ALLEN & OVERY

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

The proposed UK regime for inbound financial services firms post a hard Brexit

November 2019

1. Introduction

1.1 On 29 October 2019, the UK and EU27 agreed that the two year time line set out in Article 50 of the Treaty on European Union (**TEU**) should be further extended and exit day postponed from 31 October 2019. The revised exit day for the UK to leave the European Union (**EU**) is now 11pm on 31 January 2020 (**exit day**), although this will be modified if the UK Parliament approves the current draft Article 50 Withdrawal Agreement that has been negotiated between the UK and the EU27 before that date, in which case the Exit Day will be 1 December or 1 January.

1.2 This article considers the temporary permissions regime that the UK has put in place to enable inbound passported firms and investment funds to continue their activities in the UK for a limited period in circumstances where the UK leaves the EU without the Article 50 withdrawal agreement and proposed transitional period having been ratified (a **hard Brexit**). We also look at the transitional relief that will apply in respect of the so-called 'contractual continuity' issues associated with the loss of passporting rights by firms at the point of Brexit as well the UK's overseas person exclusions that enables firms to carry on certain regulated activities in the UK on a cross-border basis without requiring authorisation and will continue to be available to firms post a hard Brexit.

2. Background

2.1 If the UK leaves the EU without a deal or any transitional arrangements, reciprocal market access will no longer be available through the passporting arrangements between the EU and UK for firms and investment funds. The UK will become a 'third-country' and EEA-based firms might need to seek authorisation in the UK to continue to access the UK market and EEA-domiciled investment funds would need to seek recognition in the UK to continue to be marketed here.

2.2 In December 2017, the UK Government confirmed it would bring forward legislation to set up a temporary permissions regime (**TPR**) for inbound passported firms and investment funds to enable them to continue their activities in the UK for a limited period after Brexit. The aim of the TPR is to reduce the risk of harm associated with an abrupt loss of permission by enabling firms that passport into the UK to undertake new business that falls within the scope of their existing permissions, continue to perform their contractual rights and obligations and manage existing business. The proposals also allow relevant EEA-domiciled investment funds to continue to be marketed in the UK to new and existing investors. Other types of entity – for example, trade repositories, are outside the scope of this TPR, as they do not use the same means to access the UK market.

The legislative framework required to implement Brexit

2.3 As part of its Brexit preparations, the UK Parliament passed the European Union (Withdrawal) Act 2018 (**EUWA**)[1]. The EUWA will repeal the European Communities Act 1972 (**ECA**) on exit day (unless a deal or further extension is agreed), preserve existing UK laws which implement EU obligations and convert existing directly applicable EU law at the point of exit into UK law. It has given ministers powers to make secondary legislation amending this body of law to ensure it functions effectively when the UK leaves the EU.

2.4 It is worth noting that because the EUWA operates on the assumption that the UK will leave the EU on exit day, if a transitional arrangement is ratified extending the time that EU law applies in the UK to the end of 2020 (possibly beyond), a new Act of Parliament will be required to provide for changes to the EUWA to save the effect of the ECA during that period.

2.5 Once the EUWA received Royal Assent at the end of June 2018, HM Treasury (**HMT**) commenced work on the secondary legislation required to ensure the UK continues to have a functioning financial services regulatory regime in the event of a 'hard' Brexit where no transitional period is ratified. This has included the publication of the statutory legislation creating the TPRs for the following types of firms:

a) Treaty firms and EEA firms which passport (whether on an establishment or services basis) into the UK under the Financial Services and Markets Act 2000 (**FSMA**), including those types of firms who also have top-up permissions (**TP firms**) – the "EEA Passporting Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018[2]" statutory instrument (**TPR SI**) was approved by Parliament in November 2018;

b) EEA electronic money institutions (**EMIs**), EEA payment institutions (**PIs**) and EEA registered account information service providers (**RAISPs**) – the "Payments and Electronic Money (Amendment) (EU Exit) Regulations[3] "SI was approved by Parliament in November 2018; and

c) Managers of EEA-domiciled UCITS and AIFs that market those funds in the UK (**TP marketing fund managers**) – the EU Exit SIs[4] for investment funds and their managers (**TPR Fund Regulations**) were approved by Parliament in February 2019.

The UK Regulators' approach to the TPR

2.6 Whilst the TPR SIs include provisions to make the required changes to the UK's legal and regulatory framework, the question of how the regulators' rulebooks will apply to firms in the TPR has been left for the regulators to devise and articulate.

