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Brexit and access to UK financial markets

An analysis of the Temporary Permissions Regime and the Overseas Persons Exclusion

By Azad Ali and Chris Hobson

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Executive Summary

- The withdrawal of the UK from the EU under a "no deal" scenario will inhibit EU27 firms' access to the UK financial markets.
- Whilst the UK is committed to offering a degree of access to EU27 firms in these circumstances under a temporary permissions regime, it is not as smooth as the EU passporting framework, and is limited in time. The regime would require passported EU27 firms to be subject to UK supervisory oversight which firms will need to understand and be comfortable with.

  The regime is also designed to be a mechanism to transfer EU27 firms that currently rely on the passport to full UK authorisation.
- EU27 firms that are active in the broker-dealer space may be able to rely on the overseas persons exclusion. This exclusion is potentially a useful means for EU27 firms seeking to continue doing UK business and who do not wish to seek UK authorisation whether on a temporary or permanent basis.

Background

This briefing considers: (i) the temporary permissions regime relevant to EU27 firms currently operating in the UK on the basis of a passport right; and (ii) the overseas persons exclusion which, if relied on, obviates the need for a UK licence.

The UK approach to Brexit

The UK's forthcoming withdrawal from the EU ("**Brexit**"), scheduled for 30 March 2019 (the "**Brexit Date**"), will impact the way in which authorised firms in the UK service clients located in EU member states (the "**EU27**") as well as EU27 firms providing financial services to UK clients. This is the consequence of the loss of the "passport", which enables EU-wide access under a single home state authorisation (either through cross-border provision of services or through the establishment of branches).

The UK is currently focussed on achieving access to the EU financial markets through a wide-ranging free trade agreement. The UK government's White Paper, published on 12 July 2018, sets out proposals to achieve this.[1] In the area of financial services, the UK proposes an 'expanded equivalence' regime to ensure mutual access to each other's financial markets. This would involve the enhancement of the EU's existing equivalence regimes to enable a wider range of UK firms to provide services in the EU on a cross-border basis and *vice versa* on the basis of equivalent financial regulatory regimes. The proposals (even if accepted) do not include any measure to replicate the branch passport regime, and the EU27 do not appear to be proposing this either. As such, UK branches of EU27 firms will either have to seek standalone UK authorisation or curtail their business so as to avoid carrying out regulated activities.

The enhanced equivalence proposal would be bolstered by additional procedures designed to ensure that an equivalence determination by the EU in respect of the UK would be managed appropriately and could not be unilaterally withdrawn. The UK considers that such an arrangement would ensure a high degree of access for UK firms, but it is currently unclear whether the EU will accept the proposal. The free trade agreement, of which the enhanced equivalence proposal is a part, is separate from the draft Withdrawal Agreement. The draft Withdrawal Agreement makes provision for the exit of the UK but also includes a transition period following Brexit, during which the UK would continue to be subject to EU law. During the transition period, EU27 firms would be able to exercise their passport rights to provide financial services in the UK until the end of the transition period, which is currently set at 31 December 2020. The transition period will only come into force if and when the

[1] Please refer to our fuller briefing on this, available here.

Withdrawal Agreement is finalised. If there is no agreement between the EU and the UK on the transition period, the temporary permissions regime (the "**TPR**"), outlined below, will apply with respect to EU27 firms providing financial services in the UK.

Maintaining access to EU markets

In the absence of an agreed approach between the UK and the EU governing access to EU financial markets, various strategies are being deployed by UK-authorised firms currently relying on the passport in order to service EU clients following Brexit. These strategies generally involve the use of a hub in a EU27 member state, sometimes with intra-group arrangements (for back-to-back booking of trades etc.) with the current UK entity. The EU27 hub would be able to rely on passport rights, established under the Single Market Directives,[2] to provide services to clients based in other EU27 member states. Alternatively, there may be a degree of reliance on member state-specific exemptions from licensing requirements. In some limited instances, reliance can be placed on "reverse solicitation" by EU clients which would obviate the need for a licence.

Maintaining access to UK financial markets: The Temporary Permissions Regime

There has so far been less attention on the impact of Brexit on EU27 firms accessing UK financial markets. Such analysis is now crucial as EU authorities are urging EU27 firms to accelerate their planning for Brexit on the basis of a 'no deal' scenario in which mutual market access will be significantly constrained.[3] EU27 firms have been instructed to consider the impact of this contingency on their operations in the UK, including in respect of authorisation requirements, exposure to UK financial market infrastructure and potential impact on key relationships with UK clients.

