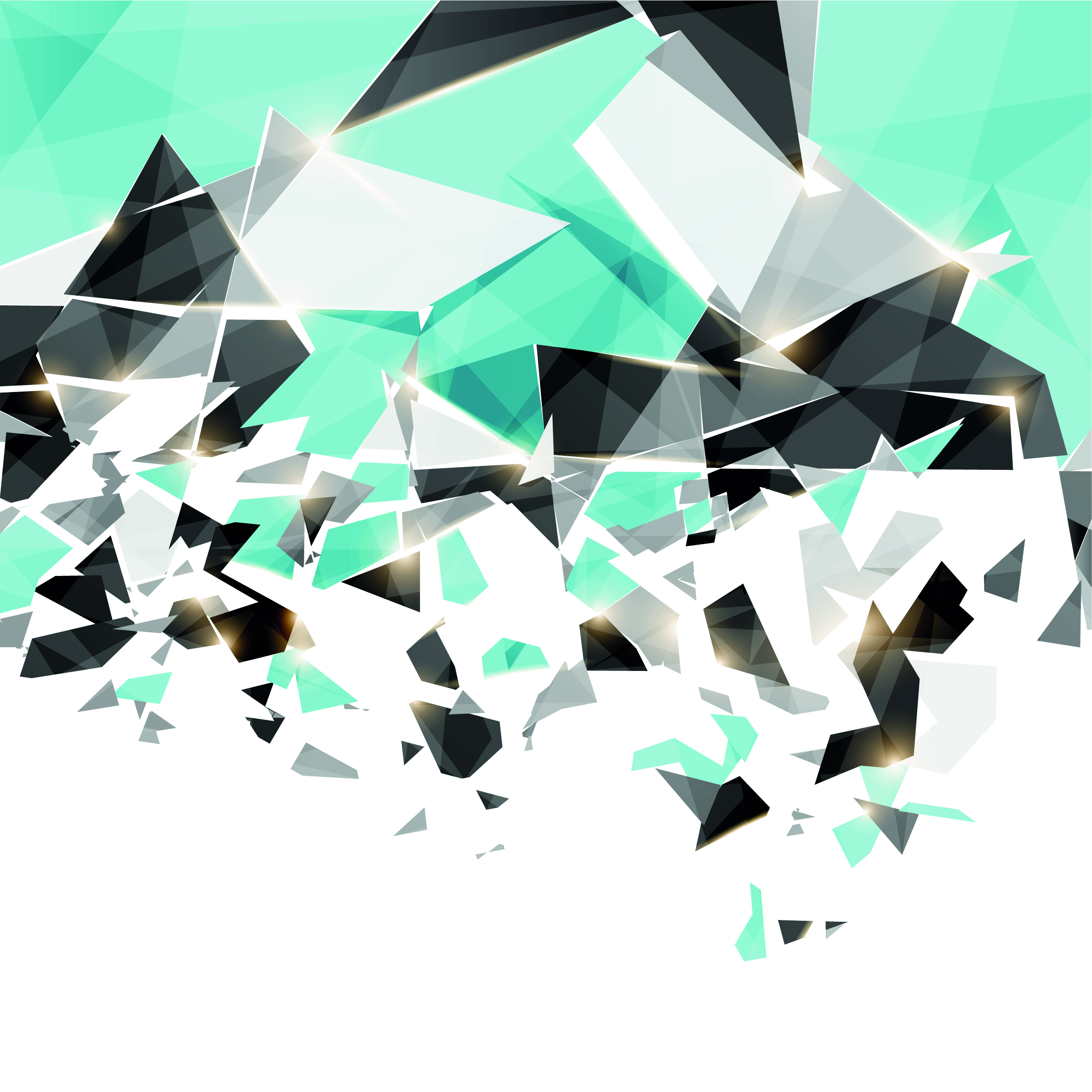
Whilst the UK regulator’s announcements are helpful, it is only one side of the story. Given the on-going political uncertainty and the fact that the transitional arrangements are unlikely to be legally binding until the end of 2018, firms have only been provided with certainty as regards the approach of the UK regulators – if political agreement fails to be ratified, the UK authorities will use the temporary permissions regime to maintain the status quo, at least immediately following a ‘hard’ Brexit. The European authorities have not provided this comfort and clearly expect firms to continue with their contingency plans.

Immediately following the political announcement regarding the terms of the transitional arrangement, the Eurozone’s top financial services supervisors told banks to keep planning for Brexit without any transition arrangements on the basis that the agreed arrangements are not legally binding and may yet be vulnerable to political risk. On 26 March, the ECB published a [speech](https://www.bankingsupervision.europa.eu/press/speeches/date/2018/html/ssm.sp180326.en.html) on its supervisory priorities and annual report for 2017 supervisory activities. In relation to Brexit, the ECB stated that “banks wishing to relocate to, or expand activities in, the euro area, and needing authorisation post-Brexit, need to submit applications to the ECB and NCAs by the second quarter of 2018 at the latest”.

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If you would like to discuss the issues raised in this paper in more detail, please contact any of the experts   
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