[1] The European Union (Withdrawal) Act 2018: http://www.legislation.gov.uk/ukpga/2018/16/pdfs/ukpga_20180016_en.pdf
[2] The EEA Passporting Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018: https://www.legislation.gov.uk/uksi/2018/1149/pdfs/uksi_20181149_en.pdf
[3] The Payments and Electronic Money (Amendment) (EU Exit) Regulations: http://www.legislation.gov.uk/uksi/2018/1201/pdfs/uksi_20181201_en.pdf
[4] The Alternative Investment Fund Managers (Amendment) (EU Exit) Regulations 2019: http://www.legislation.gov.uk/uksi/2019/328/pdfs/uksi_20190328_en.pdf and the Collective Investment Schemes (Amendment) (EU Exit) regulations 2019: http://www.legislation.gov.uk/uksi/2019/325/pdfs/uksi_20190325_en.pdf

2.7 In October 2018, the UK Parliament approved a SI[5] under the EUWA which gives the Financial Conduct Authority (**FCA**), the Prudential Regulation Authority (**PRA**), the Bank of England (**BoE**) and the Payment Systems Regulator (**PSR**) responsibility for amending and maintaining EU-derived provisions in their rules and existing EU Binding Technical Standards (i.e. Level 2 regulatory technical standards and implementing technical standards) (**BTS**) which will be incorporated into UK law by the EUWA, so that they function effectively after exit day. The regulators' powers are subject to the constraints in the EUWA – they are limited to addressing deficiencies and dealing with any failure of UK law to operate effectively after exit, and the power is time-limited.

2.8 On 10 October 2018, the FCA published the first two consultation papers required to ensure their rules would operate effectively on a hard Brexit. The first – **CP18/29**[6] – looked at how firms and funds can enter the TPR, how long each will operate for and the regulatory rule-set that will apply to firms and funds marketing activities during that time. The second – **CP18/28**[7] – considered the changes required to the Handbook and BTS in order to reflect the secondary legislation made under the EUWA as it is published. Firms and funds availing themselves of the TPR were told to have regard to the proposed changes being made under that paper. The consultations ran until 7 December 2018 and in February 2019, the FCA published a policy statement (**PS19/5**[8]) which (amongst other things) set out its near final proposals on the changes consulted on under CP18/28 and CP18/29. On 29 March and 18 April 2019, the FCA published its final rules for firms which are unchanged from the near-final versions except for minor amendments, including updating references to statutory instruments. The regulator has subsequently published an additional consultation paper in September looking at further minor and consequential changes arising from the second extension.

2.9 On 25 October 2018, the PRA published two consultation papers (**CP25/18**[9] and **CP26/18**[10]) which covered, among other things, the PRA's approach to banks and insurance companies in the TPR. The PRA's approach to the regulatory ruleset for the TPRs differed in a number of respects from that of the FCA. The PRA proposed taking a tougher line in imposing the requirements applicable to third country firms on TPR firms, subject to relatively limited transitional relief. In February 2019, the PRA published a policy statement (**PS5/19**[11]) jointly with the Bank of England (**BoE**) which (amongst other things) set out near final proposals in relation to the changes consulted on in CP25/18 and CP 26/16. On 18 April 2018, the BoE and PRA published final policy materials including EU Exit Instruments, Supervisory Statements and a Statement of Policy. These generally have the effective date of 'exit day' – namely, 11pm on 31 October 2019. The BoE and PRA confirmed that they had not changed the policy or significantly altered the text of the published materials since their publication as 'near-final' back in February. On 25 July 2019, the BoE and PRA published CP18/19[12] which looks at further minor amendments to financial services legislation (specifically the EU Exit Instruments published in April) following the extension of the Brexit deadline to 31 October.

Temporary transitional tool

2.10 On 8 October 2018, HMT confirmed it would bring forward legislation to allow regulators to grant some flexibility in applying new requirements under the EUWA. The temporary transitional powers (**TTP**) are set out in Part 7 of the Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019[13], which was approved by the UK Parliament in February 2019. The aim of the powers is to support firms adjusting to new regulatory requirements arising from Brexit if the UK leaves the EU without a transition period in place. The TTP

[5] The Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 : http://www.legislation.gov.uk/uksi/2018/1115/pdfs/uksi_20181115_en.pdf

[6] FCA Consultation Paper 18/29: Temporary permissions regime for inbound firms and funds: https://www.fca.org.uk/publication/consultation/cp18-29.pdf

[7] FCA Consultation Paper 18/28: First Brexit consultation: https://www.fca.org.uk/publication/consultation/cp18-28.pdf

[8] FCA Policy Statement 19/05 – Brexit policy statement: https://www.fca.org.uk/publication/policy/ps19-05.pdf

[9] The PRA's consultation paper CP25/18: https://www.bankofengland.co.uk/-/media/boe/files/paper/2018/cp2518