The UK government has confirmed that it will offer a way for firms to retain access to UK financial markets to EU27 firms after the Brexit Date, in circumstances where an overall deal is not agreed. To achieve this, the UK government has published a draft statutory instrument implementing the TPR for EU27 firms that currently exercise passport rights to provide services in the UK. Under the TPR (as currently drafted), EU27 firms that exercise passport rights in the UK will be treated as if they had been granted permission under the Financial Services and Markets Act 2000 ("**FSMA**") to provide those services in the UK.[4] This applies both where the EU27 firm has exercised passport rights to establish a branch in the UK and where the EU27 firm provides services on a cross-border basis in the UK. Further, EU27 firms that have existing permissions in the UK under FSMA (as well as relying on the passport) will be deemed to hold a varied permission to provide any additional services that they currently provide in the UK under the passport.[5] The effect of these provisions is to enable EU27 firms that exercise passport rights on the Brexit Date to continue providing such services on the basis of deemed permissions under UK regulation.

In order to qualify for temporary permission under the TPR, EU27 firms must, prior to the Brexit Date, submit either an application for full authorisation or a notice of intention to exercise their rights under the TPR. The application process for full authorisation is laborious and requires the production of (among other things) a business plan and various financial information. The requirements for notifications under TPR have not yet been set but will be finalised by the Prudential Regulation Authority ("**PRA**") and the Financial Conduct Authority ("**FCA**") once the TPR has been finalised.[6] It is likely that the notification will be less stringent than a full application but EU27 firms may still be required to provide the FCA or PRA, as appropriate, with some of the detail that would be required under a full authorisation procedure when submitting the notification. The TPR will apply initially for three years following the Brexit Date, although HM Treasury has the option to extend this period once only for a further 12 months.[7] Accordingly, EU27 firms may rely on TPR for a maximum of four years following the Brexit Date. After the expiry of this period, EU27 firms will be required to consider other options for the provision of services in the UK, as explained in more detail below.

The TPR as currently drafted has several drawbacks when compared with the existing passport regime. There are administrative steps to be taken by EU27 firms before relying on the TPR, either in the form of a full application for permission under FSMA or a notification to the PRA or FCA. EU27 firms relying on the TPR may also be subject to a requirement to contribute to the Financial Services Compensation Scheme ("**FSCS**") if they have exercised their passport rights to establish a branch in the UK. The FSCS includes the UK's deposit guarantee scheme and a compensation scheme to deal with losses arising from failures of other types of authorised firms. Fundamentally, the TPR is designed to be a transition to full oversight by the PRA or FCA, depending on the type of firm relying on the TPR. This

2 The Single Market Directives are: CRD IV, Solvency II, MiFID II, the Insurance Mediation Directive, the Mortgage Credit Directive, the UCITS Directive and AIFMD.
3 ECB Newsletter of 16 May 2018 and European Commission Press Release of 19 July 2018.
4 Article 6, The EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018 (the "**TPR Regulations**").
5 Article 9 TPR Regulations.
6 Article 12(2) TPR Regulations.
7 Article 16 TPR Regulations.

contrasts with the passport, under which supervision is carried out by the home state regulator with limited oversight by the host state regulator. When relying on the TPR, EU27 firms would be subject to the full panoply of enforcement and supervision powers available to the PRA and/or the FCA. EU27 firms may not be comfortable with this additional layer of supervision, compliance infrastructure and accountability to UK regulators. For such firms, other options for UK market access (particularly the overseas persons exclusion ("**OPE**")) are likely to be more useful means of providing services without encroaching into the UK regulatory licensing perimeter.

The options available for EU27 firms that currently operate in the UK through a passported UK branch are more limited than for those firms that provide cross-border services under the passport as the OPE would not be available for such UK branches. As a result, standalone authorisation of such branches would be required, at least from the expiry of the temporary permission period provided for under the TPR, unless such firms could rely on the limited range of exclusions available in respect of services provided from an establishment in the UK. We consider below the degree to which EU27 firms, principally in the investment banking and broker-dealer space, could service UK clients on a cross-border basis without requiring a full or temporary UK licence or authorisation after the Brexit Date.

Authorisation is governed by Part 4A FSMA and is contingent on a finding by the UK regulators of equivalence between the regulatory regime applicable to the head office of the EU27 firm and the UK's regulatory regime. If there is divergence between the UK and the EU in the area of financial services regulation post-Brexit, it is possible that the PRA and/or the FCA may reject or otherwise restrict EU27 firms' applications for authorisation. As at the Brexit Date, the UK has committed to retain all EU-derived laws and regulations,[8] so one would reasonably assume that equivalence assessments by the PRA and/or FCA would be relatively straightforward, notwithstanding gold-plating and enhancements to EU-derived regulations in a number of areas of UK banking and broker-dealer regulation.[9] Further, it is unlikely that a firm that has relied on the TPR would be denied authorisation once its temporary permission expires, provided that it has applied for authorisation.

