THE UK TEMPORARY PERMISSIONS REGIME: EXTENSION OF PASSPORTING INTO THE UK ON A 'NO-DEAL' BREXIT

Date: 11 January 2019

Brexit Alert

By: Philip J. Morgan, Andrew Poole, Charlotte Bascombe

This alert is relevant in the context of a 'no-deal' Brexit only, although affected firms and fund managers may have to take certain actions before it is certain whether there will be a 'no-deal' Brexit.

The UK Government published a Statutory Instrument on 6 November 2018 that, in the event of a 'no-deal' Brexit, will establish the temporary permissions regime ("TPR") to allow EEA (non-UK) firms and EEA (non UK) funds to continue operating and marketing in the UK for an interim period despite the loss of passporting rights.

This alert discusses the TPR and what you may need to do now to prepare for a potential 'no-deal' Brexit.

IS THE TPR RELEVANT TO ME?

- Yes, if you are (or have an affiliate that is) a European Economic Area ("EEA") (non-UK) domiciled financial services firm that currently does regulated business in the UK under an EEA passporting right.
- Yes, if you market in the UK any EEA (non-UK) domiciled funds (Undertakings for collective investments in transferable securities ("UCITS") or alternative investment funds ("AIFs")) which have an EEA UCITS management company or EEA alternative investment fund manager.

KEY POINTS

- The TPR will only become operational if there is a 'no-deal' Brexit on 29 March 2019 ("Exit Day") with no transitional period
- The TPR will effectively preserve passporting rights into the UK for EEA (non-UK) firms and allow the continued marketing of EEA (non-UK) funds into the UK on the same basis as currently, for up to 3 years. This period, however, is subject to the allocation at some point during the 3 years of a 3-month 'landing slot' by the Financial Conduct Authority ("FCA"). Within its allocated 'landing slot' an EEA (non-UK) firm will need to either apply for full FCA authorisation or drop out of the TPR. An affected EEA (non-UK) fund will, during the relevant 'landing slot', need to either (i) apply for full FCA recognition (where relevant), (ii) make an appropriate notification to the FCA under the national private placement regime (where relevant), or (iii) drop out of the TPR and cease UK marketing. The TPR is not relevant to funds not domiciled in the EEA as of 29 March 2019.

- EEA (non-UK) firms and funds may only obtain the benefits of the TPR if they notify the FCA using the FCA's online Connect system during the notification window of 7 January to 28 March 2019.
- If an EEA (non-UK) firm has its application to become authorised refused, it will automatically leave the TPR based on the FCA's decision notice. Where an EEA (non-UK) firm chooses not to apply for authorisation, or withdraws its application, the FCA will have the ability to cancel the firm's temporary permission. In both circumstances, EEA (non-UK) firms will be permitted a period of 'supervised run-off' of 5 years in which to complete pre-existing regulated business contracts in the UK but will not be permitted to enter into new contracts for regulated business with UK customers without full FCA authorisation.
- If an EEA (non-UK) fund does not take appropriate steps to become recognised or notified, as applicable, within its specified 'landing slot', it will automatically leave the TPR. In these circumstances, EEA (non-UK) UCITS will need to apply for FCA recognition to be marketed to UK retail investors. Other EEA (non-UK) funds (including EEA AIFs) may continue to be marketed in the UK under the national private placement regime to professional investors and certain other persons subject to appropriate FCA notification and certain other requirements.
- This alert sets out how to approach the TPR, including what you should be doing now to prepare for a potential 'no-deal' Brexit.

THE PROPOSED TRANSITION FOR INBOUND EEA PASSPORTING FIRMS AND FUNDS IN THE EVENT OF A 'NO-DEAL' BREXIT

This alert provides current details of the TPR for both EEA (non-UK) firms and funds and provides guidance on how to access the TPR. It is important to note that the TPR has not been finalised and further revisions are expected in response to industry comments.

Section 1 is relevant to EEA (non-UK) firms.

Section 2 is relevant to EEA (non-UK) funds.

Section 1 - TPR for EEA (non-UK) firms

If Brexit occurs on Exit Day with no transitional period for financial services firms (a "No-Deal Brexit"), the EEA passporting regime for financial services activities will fall away on Exit Day. Such an outcome could result in serious disruption, as EEA (non-UK) firms may require a change in business model to continue to carry on regulated activities in the UK. The TPR, if implemented, will preserve the passporting rights of inbound EEA (non-UK) firms, allowing firms to continue their operations in the UK with comparatively minor disruption for an interim period. However, the TPR is not self-executing, as discussed below.

AVAILABILITY OF THE TPR

The TPR is available to EEA (non-UK) financial services firms that, on Exit Day, are permitted to carry on regulated activities in the UK by virtue of the EEA passporting regime. Treaty firms (EEA (non-UK) firms exercising EEA treaty rights to do business on a cross-border basis in the absence of passporting rights) who qualify under Schedule 4 to the UK's Financial Services and Markets Act 2000 ("FSMA") will also be able to use the TPR.