[10] The PRA's consultation paper CP26/18:https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp2618-complete

[11] The PRA and BoE's joint policy statement PS5/19: https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018.pdf?la=en&hash=1B26AA88A7DCA56C731498A74DB2B688EC79CD58

[12] PRA/BoE CP 18/19: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2019/cp1819-complete.pdf

[13] The Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019: http://www.legislation.gov.uk/uksi/2019/632/pdfs/uksi_20190632_en.pdf

will allow the regulators to delay, or phase in, regulatory requirements where they change as a result of Brexit or where they apply to firms for the first time. Firms will not need to apply for transitional relief to benefit from it. Instead, the regulators will issue transitional directions setting out the terms of the proposed transitional relief.

2.11 In February 2019, the FCA published a statement[14] about their general approach to using the TTP plus two near-final draft transitional directions – these were subsequently superseded in March and then again in September:

a) **FCA transitional direction**[15] – This was accompanied by *Annex A* (application of the "standstill" in the transitional direction to amendments made in statutory instruments and exit instruments amending technical standards) and *Annex B* (application of the standstill in the transitional direction to amendments made in the FCA Handbook).

b) **FCA prudential transitional direction**[16] – This includes Annex 1, which comprises section A (application of the prudential standstill direction to amendments made in statutory instruments and exit instruments amending BTS) and section B (application of the direction to amendments made in the FCA Handbook).

2.12 The directions are intended to provide transitional relief in a number of areas, postponing the application of onshoring changes to firms' obligations. They will deliver a standstill for firms, which will continue to be subject to pre-exit requirements for a period of 14 months – in July the regulator confirmed this would be until 31 December 2020 although this may now be extended to reflect the further extension of Article 50. At the end of this period, all onshoring changes (that is, amendments to rules and legislation made using powers under the EUWA) will apply. However, as outlined in the 1 February 2019 statement, there are certain areas where the FCA does not consider it consistent with their statutory objectives to grant transitional relief. PS19/5 built upon this statement and areas where the regulator expects firms and other regulated entities to begin preparing to comply with Brexit-related changes to UK regulatory obligations include MiFID II transaction reporting, EMIR reporting obligations and contractual recognition of bail-in.

2.13 In February 2019, the BoE also published the following near-final directions made by it and the PRA using the TTP:

a) PRA direction[17], together with general guidance; and

b) BoE direction[18], together with general guidance.

2.14 The directions are intended to provide transitional relief in a number of areas, postponing the application of onshoring changes to firms' obligations. They will deliver a standstill for firms, which will continue to be subject to pre-exit requirements for a period of 15 months until 30 June 2020. At the end of this period, all onshoring changes will apply. The directions contain a list of areas that are excepted (for example, contractual recognition of bail-in rules, stay in resolution rules and Financial Services Compensation Scheme (**FSCS**) rules, obligations relating to the securitisation regulation) from the general transitional provision, as well as a number of specific transitional provisions. The final directions will apply without firms needing to take any action to benefit from the transitional relief. The PRA and BoE's approach to the use of TTP (including in relation to TP firms) is discussed further in the February 2019 version of PS5/19. For TP firms, the PRA will only use its TTP to grant transitional relief in certain limited areas, for example, in relation to remuneration rules where they go beyond CRDIV requirements.

2.15 On 18 April 2019, the BoE and PRA confirmed that they would not be publishing final versions of the BoE and PRA transitional directions and transitional guidance materials published as 'near-final' in Section A of the

[14] FCA Statement of 1 February 2019 on how they will use the TTP: https://www.fca.org.uk/news/statements/brexit-what-we-expect-firms-now#annex
[15] FCA transitional direction: https://www.fca.org.uk/publication/handbook/draft-transitional-direction.pdf
[16] FCA prudential transitional direction: https://www.fca.org.uk/publication/handbook/draft-prudential-transitional-direction.pdf
[17] PRA direction: https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/ps519-section-a-app1.pdf
[18] BoE direction: https://www.bankofengland.co.uk/-/media/boe/files/paper/2019/ps519-section-a-app7.pdf

February 2019 version of PS5/19. In light of the second extension, the BoE and PRA indicated that they would consider whether to make any changes and would publish further information on this in due course.

2.16 On 25 July 2019, the BoE and PRA published CP18/19 which confirmed that in line with the approach adopted by the FCA, the duration of the directions would be extended out to 31 December 2020 if the UK leaves the EU on 31 October 2019 without a deal. CP18/19 also highlighted a number of clarifications and updates that the Bank and PRA intend to make for the final directions compared to the near-final versions published on 28 February 2019. In light of the further extension to Article 50, it is expected that the date may be revised again.