Authorisation may involve conversion of the branch to a UK subsidiary as a condition of approval. Unlike branches, subsidiaries would be subject to the full range of both capital and conduct of business regulations. A branch of a bank would only be subject to conduct of business regulations, focussed on consumer protection, but with reliance on head office authorisation in the EU27 member state in respect of prudential matters apart from certain liquidity requirements.

The overseas persons exclusion: a potential solution for EU27 firms conducting wholesale financial services business on a cross-border basis in the UK

EU27 firms that have exercised their passport rights to provide services on a cross-border basis in the UK may be able to rely on the OPE. The OPE enables firms established outside the UK to provide certain services to clients in the UK on a cross-border basis without obtaining authorisation in certain circumstances. The OPE has been highlighted by the FCA as a potentially useful tool to enable EU27 firms to continue servicing UK clients. Andrew Bailey, the FCA's chief executive, viewed the OPE, together with the UK's approach to supervision of branches of international firms, as "*a sensible and proportionate way to support stable global financial markets.*"[10]

The OPE enshrines the UK's longstanding commitment to open wholesale financial services markets. Few other jurisdictions maintain such an accommodating regulatory perimeter. It is likely that the OPE will be maintained after Brexit notwithstanding prior instances, most recently during the MiFID II implementation process,[11] where some consideration was given to the repeal or narrowing of the OPE.

We analyse below the key features of the OPE, the conditions applicable to its use and its scope. The analysis will show that the OPE, whilst broad, is not a panacea for EU27 firms seeking to access the UK financial markets post-Brexit. The OPE does not provide coverage for all client types or for all activities. Further, it is unlikely that the EU will seek to mirror the OPE on an EU-wide basis. As a result there are concerns that the breadth of the OPE creates an incentive for UK firms to operate out of an EU27 hub and serve UK clients without needing UK authorisation.

8 EU (Withdrawal) Bill – Factsheet 2: Converting and preserving law.

9 UK branches of EU firms that currently operate on the basis of passport rights will be required to apply for authorisation as a branch post-Brexit. However, the Bank of England has confirmed that such branches "*may…plan on the assumption that the re quirements for equivalence, supervisory cooperation and adequate assurance over resolution [set out in the application process for authorisation as a branch] will be met…*" (The Bank of England's approach to the supervision of international banks, insurers and central counterparties, 20 December 2017). As such, the application process for branches of these types of EU firms will be streamlined.

10 *Brexit: what does it mean for financial markets to be open?* Speech by Andrew Bailey, Chief Executive of the FCA, at City Week 'The International Financial Services Forum' 24 April 2018.

11 Preparation for the application of Title VIII MiFIR.

An important related issue is whether an activity is carried out in the UK in the first place. Having UK-based clients does not always mean that the relevant regulated activity is being carried out in the UK. It is only when there is a risk that regulated activities would be seen to be carried out in the UK that the OPE (and other exclusions) are relevant. We set out some considerations relating to when activity is seen from a UK perspective as being carried out in the UK.

The UK Regulatory Perimeter

Section 19 FSMA provides that no person may carry on a regulated activity in the UK, or purport to do so, unless he is an authorised person or an exempt person.[12] This provision is referred to as the "**General Prohibition**". The General Prohibition establishes the UK's regulatory perimeter and breach of it carries with it criminal sanctions.

EU27 firms will be required to consider whether they are carrying out regulated activities "in the UK" as at the Brexit Date for the purposes of the General Prohibition. If they are, they will be within the UK regulatory perimeter. As such, if they do not obtain authorisation (or are otherwise exempt) they will have to avoid carrying out any regulated activities in the UK unless an exclusion such as the OPE can be relied on. Under FSMA, an activity is a regulated activity if is an activity of a specified kind which is carried on by way of business and relates to an investment of a specified kind.[13] The specified kinds of activities are set out in Part II of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the "**RAO**") and the specified investments are set out in Part III RAO. If a firm is carrying out any of the activities listed in Part II RAO in relation to an investment set out in Part III RAO by way of business,[14] the firm is carrying out a regulated activity.

