Call for evidence on UK overseas framework

Date: 11 March 2021

Sent to: overseasframeworkcfe@hmtreasury.gov.uk

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

1. Introduction

1.1 HM Treasury (**HMT**) has published its "*Overseas Framework: Call for Evidence*" (December 2020) (the **CFE**) at a significant juncture for UK financial services. Following the UK's withdrawal from the European Union and the expiry of the transition period, we agree now is a suitable time for examining the regulatory framework applicable to overseas firms. Moreover, the increased autonomy of HM Government and the UK authorities following Brexit presents greater opportunity for making improvements.

1.2 The ability to provide cross-border services into the UK is not solely of interest to overseas firms. It is also key to providing UK financial market participants with access to global markets with minimal frictions. It therefore has a much wider significance: deepening markets, fostering competition and supporting consumer choice, both for individuals and businesses. Historically, the UK has been open to cross-border wholesale business. This openness has helped to underpin the UK's position as an international financial centre, with all the wider social and economic benefits this brings.[1]

1.3 Looking to the future, continuing to balance openness with robust standards will ensure the UK maintains its status as both a thriving hub and model for regulation globally. UK Finance therefore welcomes HMT's CFE as an opportunity to outline its members' views on existing arrangements, and suggest how they might be improved.

1.4 HMT's review of the UK overseas framework forms part of the broader reform of the UK's regulation of financial services. Hence our response to the CFE should be read with our response to HMT's "*Financial Services Future Regulatory Framework Review: Phase II Consultation*" (October 2020) (the **Future Framework Consultation**).[2] In particular, improvements to the UK's overseas framework should form part of a wider set of measures to differentiate the UK as the best place in the world in and from which to provide financial services.

1.5 These measures will include efforts to promote the export of financial services from the UK. It will be important to align such measures with improvements to the UK's overseas framework, not least because firms in the UK combine a mix of services, some by way of

[1] For example, see TheCityUK "*Key facts about the UK as an international financial centre 2020*"; https://www.thecityuk.com/assets/2020/Reports/8716847a2f/Key-facts-about-the-UK-as-an-international-financial-centre-2020.pdf (accessed 25 February 2021).

[2] https://www.ukfinance.org.uk/system/files/F2R2-phase-II-consultation-FINAL.pdf.

"export" to the customer, client or counterparty concerned, others enabled through the UK overseas framework, in doing business abroad. The UK overseas framework needs to work in tandem with the UK's export-enabling measures (see paragraph 1.10 below) to improve the competitiveness of the UK internationally as a location for the businesses concerned.

1.6 In wholesale markets, the framework operates well in practice, but the law is neither as comprehensive, nor clear, as it could be. As outlined further below, the regimes applicable to overseas firms are currently scattered across statute and regulators' rulebooks, having developed piecemeal over an extended period of time. The Overseas Persons Exclusion (**OPE**), for example, despite forming a cornerstone of the UK's position as an international centre in relation to designated investment business, is complex (especially given the linkage with the UK's intricate financial promotion regime) and arguably unclear in certain respects. We are therefore supportive of rationalising the framework where possible, so it is easier for firms to navigate across the sub-sectors of the financial services regime.

1.7 In the private wealth environment, the framework for access to high net worth retail clients is highly complex, and both difficult and expensive to operationalise. We believe that review of retail access as regards high net worth retail clients, including a reappraisal of the financial promotion regime, would be appropriate. We have made a number of observations below about the difficulties in this area, along with suggestions that we believe should be implemented.

1.8 We have supplemented our more general observations made in response to the CFE's questions with a technical appendix, which provides a more detailed examination of the way in which firms have to navigate the issue of territoriality in legislation and related guidance. We hope this will be of assistance to HMT in understanding some of the issues faced by firms and their legal advisors in practice.

1.9 Given the importance of these channels for inbound services, any legislative changes will require careful consideration to ensure they both meet firms' needs and avoid unintended consequences. As a result, our members strongly encourage HMT to undertake further engagement with stakeholders prior to introducing any new legislation.

1.10 Alongside our response to this CFE, we would draw HMT's attention to UK Finance's recent publication "*International Trade in Financial Services: Defining trade policy for banking, payments and related financial services*" (**Trade in FS Paper**).[3] The Trade in FS Paper addresses in detail many of the wider issues relevant to this area.

1.11 Unless otherwise stated, paragraph references in this document are to the CFE.

2. Responses to questions

Q1: Please describe your business model, entities, and the types of financial services activity your firm (or group, where relevant) undertakes in relation to the UK, or will undertake after the end of the transition period.

2.1 UK Finance represents a wide range of firms providing finance, banking, markets and payments-related services in or from the UK. We have therefore not addressed this question.