In-flight legislation

2.17 The UK government had intended to legislate to clarify the status of "in-flight" EU financial services legislation. For these purposes, "in-flight" legislation referred to:

a) EU legislative measures that had been adopted by the EU, but did not yet apply and so did not fall within the scope of the EUWA; and

b) Legislative proposals that were currently in negotiation and may be adopted up to two years post EU-exit.

2.18 The Financial Services (Implementation of Legislation) Bill stalled during its Parliamentary process and then fell when Parliament was prorogued on 8 October 2019. To the extent hard Brexit takes place on 31 January 2020, a new bill would have to be introduced into Parliament to ensure (for example) that elements of the EU risk reduction package (including under CRDV) are brought into the UK statute book as they will not be onshored under the EUWA.

3. Overview of how the TPR will operate

3.1 Firms have been required to ensure that they notify the relevant regulator of their intention to enter the TPR. The PRA is the lead regulator for EEA credit institutions, significant investment firms and insurers and therefore these types of firms have been required to contact it. The FCA is, however, the lead regulator for conduct matters for these firms (hence they are known as dual regulated) and therefore the materials that it produces on the TPR will also be important. There is one important exception to this in respect of EEA credit institutions that do not accept deposits in the UK; such firms will need to approach the FCA. All other incoming EEA firms have been required to notify the FCA.

3.2 The FCA's CP18/29 and PS19/5 built on the information that the FCA first released on its webpage back in July 2018 in relation to the notification process. Namely:

a) firms need to notify the FCA that they intend to use the TPR via the online process using the Connect system which opened in early 2019. On 7 January 2019, the FCA issued a press release confirming that the notification window was open as well as providing further details on how the notification process would operate.

b) the notification window will close on 30 January 2020 – this deadline was extended for a fourth time once there was political agreement to further extend the article 50 time line. Once the notification window closes, firms that did not submit a notification will not be able to use the TPR and fund managers who have not submitted a notification for a fund will not be able to market it in the UK after exit day via the TPR. Details of firms with temporary permission and details of EU domiciled UCITs funds with temporary permissions to be marketed in the UK will be shown on the FS Register;

c) firms will be allocated a three-month application period (a 'landing slot') within which they will need to submit their application for UK authorisation. Landing slots will be allocated based on the type of business undertaken and will be confirmed by the FCA after exit day. The first landing slot was originally planned to be October to December 2019 and the last to be January to March 2021 – this timing will need to be revised as a result of the extension to the Article 50 time line. Firms will not be invited to express a preference for a particular landing slot;

d) firms with top-up permissions will need to submit a Variation of Permissions (VoP) application rather than an authorisation application; and

e) if firms no longer wish to continue business in the UK they will be able to apply to cancel their temporary permission once they have ceased all UK business.

3.3 In relation to incoming EEA credit institutions and incoming EEA insurers, firms needed to notify the PRA that they intend to use the TPR. Whilst the PRA extended the notification window from 28 March to 11 April following the first extension to the Article 50 time line, on 11 April the regulator confirmed that it would not be extending the window further to take account of any revised time line.

4. The FCA's general approach in applying the rule-set to TP firms

4.1 In CP18/29 the FCA explained that it had considered a number of factors when determining what rules should apply to TP firms, including consumer protection, the ability for TP firms to comply with the rules from exit day, the nature of the regime as well as how they intend to supervise TP firms and the time and resources available ahead of exit day. In PS19/5 the FCA confirmed that it would proceed with the proposals broadly as consulted on.

4.2 A number of alternative approaches were considered, including either applying all rules to TP firms which apply to current third-country firms or applying no additional rules to TP firms other than those which currently apply to incoming passporting or Treaty firms. On balance, however, the FCA has confirmed that their proposed approach is to require firms that are in the TPR to comply, in respect of their UK business, with:

a) all FCA rules which currently apply to them;

b) all FCA rules which implement a requirement of an EU directive which are currently reserved to the TP firm's home state and which therefore the FCA do not currently apply to EEA firms (i.e. home state rules) – it is particularly welcome to note that the FCA intends to accept 'substituted compliance' in respect of these rules. If firms can demonstrate they continue to comply with the equivalent home state rules in respect of their UK business (including where this is on a voluntary basis if the relevant rules cease to cover UK business) they will be deemed to comply with the FCA rules;

c) certain additional FCA rules which the FCA believes are necessary to provide appropriate consumer protection or relate to funding requirements; and

d) all guidance on the rules set out above must be considered.

4.3 While TP firms are required to apply these rules with the changes which are being made to take account of Brexit, temporary relief will be provided from these changes through the use of the TTP discussed above.

How will application of the rule-set differ as between branch and services firms?

