

CLIENT ALERT

FCA's Preparation for a 'No Deal' Brexit

The FCA's Temporary Permissions Regime for EEA Firms and Funds Passporting into the UK

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Background

The UK Government and the EU reached an agreement in March 2018 to provide for a transitional period when the UK leaves the EU in 2019. The terms of that withdrawal agreement are still being negotiated with the EU but allow for an implementation or transitional period from 29 March 2019 to 31 December 2020 under which existing EU rules will continue to apply in the UK. In addition, the UK will be required to implement new EU law that comes into effect during that period. During the transitional period, the EU's single market in financial services will continue and firms both in the UK and the EEA can continue to operate cross-border on the basis of their existing passports.

This briefing considers the situation where no withdrawal agreement is entered into and there is "no deal".

Impact of a 'no deal'

The UK Government has recently published a series of technical notices setting out its preparations for a no-deal scenario.

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In the case of banking, insurance and other financial services,¹ the UK Government has committed to introducing a temporary permissions regime (**TPR**) that will allow EEA firms currently passporting into the UK to continue operating in the UK for up to three years after exit (*i.e.* after 29 March 2019), whilst such firms apply for full authorisation from UK regulators. The draft legislation for the TPR has been published² and the UK financial regulators, the Financial Conduct Authority (**FCA**),³ the Bank of England⁴ and the Prudential Regulation Authority (**PRA**) have published their approach to implementing the TPR. The TPR will also allow funds with a passport to continue marketing in the UK while seeking UK recognition. There is additional legislation covering EEA payment institutions, EEA electronic money institutions and registered account information services not covered in this briefing.

The existing basis for EEA investment firms and funds providing services in the UK

Financial services firms providing services in the UK currently do so either by being authorised in the UK or, if authorised in the EEA, by using the passporting regime to establish a presence or carry out permitted activities in the UK cross-border. EEA investment funds can be marketed across the EEA including in the UK, under similar passporting provisions.

Post-Brexit

If there is no withdrawal agreement and consequently no transitional period, when the UK withdraws from the EU, the UK will become a "third country" in relation to the EU and EEA firms will no longer be able to passport their services into the UK. Consequently, EEA firms may need to seek authorisation in the UK to continue to access the UK market. Similarly, EEA investment funds will need to seek UK recognition to continue to market in the UK.

Under the TPR, EEA firms currently passporting into the UK which notify the FCA of their activities will be given permission under Part 4A of the Financial Services and Markets Act 2000 (**FSMA**) to continue those activities on a temporary basis for up to three years until they have received authorisation. The scope of the permission will reflect the scope of a firm's existing passporting permission pre-Brexit.

Separate legislation will enable EEA investment funds to continue to be marketed in the UK during the TPR. Draft legislation will be published this autumn.

The TPR will come into effect on 29 March 2019 if the UK leaves the EU on a no-deal basis. It will not be required if the UK and the EU agree to a withdrawal agreement.

¹ <https://www.gov.uk/government/publications/banking-insurance-and-other-financial-services-if-theres-no-brexit-deal/banking-insurance-and-other-financial-services-if-theres-no-brexit-deal>

² <https://www.legislation.gov.uk/ukdsi/2018/978011172421/contents>

³ <https://www.fca.org.uk/markets/eu-withdrawal/temporary-permissions-regime>

⁴ <https://www.bankofengland.co.uk/news/2018/july/temporary-permissions-and-recognition-regimes>

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EEA firms and funds who can use the TPR

The regime is available to firms providing services in the UK before exit day by virtue of exercising their passport including banks, insurers, investment firms, UCITS, AIFMs and firms authorised under the Insurance Mediation Directive and Mortgages Directive and electronic money and payment institutions.

The passport rights could be on the basis of a freedom of establishment (the ability to operate out of a UK branch) or a freedom to provide services (cross border without a branch) or both.

Funds which can use the regime

EEA-domiciled UCITS schemes and Alternate Investment Funds (**AIFs**) will be able to use the TPR if the FCA receives notification of their intention to market in the UK under the relevant passport prior to 29 March 2019.

The FCA will provide further information on the requirements for funds; however, it is expected that fund managers will be required to notify the FCA of which EEA funds they want to continue to market in the UK. It is expected that notifications may be accepted as of early January 2019 and the notification window will close prior to the exit day.

After that day, fund managers that have not submitted a notification for an EEA fund will be unable to use the TPR for that EEA fund and will not be able to continue marketing the EEA fund in the UK.

Details of investment funds with a temporary permission which will be able to continue marketing to UK retail investors will be shown on the UK FS Register.