Location of regulated activities for the purposes of the General Prohibition

Activities undertaken by firms with head offices outside of the UK will be deemed to take place in the UK if the activities are carried out from an establishment maintained by the firm in the UK.[15] The concept of 'establishment' is wider than that of 'permanent place of business' (considered further below) as 'establishment' includes merely temporary places of business, such as a stall at a roadshow. Further, a firm based outside the UK may nonetheless potentially be considered to be carrying on activities in the UK even if such firm does not have any establishment in the UK. This could well be the case if, for instance, the firm performs regulated activities remotely by means of the internet or telecommunications, as well as through occasional visits.[16]

A further potential criterion to determine the location of an activity is that of the location of the "characteristic performance" of that activity. The EU Commission has previously recommended that EU member states adopt a characteristic performance assessment to determine whether a regulated activity is deemed to be carried out in another EU member state so that a passport notification is required in respect of services carried out in that other EU member state.[17] Under this test, a regulated activity will be considered to be carried out on a cross-border basis in another member state if the essential supply for which payment is due is located in that other member state. As this test is relevant to determining whether a passport notification for cross-border services is required, it is therefore not strictly applicable to cross-border services provided in a member state by non-EU firms. Further, the Commission's guidance was provided in the form of an interpretative communication which is not binding on EU member states under EU law and does not form part of the EU *acquis* that is to be retained and 'on-shored' by the UK after Brexit. Moreover, certain jurisdictions have adopted a solicitation test in place of the characteristic performance assessment. It is also arguable that subsequent Single Market directives and other EU legislation enacted since the "characteristic performance" test was introduced have necessarily superseded the test.

12 Authorised persons are defined under s. 31 FSMA as: (i) those persons who are authorised under FSMA to carry on one or more regulated activities; (ii) EEA firms exercising passporting rights; (iii) a Treaty Firm qualifying for authorisation; and (iv) any other persons otherwise authorised by a provision of, or made under, FSMA. An exempt person is defined under s. 417(1) FSMA as a person who is exempt from the general prohibition as a result of an exemption order made under s. 38(1) FSMA, or as a result of s. 39 FSMA or under s. 285 FSMA. Note that limb (ii) and (iii) will be amended as a result of the TPR Regulations.

13 S. 22 FSMA.

14 The circumstances in which firms will be deemed to be carrying out regulated activities 'by way of business' for the purposes of s. 22 FSMA are described in PERG 14.5. For certain regulated activities, the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by way of Business) Order 2001 sets out more detailed criteria for satisfying the 'by way of business' test. We assume that firms are carrying out regulated activities by way of business for the purposes of this paper.

15 S.418(5) FSMA.

16 PERG 2.4.6G

17 Commission Interpretative Communication: Freedom to Provide Services and the Interest of the General Good in the Second Banking Directive, 20 June 1997.

Accordingly, the better view is that the determination as to whether an activity is located in the UK, is dependent on the UK rules principally as set out in FSMA and associated FCA guidance. That said, the "characteristic performance" test may still be a useful interpretative tool in informing assessments of location of a regulated activity from a UK perspective.

As noted above, a significant part of the UK test for determining whether an activity is deemed to take place in the UK is based on whether a third country firm is carrying out these activities from an 'establishment' in the UK, although for particular regulated activities (such as deposit-taking) specific considerations apply to determine location.[18] In many instances, the UK's approach to determining the location of an activity is less stringent than the characteristic performance test such that having a cross-border services passport to cover banking or MiFID activities, for example, would not inevitably mean that the relevant activity would be regarded as being carried out in the UK. It is likely that many firms would be able to continue providing financial services in the UK after Brexit on the basis of a territorial analysis of the location of their activities, perhaps combined with the application of an exclusion such as the OPE.

Scope of the OPE

Exemptions from the RAO generally

The RAO sets out a number of exclusions from the regulated activities framework. The exclusions operate by providing that certain activities are not regulated activities for the purposes of the General Prohibition. The exclusions can be categorised into 'specific' exclusions and 'general' exclusions.

Specific exclusions apply to only one regulated activity. For instance, a person will not be considered to be advising on investments (a regulated activity under Article 53 RAO) if the advice is contained in a newspaper or other periodical and the principal purpose of the publication is not the provision of investment advice.[19] General exclusions apply to several regulated activities, such as the exclusion for certain intragroup transactions and activities.[20] The OPE is also a type of general exclusion.

Scope of the OPE

The OPE applies only in respect of the following regulated activities:

(a) Dealing in investments as principal (Article 14 RAO);

(b) Dealing in investments as agent (Article 21 RAO);

(c) Arranging deals in investments (Article 25 RAO);

(d) Operating a multilateral trading facility (Article 25D RAO);

(e) Operating an organised trading facility (Article 25DA RAO);

(f) Advising on investments (Article 53 RAO);

(g) Arranging regulated mortgage contracts (Article 25A RAO), regulated home reversion plans (Article 25B RAO), regulated home purchase plans (Article 25C RAO) and regulated sale and rent back agreements (Article 25E RAO);

(h) Entering into or administering a regulated mortgage contract (Article 61 RAO), regulated home reversion plans (Article 63B RAO), regulated home purchase plans (Article 63F RAO) and regulated sale and rent back agreements (Article 63J RAO); and

(i) Agreeing to carry on specified kinds of activity (Article 64 RAO).