4.4 After exit day, the ruleset applicable to TP firms will change to that applicable to third-country firms, subject to certain modifications and as amended by an overarching rule set out in the General Provisions of the Handbook. TP firms that operate in the UK on a cross border basis (services firms) will see the biggest change, as a number of requirements will apply to TP firms in the same way whether they operate in the UK through a branch or cross border.

The general approach for supervising fund marketing

4.5 In line with the general approach, operators, depositaries and trustees of EEA-domiciled investment funds will be required to comply with all the FCA rules that applied immediately before exit day in relation to the marketing of the relevant fund in the UK and the FCA will supervise them on that basis. The FCA will not take on responsibility for supervising rules that apply to the fund or its manager in their home states, because that would, in the regulators view, go beyond the aim of maintaining existing arrangements to avoid disruption to firms and investors. However, the TPR Funds Regulations would have the effect of applying current EU directive obligations that apply to the fund operator or the management company of the fund in their home state and which require them to fulfil certain obligations in the state where they are marketing the fund (the host state) and certain EU directive obligations that apply to the national competent authority of the fund or its management company, which require it to provide specified information to the national competent authority of the host state, in this case the UK.

4.6 References to a 'UCITS qualifier' or an 'AIFM qualifier' will be removed from the Handbook and the general approach for TP firms outlined above will be extended to fund marketing activities in the TPR.

Additional information for EMIs, PIs and RAISPs

4.7 Chapter 5 of CP18/29 confirmed that the FCA's proposals in relation to contributions to the Single Financial Guidance Body (SFGB), the planned proposal to extend the compulsory jurisdiction of the Financial Ombudsman Service (FOS) and the approach to funding the TPR will all be applicable to EMIs, PIs and RAISPs. The FCA also took the opportunity to clarify how the approach to the use of agents, safeguarding and the transition to authorisation/registration will work for PIs, EMIs and RAISPs within the TPR, although they were not consulted on as they do not require changes to the Handbook. The process for leaving the regime will be different for PIs and most EMIs due to the different authorisation and registration conditions that apply to those types of firms as compared to a TP firm.

5. The PRA's general approach in applying the rule-set to TP firms

5.1 In contrast to the FCA, which has proposed a highly detailed set of rules determining the application of its regulatory ruleset to TP firms, the PRA proposes a more straightforward approach, based on the fact that TP firms will become third country firms from the point they enter into the TPR.

Branches

5.2 TP firms operating UK branches will be required to comply with all of the requirements to which third country firms are subject, subject to the transitional relief discussed in paragraph 2.14 above.

Services firms

5.3 TP firms operating on a services basis will be subject to a more limited set of rules that could apply to a third country firm without a UK branch. Chapter 7 of CP 26/18 indicated that these include parts of the:

a) Fundamental Rules

b) Auditors

c) Change in Control

d) Close Links

e) Fees

f) General Provisions

g) Information Gathering

h) Interpretation

i) Notifications

j) Use of Skilled Persons

k) various Parts setting out the Senior Managers and Certified Persons (SMCR) requirements

l) parts relating to the FSCS.

5.4 All guidance on the rules set out above will also continue to be relevant.

SMCR

5.5 The PRA proposed applying the SMCR on the same basis to TP firms as it does to third country firms. This would entail both branches and services firms appointing an SMF 19 (Head of Overseas Branch) with respect to the UK business (and in some cases other SMFs), and allocating the PRA's Prescribed Responsibilities (**PRs**) for third country branches among their (deemed) SMFs and setting them out in their Statements of Responsibilities. Feedback to CP26/18 included a request not to apply all the PRA PRs for third country branches to firms in TPR, as it may not be feasible or proportionate for SMFs in these firms to demonstrate compliance with all these PRs from the outset. The PRA accepted the comment.

5.6 Accordingly, the PRA will not apply all the PRs for third country branches to firms in TPR. Instead the following will apply:

a) the existing PR for 'compliance with the UK regulatory system applicable to the firm'; and

b) for those firms which apply for Part 4A authorisation as a third country branch, 'and until such time as the application has been determined or withdrawn', a bespoke, new PR for managing the process of obtaining such permission.

5.7 The bespoke, new PR will apply for the duration of the application process as a third country branch and until the firm:

a) obtains such authorisation, when the full list of PRs for third-country branches will apply to the firm; or

b) withdraws its application for, or fails to obtain authorisation as a third country branch and is are placed into the Supervised Run-off regime (discussed in section 6 below (**SRO**)), in which case the proposed SM&CR requirements for firms in SRO will apply.

