FCA Issues Consultation on Temporary Permissions Regime for EEA Firms Following Brexit

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As part of its preparation for a possible "no-deal" Brexit in March 2019, the UK's Financial Conduct Authority ("FCA") recently published a consultation paper on proposed rules for its "temporary permissions regime". The regime is designed to provide continuity for firms in the European Economic Area ("EEA") that currently use their home state "passport" to cover the activities of a UK branch, for the provision of services on a "cross-border" basis into the UK, and for the marketing of EEA funds in the UK.

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Process to use the regime

Firms that want temporary permission will need to notify the FCA between early 2019 and "exit day" (the date the UK leaves the European Union, currently expected to be 29 March 2019). To obtain temporary permission, a firm must first have obtained the relevant passport from its home state regulator. The UK legislation that establishes the temporary permissions regime makes it clear that temporary permission can be used for up to three years following exit day or (if earlier) until the firm obtains permanent authorisation from the FCA. In order to provide additional structure to the permanent authorisation application process, the FCA draft rules propose that firms submit an application for authorisation during one of six three-month windows (or "landing slots") following exit day to which each firm will be assigned. The FCA anticipates that the first landing slot will be between October and December 2019, with the last slot closing at the end of March 2021. If a firm does not apply for authorisation before the end of its landing slot, its entitlement to use the temporary permission will end. Firms that cease all regulated business in the UK before the end of the temporary permissions regime can apply to cancel their temporary permission.

It is not known in which order the FCA will issue "landing slots", although it seems likely that the FCA will wish to process applications from banks and other large institutions first. Firms may raise concerns as to the lack of flexibility in this process—it is not known whether firms will have flexibility to submit an application earlier than their assigned slot or defer their application if they do not have sufficient time to complete it, and firms may face disadvantages if they are given later landing slots than their competitors.

UK branches

A firm in the EEA that has established a UK branch and which intends to continue to operate that branch following Brexit will need to notify the FCA of its intention to apply for temporary permission. Subsequently, the firm will apply for permanent authorization from the FCA in its assigned "landing slot". In practice, there is limited precedent for the FCA to authorise branches (as opposed to separate entities) of some types of firms, such as asset managers—although in principle there is no reason why the FCA cannot do so. However, firms will need to be mindful of the FCA's threshold requirements for authorisation, particularly regarding substance (having sufficient personnel and other resources) and management.

Cross-border services

The temporary permissions regime is also available for firms which perform services on the basis of the cross-border services passport. Historically, there has been a lack of clarity on the circumstances in which a firm can be said to perform services on a cross-border basis, and it is likely that many EEA firms only hold the services passport to cover their activities in the UK as a matter of legal certainty. These firms will need to consider carefully whether they have a real business need for undertaking the process of applying for temporary permission and then permanent authorisation. If their activities in the UK are limited, the requirement for full authorisation—in particular, the establishment of a permanent UK office—may be too onerous. For example, a firm might conclude that, whilst it holds the cross-border services passport, it does not in fact perform any activity in the UK—or that it performs an activity (such as marketing) that is not in itself authorised in the UK. Firms that do not have a UK office may also use the overseas persons exclusion in UK legislation,[1] which is available for firms that conduct a regulated activity in the UK other than from a "permanent place of business"—although there are conditions that need to be complied with in each case.

Fund marketing

It is intended that, under the temporary permissions regime, an EEA manager that is currently marketing an EEA-domiciled alternative investment fund under the passport may continue to do so. Notifying the FCA prior to exit day will allow an AIFM to market a relevant fund on the same terms as those that applied before the UK left the European Union. If an AIFM does not notify the FCA prior to exit day, it will lose its marketing passport rights, and will likely have to make a new application to the FCA to market the fund on the basis of the National Private Placement Regime (NPPR) – see below. EEA managers of EEA funds bearing the European Venture Capital Fund

[1] Article 72 of Financial Services and Markets Act (Regulated Activities Order) 2001.

(EuVECA), European Social Enterprise Fund (EuSEF) and European Long Term Investment Fund (ELTIF) labels can also use the regime.

Following exit day, the FCA will allocate a "landing slot" to firms that have opted in to the temporary permissions regime, when the AIFM must submit its application for notification under private placement. The FCA will then confirm that the AIFM can market the fund under private placement in place of the temporary passport. As an alternative, the AIFM can obtain recognition of the fund under the FCA's procedure for "individually recognised overseas schemes", although this will likely only be relevant for EEA UCITS schemes.

As mentioned above, unless an EEA manager takes advantage of the temporary permissions regime, the only way in which it could market a fund in the UK after exit day (including a sub-fund of a fund registered under the temporary permissions regime) will be on the basis of private placement, in a similar way to non-EEA managers or non-EEA funds. Private placement, however, will require cooperation arrangements to be in place. Whilst it is widely expected that those arrangements will be in place before exit day, it is not yet certain.

Supervision

Once a firm has been granted temporary permission, the FCA will also have the challenge of supervising it—under the passport mechanism, supervision of non-UK firms was largely a matter for the home state. The FCA intends to require firms to comply in the UK with (i) all FCA rules which apply to them as of exit day (current "host state" rules, focused on client-facing conduct of business requirements); (ii) all FCA rules which implement a requirement of an EU Directive which are reserved to the firm's home state (current "home state" rules, covering establishment, capital and other conduct of business rules); and (iii) certain additional FCA rules which the FCA believes are necessary to provide appropriate consumer protection (such as FCA custody rules) or which relate to funding requirements (such as the levy for the financial services compensation scheme). The FCA will accept "substituted compliance" regarding home state rules such as regulatory capital, for firms that demonstrate to the FCA that they continue to comply with the equivalent home state rules regarding their UK business.

For fund marketing, the FCA will require managers to provide information (such as changes to marketing documents) directly to the FCA as well as to the manager's home state supervisor, with the FCA able to revoke authorisation to market. If the FCA concludes cooperation arrangements with EEA state supervisors, the need for duplicate reporting might be avoided.

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