The OPE does not apply uniformly to each of these regulated activities. Nor does it cover deposit-taking activity, the touchstone for banking regulation in the EU27 and the UK, albeit deposit-taking is generally regarded as being carried out from the location of the overseas bank and not in the UK.[21] The OPE does not cover asset management or most insurance activities either. Firms must therefore analyse whether they are able to rely on the OPE in respect of the activity they are carrying out. Most broker-dealer and investment banking activities falling within the scope of the MiFID regime and relating to dealing (as principal or agent), arranging and advising would fall within the scope of the OPE.

18 Paragraph 7, HMT Memorandum: *Provision of cross-border financial services in the United Kingdom by firms from Switzerland*.
19 Article 54 RAO.
20 Article 69 RAO.
21 Paragraph 7, HMT Memorandum: *Provision of cross-border financial services in the United Kingdom by firms from Switzerland*. See also FSA guidance issued in respect of the Banking Act 1987 (now superseded by the FSMA), specifically Part 1D thereof.

Key Concepts

The application of the OPE differs according to the type of activity concerned, although in all cases the firm must qualify as an overseas person. Other concepts relevant to the OPE are whether: (i) the firm engages in regulated activities 'with or through' an authorised or exempt person; and (ii) the firm engages in regulated activities with clients in the UK as a result of a legitimate approach. One or both of these concepts are conditions to reliance on the OPE for many of the activities covered by the OPE. Each of the elements are analysed below.

What is an overseas person?

An overseas person is defined as a person who carries on an activity of a kind specified in the RAO but who does not carry out such activities, or offer to do so, from a permanent place of business maintained in the UK.[22] The meaning of 'permanent place of business' is not defined in the RAO and no further guidance on the meaning of this phrase is given in the FCA Perimeter Guidance Manual ("**PERG**"). However, the Securities and Investments Board (a predecessor of the FCA) gave the following guidance on a similarly worded provision in the Financial Services Act 1986 (the predecessor to FSMA):

(a) the element of permanence excludes business carried on from a merely temporary place of business, such as a stall at a conference;

(b) the requirement for the place of business to be maintained excludes one-off transactions concluded by an officer of the overseas person from the offices of a UK subsidiary of that overseas person; and

(c) if a subsidiary of an overseas person maintains a place of business on behalf of the overseas person (i.e. a business line for the overseas person that is separate from the business of the subsidiary) the parent may lose its status as an overseas person.[23]

An EU27 firm may qualify as an overseas person even if it has a subsidiary (or other affiliate) or a branch in the UK. However, in these circumstances, the overseas person must ensure that there is a strict division between the business of its UK affiliate or branch and any activity carried out in the UK from the head office in the EU member state. In terms of *ad hoc* presence in the UK, care needs to be taken that such presence does not evolve into being permanent. This could possibly occur where a *de facto* office is set up in a hotel, for example, or where employees of the overseas firm engage in a series of transactions or pattern of trading on behalf of the overseas firm from an establishment of the overseas firm in the UK, such as a UK branch. Attending meetings in the UK would not, without more, amount to a permanent presence.

'With or through' an authorised or exempt person

The RAO provides that a transaction is entered into "through" a person if he enters into it as agent or arranges for it to be entered into by another person as agent or principal.[24] The FCA has elaborated on this in its guidance: an overseas person will be deemed to be acting with or through an authorised person or an exempt person where "*the nature of the regulated activity requires the direct involvement of another person and that person is authorised or exempt (and acting within the scope of his exemption).*"[25] There are a wide variety of circumstances in which an authorised person or an exempt person may be involved in the performance of a regulated activity, but for the purposes of the OPE 'direct' involvement is required. A person will be directly involved in the performance of a regulated activity if, for instance, the overseas person deals as principal directly with that person or the overseas person arranges for that person to enter into a transaction.

The term 'authorised person' is defined in s. 31 FSMA. Under this provision as it currently stands, an authorised person includes a person with permission under Part 4A FSMA to carry out one or more regulated activities as well as EEA firms which exercise passport rights to carry out regulated activities in the UK. After the Brexit Date, EEA firms exercising passport rights to access the UK market will no longer qualify as authorised persons unless they obtain authorisation under Part 4A FSMA. As such, an overseas person seeking to rely on the OPE to carry out regulated activities with or through an authorised person must deal exclusively with firms that have been authorised under Part 4A FSMA, i.e. firms with standalone UK authorisation.