EFFECT OF TEMPORARY PERMISSION FOR EEA (NON-UK) FIRMS

The TPR will have the effect of temporarily authorising an EEA (non-UK) firm to undertake those regulated activities in the UK that were previously covered by its passport. The firm's authorisation under the TPR will be akin to an authorisation sought and obtained under Part 4A of FSMA. An EEA (non-UK) firm in the TPR will be subject to the same FCA rules that applied to them immediately prior to Exit Day and potentially certain additional FCA rules that concern matters implemented by a European Union directive that were previously reserved to the firm's home member state. This position is subject to the publication of finalised rules by the FCA expected shortly. The intention is to ensure a level playing field in which all firms operating under the oversight of the FCA whilst in the TPR comply with a uniform set of requirements and to avoid the risk that the TPR allows EEA (non-UK) firms to benefit from reduced regulatory oversight.

FCA NOTIFICATION PROCESS

EEA (non-UK) firms looking to take advantage of the TPR must submit their temporary permissions notification form through the FCA's Connect system. The window to submit notifications opened at 9am on 7 January 2019 and will close on 28 March 2019 (day before Exit Day). Once the notification window has closed, firms that have not submitted a notification will not be able to use the TPR and will require full authorisation by the FCA in order to carry on regulated activities in the UK from Exit Day.
In the lead up to the notification, the FCA recommends that firms contemplating a TPR notification:

complete the FCA's online survey https://www.fca.org.uk/eu-withdrawal/survey-eea-inbound-passported-firms

register for the FCA's Connect system; and

review the firm's passport permissions and notify the FCA, through their national competent authority, of any changes as soon as possible.

ALLOCATION OF TPR LANDING SLOTS

The TPR will allow EEA (non-UK) firms to continue to carry on regulated activities in the UK for a limited period while they seek full FCA authorisation. The period of time spent within the TPR will vary from firm to firm. The TPR, if implemented, will operate for an initial period of 3 years. However, the FCA currently plans to issue firms with a 3 month landing slot at some point during the 3 year lifespan of the TPR. During its 3 month landing slot, a firm must apply for full FCA authorisation if they wish to continue to carry on regulated activities in the UK. The first landing slot is anticipated to be from October to December 2019. The consequence of this is that a firm could spend as little as 9 months operating under the TPR. The FCA has proposed that the allocation of landing slots will be subject to "the type of business undertaken". Further clarity has been sought in relation to the process and criteria for allocation and the FCA's response is awaited.

DISCLOSURE OF TPR STATUS TO RETAIL CLIENTS

Firms in the TPR will be subject to enhanced disclosure requirements to retail clients. The FCA has proposed that firms should include specific disclosures in letters or electronic equivalents to retail clients to alert them of their temporary permissions status. In addition, the FCA also proposes that EEA (non-UK) firms passporting into the UK under the TPR on a cross-border basis but without establishing a UK branch (EEA services firms) disclose to retail clients that the applicable consumer protections may be different to those in the UK.

EXITING THE TPR

An EEA (non-UK) firm will exit the TPR following a decision by the FCA on its application for full authorisation. If successful, a firm will automatically exit the TPR and begin operating as a fully FCA-authorised firm. If a firm has its application for full authorisation refused, it will automatically exit the TPR on the basis of the FCA's decision notice. In these circumstances, a firm will be granted a period of 'supervised run-off' of 5 years in which to complete pre-existing regulated business only, which will be extended to 15 years for contracts of insurance. Such firms will not be permitted to enter into new contracts for regulated business with UK customers without full FCA authorisation.

If an EEA (non-UK) firm chooses not to apply for full authorisation or withdraws its application within its allocated landing slot, the FCA will have the ability to cancel its temporary permission. If temporary permission is cancelled, the firm would instantly exit the TPR but would retain access to the period of 'supervised run-off' described above.

Section 2 - TPR for EEA (non-UK) funds

In the event of a No-Deal Brexit, the EEA passporting regimes for funds - i.e. UCITS and AIFs - will fall away on Exit Day. Such an outcome could result in serious disruption, as fund managers would be unable (i) to continue to market EEA (non-UK) funds to UK retail investors without obtaining individual FCA recognition of the funds and (ii) to market to UK professional investors without an appropriate FCA notification to market under the UK's national private placement regime. The TPR, if implemented, will temporarily preserve passporting rights permitting the marketing of inbound EEA (non-UK) funds in the UK. However, the TPR is not self-executing, as discussed below.

AVAILABILITY OF THE TPR TO EEA (NON-UK) FUNDS MARKETED IN THE UK

The TPR is available to:

1. EEA (non-UK) UCITS recognised under s.264 of FSMA, which implements UCITS directive passporting rights; and
2. EEA (non-UK) AIFs entitled to be marketed to professional investors in the UK through the exercise of Alternative Investment Fund Managers Directive ("AIFMD") passporting rights.

The TPR is not available to funds not currently domiciled in the EEA.