5.8 The PRA expects firms to allocate the bespoke, new PR to individuals with deemed approval as SMF19 in firms in TPR.

5.9 To accommodate the need for new senior managers to be registered as a result of their change in status, the TPR SI provides a discretionary power for the regulators to deem senior managers approved following the submission of their application on a temporary basis. The PRA proposed to direct firms in the TPR to apply for SMF approval using an adapted form of Short Form A and a short form statement of responsibilities. Firms are expected to have a 12 week window from exit day in which to submit applications, within which relevant personnel will be deemed approved: thereafter they will be within the transitional regime until the application is determined.

Depositor protection

5.10 As a result of Brexit, UK branches of incoming EEA firms will no longer automatically be within the scope of the relevant Home State depositor protection regime. It is expected that deposits taken by services firms from a place of business within the EEA will continue to benefit from the relevant Home State depositor protection regime.

5.11 In order to ensure that eligible depositors with accounts with incoming branches remain protected, the PRA proposes to provide FSCS protection to such depositors from exit day, with no transitional relief. This will oblige branches to:

a) put in place new disclosures and acknowledgements (including stickers and posters) for new customers following exit date;

b) make disclosures to existing customers as to the changes in depositor protection within two months following exit date;

c) provide staff training on the change in depositor protection;

d) meet the UK Single Customer View (SCV) reporting requirements; and

e) pay FSCS levies.

5.12 The systems changes necessary to provide information to the SCV are likely to be particularly challenging for branches.

How will application of the rule-set differ as between branch and services firms?

5.13 After exit day, the ruleset applicable to TP firms will change to that applicable to third-country firms, subject to the transitional provisions mentioned above. TP firms that operate in the UK on a cross border basis (services firms) will see the biggest change, as a number of requirements will apply to TP firms in the same way whether they operate in the UK through a branch or cross border.

Contrast with the FCA approach to TP firms

5.14 The approach that the PRA has proposed is radically different from the FCA's proposals. Differences include:

a) the FCA generally proposes only to preserve those requirements which implement EU directives; the PRA has chosen to apply its rules generally;

b) the FCA is offering substituted compliance for those rules which implement EU directives; the PRA does not;

c) the FCA has sought to preserve the application of existing rules which are deleted at the point of Brexit; the PRA has not.

5.15 This will make implementation particularly challenging in those areas where common requirements are currently applied by both regulators – for example systems and controls requirements, which are applied by both the PRA in a prudential context and the FCA in a conduct context.

6. Contractual continuity

6.1 On 21 December 2018, HMT published the legislative framework to allow those EEA firms that do not enter the TPR or which exit the TPR without authorisation to continue to service existing contracts for a limited period to enable an orderly wind down of their UK business (the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019 or **FSC SI**[19]). The FSC SI was approved by Parliament on 28 February 2019.

6.2 The FSC SI delivers on the commitment of the UK Government to provide transitional relief in respect of the so-called 'contractual continuity' issues associated with the loss of passporting rights by firms at the points of Brexit.

19 The Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019: http://www.legislation.gov.uk/uksi/2019/405/contents/made

6.3 A key element of the FSC SI is to make amendments to the TPR SI to provide for two interlinking regimes for permissions and exemptions. A new Part 6 of the TPR SI provides for two sets of deemed temporary **permissions** for affected firms:

a) temporary limited permission (**TLP**) for a passported firm which remains authorised in its home state; and

b) temporary limited variation of permission (**TLVP**) for a passported firm which remains authorised in its home state and has UK authorisation (a so-called **top-up permission**).

The TLP and TVP regimes are together referred to as Supervised Run-off or **SRO**.

6.4 A new Part 7 of the TPR SI provides for temporary **exemption** (**TE**) for firms with no UK branches (**services firms**) which continue to carry on passported activities following Brexit. The TE regime is referred to as Contractual Run-off or **CRO**.

Which regime do firms fall into?

6.5 Understanding the interaction of the regimes is challenging. However, it will be necessary to identify which regime a firm is in to ascertain what requirements apply.

6.6 Broadly speaking, for EEA firms with UK branches which are not in the TPR, it seems that they would be expected to avail themselves of the SRO regime to wind down their existing book of business. By contrast, the CRO regime is for EEA services firms (either immediately on Brexit or on exiting the TPR if their TLVP or TLP (as appropriate) is cancelled).

6.7 It is also important to note that firms can be moved between the SRO on the one hand and the CRO on the other by the regulators at their discretion. Guidance on the run-off regime published by HMT considers the example of a firm with significant UK exposure which enters the CRO (i.e. a services firm which seeks to avail itself of the TE), if the regulators feel that their statutory objectives would be served better if this firm was supervised in the UK, they can move it to the SRO.

What activities will firms be able to undertake?