The term 'exempt person' is defined in s. 417 FSMA, which provides that exempt persons include persons falling within a specified class specified by order of the Treasury to be exempt from the General Prohibition.[26] Examples of exempt persons include the Bank of England and the central banks of other EEA states, several international development banks and certain charities. Appointed representatives are exempt from the General Prohibition under s. 39 FSMA.[27] Recognised investment

22 Article 3(2) RAO. Note that the type of "arranging" activity here refers to the "Bringing About" activity (as explained below).
23 Securities and Investments Board, *Carrying on Investment Business in the United Kingdom*, CP 19.
24 Article 3(2) RAO.
25 PERG 2.9.17G
26 Financial Services and Markets Act 2000 (Exemption) Order 2001.
27 An appointed representative is a person that performs certain regulated activities on behalf of a principal which itself has permission to carry out those regulated activities. The counterpart at an EU-wide level is the "tied agent" regime which is specific to MiFID activities.

exchanges, clearing houses and central securities depositories are also deemed to be exempt persons by virtue of s. 285 FSMA. Further, an exemption order made by the Treasury may restrict the nature of the activities to which the exemption order applies. As a result, an exempt person may be exempt in respect of certain regulated activities (e.g. deposit-taking) but not others. If an overseas person relies on the OPE by dealing with or through an exempt person, the overseas person must ensure that the exempt person is acting within the scope of its exemption.

Legitimate approach

A "legitimate approach" is defined in Article 72(7) RAO as:

(a) an approach made to the overseas person which has not been solicited by him in any way, or has been solicited by him a way which does not contravene s. 21 FSMA; or

(b) an approach made by or on behalf of the overseas person in a way which does not contravene s. 21 FSMA.

A "legitimate approach" therefore includes approaches made by or on behalf of the overseas person to the client in the UK as well as approaches by the UK client to the overseas person. Approaches made by the UK client to the overseas person may either be unsolicited or indeed may be a result of active solicitation by the overseas person, albeit such solicitation would have to comply with UK financial promotion rules.[28]

The "legitimate approach" concept encompasses the "reverse solicitation" notion, which has been historically relied on by several EU27 jurisdictions to delineate instances when a local licence would not be required to service such clients and which is now enshrined in MiFID II in the guise of the "own exclusive initiative" concept.[29] The concept of "legitimate approach" is very helpfully much broader than this in permitting active solicitation of a UK-based client.

UK financial promotion rules

Pursuant to s. 21 FSMA, a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless such invitation or inducement is deemed to be acceptable in circumstances specified by the Treasury in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**FPO**").

The FPO sets out a variety of communications that may be made by overseas persons without contravening s. 21 FSMA. For instance, communications may be made by overseas persons to companies above a certain size[30] or to investment professionals (which captures UK regulated firms and certain other unregulated market participants).[31] For retail clients, communications can be made to such clients if they are sophisticated or high net worth and have required certification to such effect.[32] There are other exemptions in the FPO that may also be useful for these purposes. The breadth of exemptions set out in the FPO mean that the legitimate approach concept is wide enough to accommodate active solicitation of wholesale market clients (and some retail clients that meet the conditions for sophistication or high net worth).

If a client does not fall within an exemption set out in the FPO, a firm will still have the (often impractical) option of having financial promotional materials approved by a UK-authorised person. In such a case, care will need to be taken that any surrounding oral communications with a client do not include a financial promotion, which is something that is inherently difficult to manage.

Application of the OPE to Particular Regulated Activities

Dealing in investments as principal

Buying, selling, subscribing for or underwriting securities or contractually-based investments as principal is a regulated activity.[33] "Buying" includes acquiring for valuable consideration.[34] "Selling" includes disposing of an investment for valuable consideration, which may include surrender, assignment or conversion of contractual rights relating to an investment or assuming contractual liabilities, or issuance of an investment.[35] The activity of dealing in investments as principal therefore involves the MiFID activity of dealing on own account and can also involve executing client orders, underwriting and portfolio management. It includes matched principal and other trading on a riskless principal basis. Securities include shares, instruments creating or acknowledging indebtedness (such as bonds), government and public securities, and units in collective investment schemes. Contractually-based investments include options, futures and certain insurance products. Firms that deal as principal in any of the above instruments by way of business and are regarded as doing so in the UK would be carrying out a regulated activity.

28 The financial promotion regime is largely governed by s. 21 FSMA and the FPO.
29 Article 42 MiFID II.
30 A 'high net worth company' is defined as any body corporate with a called up share capital of (i) £500,000, if the body corporate has more than 20 members, or (ii) £5 million, in any other case.
31 Article 19 FPO.
32 Article 48 and 50 FPO.
33 Article 14 RAO.
34 Article 3(1) RAO.
35 Article 3(1) RAO.

Non-UK firms that are overseas persons may rely on the OPE when dealing in investments as principal with or through an authorised person or on the basis of a legitimate approach. For the most part, EU27 firms would therefore be able to rely on the OPE to deal as principal in the wholesale markets after Brexit without obtaining authorisation in the UK.