Banks and insurers

The Bank of England is the lead authority for authorising incoming EEA banks and insurers. EEA banks and insurers operating in the UK should ensure they contact the PRA, if they have not already done so.

However, incoming credit institutions that are **not** accepting deposits in the UK should contact the FCA rather than the PRA.

Gibraltar-based firms

Firms established in Gibraltar that passport into the UK will not need to use TPR and will be able to continue to operate as they do now post-Brexit until 2020. The UK Government has said it will work closely with the government of Gibraltar to design a replacement framework for after 2020.

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The FCA's notification process for firms

Firms will need to notify the FCA that they wish to use the TPR. This will be an online process and the FCA expects to open the notification window in early January 2019. The notification window will close prior to exit day.

Once the notification window has closed, firms that have not submitted a notification will **not** be able to use the TPR.

As the FCA anticipates that a large number of firms will need to apply for authorisation, it will stagger the application process for such firms. The FCA will allocate firms a period (a "landing slot") within which they will need to submit their application for UK authorisation. After exit day, the FCA will confirm firms' landing slots so they can start to prepare their applications for full authorisation. The FCA has indicated the first landing slot will be October to December 2019 and the last to be January to March 2021. This was the approach the FCA successfully took when it became responsible for the supervision of consumer credit firms.

Firms with top-up permissions from the FCA for activities not subject to passport rights will need to submit a Variation of Permissions (**VoP**) application rather than an authorisation application.

If firms change their plans, they will be able to apply to cancel their temporary permission once they have ceased all UK business.

Details of firms with temporary permission will be shown on the FS Register.

Rules which will apply to firms in the regime

As firms in the TPR will be operating on the basis of a UK authorisation, such firms will come within the full scope of FCA supervision and rule-making powers. The FCA has indicated that it will seek to take a proportionate approach that will enable firms to comply with FCA requirements from day 1 while maintaining an adequate level of consumer protection.

Firms operating within the TPR should expect to comply with:

- All FCA Handbook rules and guidance which currently apply to them.
- All FCA Handbook rules which implement a requirement of an EU directive (and relevant guidance), which are currently reserved to their EEA "home state" regulator. The FCA intends to accept "substituted compliance" in respect of these rules. Therefore, if firms can demonstrate that they are continuing to comply with the equivalent home state rules in respect of their UK business, they will be deemed to comply with the FCA's rules and guidance. The FCA is not proposing to apply any home state rules which relate to capital and related requirements as they do not wish to oversee a firm's worldwide capital position.

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- Certain additional FCA Handbook rules which the FCA believes should apply to provide appropriate consumer protection.
- The FCA's Principles for Business.

Firms should expect to have more direct contact with the FCA and the FCA may request information directly where it needs to identify or quantify the risk of harm to consumers or markets.

Other consequences for firms operating under the TPR

The FCA has highlighted other requirements which will be new for firms moving from operating under a passport to the TPR. Such firms will need to plan accordingly, including as referred to below.

The FCA has said that EEA branches operating in the UK under the TPR will be required to contribute to the UK Financial Services Compensation Scheme (**FSCS**), so that UK customers of such branches will be provided with equivalent cover to customers of UK firms. This will not apply to firms operating on a cross-border basis without a branch in the UK. The PRA will set out its proposals in relation to the FSCS for banks and insurers separately.

Likewise, EEA firms with UK branches should comply with both the Approved Persons and Senior Managers and Certification Regime. Again this will not apply to firms without a branch in the UK. They will also need to comply with the rules on client money and assets if applicable.

Autumn consultation

The FCA will consult in autumn 2018 on the detail of the rules that it will apply to firms and funds while they are in the TPR, including fees and levies. The Consultation Paper will also set out further details of how the TPR will operate. A Policy Statement and final rules will be published early next year.

If there is no deal and the TPR is required, relevant EEA firms and funds will need to follow the notification process accordingly before exit day.

For the time being, firms and fund managers should complete a short FCA online survey for inbound firms and funds, if they have not already done so. No further action is required at this stage. The FCA will contact those firms and fund managers that have completed the survey directly when its Consultation Paper is published.

We recommend that all EEA firms providing services in the UK complete that survey to ensure they are informed of developments in relation to the TPR and are ready to make a notification if required in 2019.

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Please do contact us if you would like to discuss any questions relating to Brexit or if you would like us to keep you informed of relevant developments. Other areas of interest for clients in relation to the financial markets could include legislation in relation to financial market infrastructure such as central counterparties (**CCPs**), contractual continuity in relation to derivatives, and delegation arrangements.

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