[3] https://www.ukfinance.org.uk/system/files/International%20Trade%20in%20Financial%20Services_FINAL.pdf

Q2: Do you think that the route of access to the UK market provided for by the overseas framework adequately advances the principles set out in paragraph 1.7?

2.2 The UK's overseas framework is among the most favourable legal frameworks for cross-border business and provides one of the most conducive regimes for the conduct of wholesale and high-net worth retail financial services business internationally. Even so, it could be refined so as to provide greater clarity and simplicity. By way of example:

(a) the meaning of carrying on a regulated activity "*in the UK*" is unclear given the dearth of provisions addressing territorial scope in the Financial Services and Markets Act 2000 (**FSMA**) and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the **RAO**), where regulated activities are defined; and

(b) the OPE at Article 72 of the RAO is crucial to the UK benefiting from "*maintaining an open and globally integrated financial system*". However, it is both difficult to navigate and poorly aligned with the wider regulatory framework, much of which has been shaped by EU legislation introduced since the OPE's creation in 1986.

2.3 The principles specified at paragraph 1.7 include the provision of "*robust, high-quality and proportionate regulation*" which is "*transparent and predictable*". In light of the factors illustrated above, the UK's overseas framework does not adequately advance these principles in a number of key respects.

2.4 By way of further example, as highlighted in section 4 of the appendix in relation to payment services, firms are excessively reliant on a short item of guidance in PERG within the FCA Handbook regarding territorial scope. A regime that met the ideals cited would address the issue clearly in law. Instead, we currently have a system where statute's silence on territorial matters often means regulators' guidance fills this vacuum and thereby takes on a quasi-legislative significance. Moreover, the scattered and uneven nature of such guidance means that firms and their advisors are sometimes obliged to engage in detective work to divine the regulator's intentions.[4] Given the current focus on regulatory architecture and the rule-making process, it would be worth HMT factoring this issue into any actions taken following its Future Framework Consultation.

2.5 Part of the problem is that a single "overseas framework" does not exist: we currently have a patchwork of several regimes that are both complex and unintegrated. These could be streamlined and simplified.

Q3: Are there any specific risks that the current regimes for overseas firms do not adequately address?

2.6 We have not identified any risks that the existing regimes do not adequately address.

Q4: Are there specific complexities around the regime you think need to be addressed?

2.7 Based on members' experience, we would note the following complexities:

(a) To avoid breaching the "general prohibition" at s. 19 of FSMA, determining whether a regulated activity is being carried on "*in the UK*" is often a difficult exercise. Although s. 418 of FSMA and PERG 2 of the Financial Conduct Authority (**FCA**) Handbook provide some assistance, perimeter guidance is frequently non-existent, historic or

[4] For example, see the materials still consulted in relation to deposit taking at section 2 of the appendix.

scattered across several sources. In some cases, it is also arguably inconsistent with case-law.[5] Please see section 2 of the appendix for detailed examples in relation to deposit taking and investment services. The surprising difficulties with basic perimeter questions create unnecessary friction for overseas firms when seeking to access UK clients. Clarification in this area, preferable by way of legislation, would be welcome.

(b) The "financial promotion restriction" at s. 21 of FSMA is highly technical and aspects of it do not work well. Better aligning it with the territorial scope of the general prohibition appears desirable. Members also believe that the regime could be made less restrictive in certain respects, without increasing the risk of harm to retail customers. For instance, expanding the scope of communications permissible to certified high net worth individuals pursuant to Article 48 of the FSMA (Financial Promotion) Order 2005 (the **FPO**) would facilitate the provision of a wider range of private banking services, without affecting the position of non-high net worth retail customers.

(c) Historically, the territorial scope of the UK regulatory perimeter applied consistently with that of the OPE, meaning non-UK branches of authorised firms were free to conduct activities into the UK without the application of financial promotion or conduct of business requirements where the OPE would otherwise have applied but for the existence of a UK branch. This principle has become less clear over the last 20 years. UK Finance believes that it should be clarified. Indeed, in the interest of clarity and transparency, it would be desirable if the principle that firms acting within the OPE are outside the scope of the regulators' rulebooks was reflected in legislation.

(d) Overseas market infrastructure providers are currently subject to a significant number of regimes when seeking to access UK clients. For instance, an overseas central counterparty potentially has to consider the OPE, Article 25 of the UK European Market Infrastructure Regulation (**UK EMIR**), the recognised clearing houses regime at Part XVIII of FSMA, Part VII of the Companies Act 1989 and UK implementation of the Settlement Finality Directive. Having evolved separately, these frameworks do not provide a coherent system of regulation and impose unnecessary costs on access to the UK market. UK Finance hence perceives there would be value in HMT exploring how the same outcomes could be achieved through a more integrated set of rules.