Dealing in investments as agent

Buying, selling, subscribing for or underwriting securities, structured deposits or relevant investments as agent is a regulated activity.[36] Structured deposits are defined as deposits that are fully repayable at maturity on terms under which interest or a premium will be paid or is at risk by reference to an underlying index or basket of securities.[37] 'Relevant investments' are broadly equivalent to contractually-based investments (i.e. derivatives and certain insurance contracts), albeit a wider range of insurance contracts is captured by the definition of 'relevant investments' than those included in the category of contractually-based investments. Dealing in investments as agent corresponds to the MiFID activity of execution of orders on behalf of clients and can also apply to portfolio management, underwriting and placing activities.

Again, for the most part, non-UK firms that are overseas persons may rely on the OPE to avoid the need for UK authorisation when dealing in investments as agent with or through an authorised person or on the basis of a legitimate approach.

Arranging deals in investments

Article 25 RAO specifies two types of activity that constitute arranging deals in investments. These are:

(a) Making arrangements for another person (whether as principal or agent) to buy, sell, subscribe for or underwrite a security, a relevant investment or a structured deposit ("**Bringing About**"); and

(b) Making arrangements with a view to a person who participates in the arrangements buying, selling, subscribing for or underwriting such investments ("**Facilitation**").

Bringing About activity encapsulates most brokerage or intermediation activity carried out by a firm that brings about a transaction between counterparties (where the firm itself is not counterparty, either as principal or agent).[38] Facilitation activity typically covers facilitation of transactions between counterparties (e.g. by trading venues) as opposed to bringing about a specific transaction between specific counterparties. The corresponding MiFID activity is reception and transmission of orders but portfolio management and placing can also amount to arranging activity.

The OPE applies slightly differently in respect of arranging deals in investments. Under Article 72(3) RAO, an overseas person may only rely on the OPE to carry out Bringing About activity where such arrangements are made "with" an authorised person or exempt person acting within the scope of his exemption. There is no provision for arrangements being made "through" an authorised or exempt person. Similarly, Article 72(4) RAO provides that an overseas person may only engage in Facilitation activity to the extent that such activity relates to authorised or exempt persons. The OPE does not permit an overseas person to engage in Bringing About activity or the Facilitation activity on the basis of a legitimate approach.

Given the narrower scope of the OPE with regard to arranging activities, there is the possibility of concluding that any arranging activity is not being carried out in the UK (whether or not such activity is deemed to take place in the jurisdiction of the overseas person). On this basis, there would no need to rely on the OPE or any other exclusion. There is FCA guidance to the effect that persons that arrange contracts of insurance under Article 25 RAO "*will usually be considered as carrying on the activity of arranging in the location where these activities take place*".[39] The arranging activity (at least for contracts of insurance) is therefore deemed to take place at the location of the arranger which, for an overseas person, is not the UK. However, the FCA does not specify whether the same analysis would apply to arrangements involving investments that are not contracts of insurance. Moreover, if arranging activity is deemed to take place at the location of the arranger, then the OPE as it applies to arranging activity would arguably be redundant.

36 Article 21 RAO.
37 Article 3(1) RAO.
38 Article 28 RAO provides that arrangements to which the arranger is a party do not amount to a regulated activity for the purposes of the RAO.
39 PERG 5.12.8G.

Advising on investments

Advising on investments is a regulated activity if the advice is given to a person in his capacity as an investor or potential investor, and the advice is on the merits or otherwise of dealing in some way with an investment.[40] The FCA has confirmed that advice is limited to circumstances in which a person gives an opinion with respect to a particular investment, so generic advice is not regulated for the purposes of the RAO. Further, if only information is provided about specified investments, it would not qualify as advice, so the provision of investment research is not a regulated activity provided that no opinion is expressed as to the merits of a particular investment.

Article 72(5) RAO provides that overseas persons may provide advice to UK clients on the basis of a legitimate approach. However, there is no provision for overseas persons to be able to provide advice with or through an authorised or exempt person. This is of little practical impact given that the majority of advising activity, except advice given to general retail clients, can be undertaken on the basis of a legitimate approach by or to a UK client.

Activities relating to regulated mortgage contracts

The OPE also benefits certain mortgage lending and home financing activity. Our analysis covers mortgage lending only although the same limitations to the OPE also apply to the corresponding activities in respect of other home financing products regulated in the UK.