6.8 The permission (in the case of the SRO) or exemption (in the case of the CRO) covers only those activities which are:

a) necessary for the performance of a pre-existing contract and which the firm was permitted to carry on beforehand; or

b) necessary for the purpose of reducing the financial risk of a party to, or affected by, a pre-existing contract; or

c) necessary in order to transfer property, rights or liabilities under a pre-existing contract to an authorised person; or

d) necessary in order to comply with a requirement imposed by or under an "enactment",

and only insofar as the relevant activity is necessary for that purpose. A corresponding restriction applies to financial promotions: a firm with a TLP, TLVP or TE may only issue financial promotions necessary to the performance of a pre-existing contract.

6.9 The FSC SI appears to seek to clarify that where a pre-existing contract includes the performance of an obligation which is contingent or conditional, this would satisfy the conditions for "necessary". However, uncertainty remains where performance is cancellable or discretionary.

How long will the regime last?

6.10 The regime is intended to be available to firms for fifteen years in relation to the performance of a contact of insurance, and five years for all other activities. HM Treasury may extend the period by up to five years based on a joint assessment by the FCA and the PRA. That period will commence at Brexit for firms which do not utilise the TPR, and at the point that the TPR ceases to apply otherwise.

Do firms have to do anything to enter and remain within the regime?

6.11 The FSC regime will automatically apply to EEA passporting firms that do not notify the FCA/PRA that they wish to enter the TPR, but have pre-existing contracts in the UK which would need a permission to service. A services firm relying on the CRO at exit date must notify the FCA that it is carrying on regulated activities in the UK. Following exit day, the FCA has confirmed that the status of those firms eligible for CRO will be reflected on the Financial Services Register.

6.12 The FSC SI provides that TE firms will have to keep authorisation in their home state and must notify their regulator, the FCA or PRA, if their home state authorisation is cancelled or varied or is to be varied. They must also inform the FCA or PRA if they are the subject of a criminal investigation or proceeding or the subject of an insolvency event. Firms in SRO will also be expected to maintain authorisation and supervision in their home state.

6.13 The regulators can impose such requirements as they consider appropriate on firms that go straight into the SRO regime at exit date (and which do not enter the TPR).

What rules will apply to SRO firms?

6.14 SRO firms will remain authorised and subject to the FCA and, if applicable, PRA rules. The FCA and PRA will be updating their rulebooks to reflect the changes introduced through the FSC SI (among others), and to address any deficiencies as a result of the UK leaving the EU. The PRA consulted on its proposed approach in CP32/18[20] – UK Withdrawal from the EU: Further changes to – PRA Rulebook and Binding Technical Standards – Resolution Binding Technical Standards with near final rules being published in PS5/19. The FCA issued its consultation paper, CP19/2[21] on Brexit and contractual continuity, on the 8 January 2019 and confirmed in PS19/5 that it would be implementing its proposals with minor amendments.

6.15 The FSC SI provides that that Financial Services Compensation Scheme (**FSCS**) will not apply to SRO services firms with TLVP or TLP but will apply to SRO branches which are credit institutions, insurance intermediaries, investment firms, mortgage intermediaries, UCITs management companies or certain AIFMs.

6.16 The FSC SI also provides for product intervention rules and any prohibition or restriction imposed under either Article 42 of MiFIR6 or Article 17 of the Regulation on key information documents for PRIIPS7 to apply to TE firms. There is also provision for the regulators to give deemed approval to persons performing controlled functions within TLP and TLV firms.

6.17 In broad terms, the PRA propose under CP32/18 to treat firms in the SRO as third country firms and to subject them to the same obligations and supervisory framework (including the Fundamental Rules) as other Part 4A authorised firms, with some amendments to ensure that the rules are effective and operable. In PS5/19, the PRA confirmed that its use of the TTP in relation to SRO firms would align with the approach for TP firms – namely that transitional relief would only be granted in certain limited areas, for example, in relation to remuneration rules where they go beyond CRDIV requirements.

6.18 The aim of the FCA's proposals in CP19/2, as confirmed by PS19/5, is to preserve the status quo as much as possible (in line with their approach for TP firms). Generally, SRO firms will simply need to continue to comply with the rules which currently apply to them, either in the UK or in their home state. Firms in the SRO will have a three-month period to come into compliance with the status disclosure requirements, in line with that is being proposed for TP firms.

[20] PRA CP32/18: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp3218-complete.pdf?la=en&hash=AE219BEE6FE9984D6D5898B0B45876F1A16C2CC7

[21] FCA CP19/2 – Brexit and contractual continuity: https://www.fca.org.uk/publication/consultation/cp19-02.pdf

What rules will apply to CRO firms?