EFFECT OF TEMPORARY PERMISSION FOR EEA (NON-UK) FUNDS

In respect of EEA (non-UK) UCITS, the TPR will have the effect of temporarily recognising each individual fund or sub-fund, allowing it to continue to be marketed to retail investors in the UK. For EEA (non-UK) AIFs, the TPR will allow the AIF to continue to be marketed into the UK under an AIFMD passport on the same basis as immediately before Exit Day. The TPR will continue to apply the same rules that applied to the marketing of EEA (non-UK) funds into the UK under a passport as applied immediately before Exit Day.

FCA NOTIFICATION PROCESS

Fund managers looking to take advantage of the TPR in relation to the marketing of EEA (non-UK) funds must notify the FCA of their intention to continue to market their funds to permitted investors in the UK. Fund managers must submit their temporary permissions notification form through the FCA's Connect system. The window to submit notifications opened at 9am on 7 January 2019 and will close on 28 March 2019 (day before Exit Day). Once the notification window has closed, fund managers who have not submitted a notification for a fund will not be able to market it in the UK after Exit Day by virtue of the TPR. There may be other routes available for such marketing. However, following Exit Day and assuming a No-Deal Brexit, the fund manager of an EEA (non-UK) UCITS that did not enter the TPR would need to apply for full recognition under s.272 FSMA to be marketed to retail investors in the UK.

In the lead up to the notification window, the FCA recommends that affected fund managers:

3. complete the FCA's online survey https://www.fca.org.uk/eu-withdrawal/survey-eea-inbound-passported-firms
4. register for the FCA's Connect system; and
5. check which EEA (non-UK) funds they are actively marketing in the UK and notify the FCA, through their national competent authority, of any changes as soon as possible.

ALLOCATION OF TPR LANDING SLOTS

The period of time spent within the TPR will vary from fund to fund. The TPR, if implemented, will operate for an initial period of 3 years. However, the time period during which an EEA fund may operate within the TPR will be dependent on the landing slot that it is allocated. The FCA currently plans to issue TPR funds with a 3 month landing slot at some point during the 3 year lifespan of the TPR.

During a fund's 3 month landing slot, the fund manager may apply for FCA recognition of the fund. EEA (non-UK) UCITS, once within their allocated landing slot, may choose to apply for FCA recognition under s.272 FSMA which would allow marketing to retail investors in the UK. It is widely anticipated that the FCA will reform the s.272 application process in order to facilitate an efficient process given the large volume of applications that are expected. FCA recognition may not be necessary for EEA AIFs whose EEA alternative investment fund managers may instead, in the landing slot, notify the FCA under the UK's national private placement regime of proposed marketing to professional investors in the UK. If neither of these steps are taken during the allocated landing slot, the fund will automatically exit the TPR and no longer have temporary permission to market on the same basis as before Exit Day.

The first landing slot is anticipated to be from October to December 2019. The consequence of this is that a fund could spend as little as 9 months operating under the TPR. Further clarity has been sought in relation to the process and criteria for allocation and we await the FCA's response.

ADDITION OF NEW SUB-FUNDS

HM Treasury guidance indicates that where at least one sub-fund of an umbrella UCITS structure has previously notified the FCA that it wishes to avail of the TPR, additional sub-funds created after Exit Day will also be permitted access to the TPR. Fund managers of existing EEA (non-UK) sub-funds that wish to market into the UK after Exit Day and that do not do so currently will need to utilise their passporting rights and notify the FCA of their intention to enter the TPR prior to Exit Day. This paragraph does not apply to umbrella AIF structures.

EXITING THE TPR

An EEA (non-UK) fund in the TPR for marketing purposes will automatically exit the TPR after (as applicable) (i) the approval of its application for recognition or (ii) its notification under the UK national private placement regime. If such a fund fails to apply for recognition or to submit a notification under the UK national private placement regime within its allocated landing slot, the fund will automatically exit the TPR and will no longer have temporary permission to market on the same basis as before Exit Day. In these circumstances, EEA (non-UK) UCITS will need to apply for FCA recognition to be marketed to UK retail investors. Other EEA (non-UK) funds (including EEA AIFs) may continue to be marketed in the UK under the national private placement regime to professional investors and certain other persons subject to appropriate FCA notification and certain other requirements.

WHO TO CONTACT

Should you require any further guidance on the matters raised above please feel free to reach out to the contacts below.

KEY CONTACTS

PHILIP J. MORGAN
PARTNER

LONDON
+44.20.7360.8123
PHILIP.MORGAN@KLGATES.COM

ANDREW J. MASSEY
PARTNER

LONDON
+44.20.7360.8233
ANDREW.MASSEY@KLGATES.COM

MICHELLE MORAN
PARTNER

LONDON
+44.20.7360.8255
MICHELLE.MORAN@KLGATES.COM

ANDREW POOLE
ASSOCIATE

LONDON
+44.20.7360.8178
ANDREW.POOLE@KLGATES.COM