UK mortgage regulation only applies in respect of regulated mortgage contracts ("**RMCs**"). Entering into an RMC as lender and administering an RMC are regulated activities (as are advising on RMCs and arranging RMCs).[41]

A contract is only a RMC for the purposes of the RAO if:

(a) The contract is one under which a lender provides credit to an individual or trustees;

(b) The contract provides for the obligation of the borrower to repay to be secured by a mortgage on land in the EEA;[42] and

(c) At least 40% of that land is used, or intended to be used –

(i) In the case of credit provided to an individual, as or in connection with a dwelling; or

(ii) In the case of credit provided to a trustee which is not an individual, as or in connection with a dwelling by an individual who is a beneficiary of the trust.

Any mortgages provided by EU27 firms on a cross-border basis after Brexit that do not meet these criteria will not be RMCs for the purposes of the RAO. They would likely not fall to be considered as regulated credit agreements either.[43] In broad terms, mortgages to corporate vehicles will not be RMCs nor would mortgages to buy-to-let investors (subject to certain buy-to-let mortgages that might be caught as 'consumer buy-to-let' mortgage contracts, which would require FCA registration rather than authorisation).[44]

Where EU27 firms do enter into or administer RMCs, the OPE could be available.[45] However, the OPE only applies in respect of RMCs entered into by persons who are non-resident in the UK (i.e. who are not normally resident in the UK).[46] Any RMCs entered into or administered by EU27 firms after Brexit on the basis of the OPE must therefore be restricted to non-UK resident borrowers.

Use of the OPE in relation to legacy business

EU27 firms may consider whether to rely on the OPE when providing services to existing UK clients or when continuing with existing transactions with UK clients after the Brexit Date. Certain lifecycle events in the derivatives context, for example, would involve dealing activities. These dealing activities would have to be undertaken by a firm that was either authorised or was able to rely on an exclusion after Brexit. EU27 firms that encounter such lifecycle events in their legacy business may rely on the OPE to manage such events on a cross-border basis. However, where such transactions were initially entered into by a UK branch of the EU27 firm, it would not be possible to rely on the OPE as the UK branch is a permanent place of business maintained by the EU27 firm in the UK. Accordingly, the UK branch would have to rely on another exclusion or may consider novating the legacy trade to its head office in the EU or to another non-UK branch, which may then seek to rely on the OPE to manage the legacy book.

40 Article 53 RAO.
41 Article 61(1), Article 61(2), Article 25 and Article 53 RAO.
42 We expect that this will be amended following Brexit to refer to 'land in the UK'.
43 Mortgage Credit Directive Order 2015 (SI 2015/910), implementing the Mortgage Credit Directive.
44 Article 60H RAO.
45 Article 72(5D) and (5E) RAO.
46 Article 72(5D) and (5E) RAO.

Other exclusions from the RAO

If the OPE is not available, there are other exclusions that can be relied on. For instance, EU27 firms entering into intragroup transactions with affiliates in the UK will not generally be required to obtain authorisation in the UK. EU27 firms providing M&A advice or dealing as principal or agent in connection with the sale of a company will similarly not be required to obtain authorisation in the UK. Moreover, dealing as principal in respect of derivative contracts with or through an authorised person is not a regulated activity, so much interdealer activity could continue between EU27 firms and UK counterparties after the Brexit Date. Dealing as agent with or through an authorised person is similarly exempt, as are arrangements made with or through an authorised person.

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Contacts

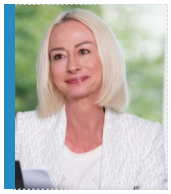
Azad Ali
Partner - London
Financial Services Regulation
E: Azad.Ali@fieldfisher.com
T: +44 (0)20 7861 4861

Christopher Hobson
Solicitor - London
Financial Services Regulation
E: Christopher.Hobson@fieldfisher.com
T: +44 (0)20 7861 4894

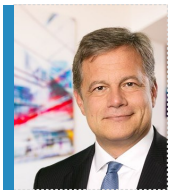
Rüdiger Litten
Partner - Germany
Financial Markets & Products
E: Ruediger.Litten@fieldfisher.com
T: +49 6920 434 2151

Thilo Danz
Partner - Germany
Financial Markets & Products
E: Thilo.Danz@fieldfisher.com
T: +49 6920 434 2152

Arnaud Grünthaler
Partner - France
Financial Markets & Products
E: Arnaud.Grunthaler@fieldfisher.com
T: +33 (0)1 70 37 81 77



Ingrid Dubourdieu
Partner - Luxembourg
Financial Markets & Products
E: Ingrid.Dubourdieu@fieldfisher.com
T: +352 621 359 076



Thorsten Voss
Partner - Germany
Financial Markets & Products
E: Thorsten.Voss@fieldfisher.com
T: +49 69 204 342 155

Carmelo Raimondo
Partner - Italy
Financial Markets & Products
E: Carmelo.Raimondo@fieldfisher.com
T: +39 02 806 731