6.19 CRO firms will be exempt persons which are generally outside the scope of the regulators' rules, subject to the following exceptions provided for in the FSC SI:

a) the FSCS will apply to CRO firms which are carrying out insurance contracts or are AIFMs or UCITS manager;

b) the FCA's product intervention rules and any prohibition or restriction imposed under either Article 42 of MiFIR or Article 17 of the Regulation on key information documents for PRIIPS will also apply to CRO firms.

6.20 The regulators' approach to applying the FSCS to firms in the CRO mirrors their approach to firms in the TPR. It is expected that deposits taken by firms in the CRO will continue to benefit from the relevant Home State depositor protection regime.

7. The UK Overseas Persons Exclusions (OPE)

7.1 As part of planning and preparations for the exit of the UK from the EU, firms considering how to restructure their businesses to ensure they can continue to service their existing UK clients post-Brexit may prefer to rely on exclusions under the UK's regulatory regime rather than entering the TPR regime or seeking to rely on the SRO or CRO regimes (as applicable). Such exclusions might enable firms to carry on certain regulated activities in the UK on a cross-border basis without requiring authorisation but would be dependent on the firm being able to ensure in practice no relevant on-going UK branch behaviours post-Brexit (as discussed further below).

7.2 Under the UK's regulatory framework, the general position under Section 19 of the UK's Financial Services and Markets Act 2000 (**FSMA**) is that no persons may carry on a regulated activity in the UK unless it is an authorised or exempt person. The Regulated Activities Order (**RAO**) sets out those activities which are 'regulated activities' when carried on by way of business in the UK. The RAO also provides for a number of exclusions, which apply to certain regulated activities in specified circumstances.

7.3 The exclusions set out in Article 72 of the RAO, permit a person (referred to as an **overseas person**) to carry on certain regulated activities in the UK on a cross-border basis without requiring authorisation. Not all regulated activities can benefit from the OPE and a detailed assessment will always need to be undertaken on a fact-specific basis. For example, there is no Overseas Person Exclusion for:

a) deposit-taking, which is an activity that it can in cases be argued (according to an analysis based on characteristic performance considerations) is performed in the location of the account (noting that consideration also need to be given to the UK financial promotions regime);

b) 'managing' or 'safeguarding and administering' investments, on the basis that it can generally be argued not to be necessary where such activities/services are considered to be performed overseas based on the characteristic performance analysis (however, one would need to ensure that any 'arranging' of custody services is also performed overseas and not in the UK given that Article 40 of the RAO also provides for the activity of arranging the safeguarding and administering of investments) (noting also that consideration also need to be given to the UK financial promotions regime); or

c) the regulated activity of entering into regulated credit agreements.

7.4 It is worth remembering that the OPE is obviously not available or necessary for activities which are not regulated in the UK such as commercial lending outside the scope of the consumer credit regime.

7.5 An "overseas person" is broadly defined under Article 3(1) of the RAO as a person who carries on certain related regulated activities (or the activity of agreeing to carry on any of these activities) but does not carry out any such activities, or offer to do so, from a permanent place of business maintained by him in the UK. Accordingly, where a person carries on any one of these activities from a permanent place of business in the UK, it will not be able to avail itself of the OPE in respect of any of them.

7.6 The availability and scope of each of the exclusions set out in the OPE vary depending on the type of activity for which the exclusion is sought. Notably, in order to benefit from an exclusion in the cases of dealing, operating a multi-lateral trading facility, advising on investments and agreeing to carry on certain regulated activities, advising the relevant activity must (in addition to other stated conditions) be the result of a "legitimate approach". Under Article 72(7) of the RAO, a "legitimate approach" is effectively defined as (i) an approach which does not contravene the financial promotions restriction in Section 21 of FSMA, or (ii) an unsolicited approach by the customer.

7.7 Section 21 of FSMA states that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless:

a) the communicator is an authorised person; or

b) the communication is approved by an authorised person; or

c) the communication is exempt.

7.8 Breach of s.21 is a criminal offence under s.25 of FSMA. A communication made in breach of s. 21 is an "unlawful communication" and breach may result in imprisonment, fines or both. It is also important to note that agreements entered into as a result of an unlawful communication may be unenforceable against the customer and the customer may be entitled to recover compensation.

7.9 It is worth noting that under Article 72(8) of the RAO, the OPE is not available where the overseas person is an investment firm or credit institution which is providing or performing investment services on a professional basis and whose home member state is the UK. This disapplication of the exclusions was achieved to align the activities caught by the RAO with those of Markets in Financial Instruments Directive 2004/39/EC, which applies to investment firms or credit institutions when they provide or perform investment services and activities.

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