(e) Moreover, due to the inheritance from EU law, both UK EMIR and the Central Securities Depositories Regulation (**UK CSDR**) make recognition (which in turn depends on equivalence) a precondition for the provision of services by overseas market infrastructure providers into the UK.[6] This limits the freedom of UK market participants to access services globally.

(f) In light of how the RAO's definition of "regulated mortgage contract" has been amended for Brexit, contracts relating to property outside of the UK now fall within the consumer credit regime. The need to rely on an exemption from being a credit agreement has complicated the provision of mortgage products where the land in question is located within the EU. Many firms would like to rely on the exemption at Article 60E of the RAO, but to do so need to either be a deposit-taker or specified in

[5] For example, see the Court of Appeal's judgement in *Fons Hf v Corporal Ltd and another* [2014] EWCA Civ 304 and the FCA's subsequent letter to the Loan Market Association, which concerned the meaning of the term "debenture".

[6] See in particular Article 25 of UK EMIR and Article 25 of UK CSDR.

CONC App 1.3 of the FCA Handbook. Making it easier for firms to rely on this exemption would be helpful given the change of circumstances caused by Brexit.

2.8 We have made specific comments about the OPE in response to question 7 below. As mentioned above, we have also included an appendix with more detailed legal analysis of the practical difficulties we have identified with the rules as they stand.

Q5: Please could you comment on the overlap between article 47 of MiFIR and the OPE. If an article 47 decision was issued, how may this affect your decisions to undertake activity in the UK?

2.9 We note that overseas firms falling within the on-shored equivalence regime at Title VIII of the UK Markets in Financial Instruments Regulation (**UK MiFIR**) are unable to rely upon the OPE after three years of a relevant determination being made by HMT.[7] In comparison with the OPE, the equivalence regime is untested, different in scope (as it applies to eligible counterparties and *per se* professional clients, but not retail clients and does not cover certain activities outside the scope of the MiFID II regime, such as regulated mortgage lending) and imposes more stringent requirements, e.g. having to be registered with the FCA and comply with certain conduct obligations when dealing with UK clients.

2.10 In UK Finance's view, it is illogical that firms benefiting from equivalence under Title VIII of UK MiFIR should be in a worse position than those providing cross-border services solely in reliance on the OPE. This is because an equivalence determination by HMT implies the risk of harm to customers is likely to be lower owing to the alignment in regulatory standards between the UK and the firm's home jurisdiction. Were the regime to be implemented, firms relying on it would also face complexity navigating where equivalence was provided and where the OPE continued to be available.

2.11 This is a good example of where aspects of UK regulation are made less effective through interaction with legacy EU law. We think it would be preferable if all overseas firms were able to use the OPE. However, as stated in UK Finance's "*Technical Briefing: What the MiFIR Third-Country Regime Means for UK-EU Cross-Border Services*" (June 2020) (the **Technical Briefing**), some overseas firms may prefer the clarity provided by the MiFIR framework and, moreover, the regimes have differences in scope. As such, we think it important that firms should be able to choose between the two approaches.[8]

2.12 In the same vein, if the UK expands its equivalence framework to permit market access in other areas of financial services, such expansion should not result in a corresponding narrowing of overseas' firms access rights. Indeed, in due course we think it would be worth reappraising the concept of equivalence as on-shored more broadly, as it may not be the best approach for the UK to take in relation to third-country market access going forward.[9]

Q6: Are there national exclusions/exemptions in other jurisdictions that provide benefits comparable to those provided by the UK's regime?

2.13 In the experience of UK Finance's members, internationally there are four broad types of overseas framework:

---

[7] Article 72(11) and (11A) of the RAO.

[8] The Technical Briefing, p. 26 (available here: https://www.ukfinance.org.uk/system/files/UK%20Finance%20Technical%20Briefing-MiFIR%20third-country%20regime_FINAL.pdf).

[9] See Part D (Equivalence-based Regimes) of the IRSG's Interim Report (as defined below) for a discussion of these issues.

(a) the requirement to become fully authorised, potentially obliging a firm to establish a branch;

(b) registration regimes, which do not require a local establishment, but require compliance with local investor protection or other obligations (which can be onerous);

(c) "light touch" registration regimes which may impose limited regulatory obligations; and

(d) exclusions which allow services to be provided to a limited set of sophisticated customers, generally in the wholesale sector or in respect of high-net worth or expatriate clients.

2.14 Of the four models, exclusions create the least friction when seeking to import or export financial services. In this context, UK Finance regards the OPE as striking the best balance between openness and consumer protection given its primary focus on the wholesale sector. We have examined the position in certain overseas jurisdictions in past publications, some of which may be useful for the purpose of comparison.[10]

2.15 In terms of other national exclusions, UK Finance is aware that Ireland has an exemption that is comparable to the OPE in many respects. In particular, we understand that regulation 5(4) of the European Union (Markets in Financial Instruments) Regulations 2017 (the **Irish MiFID II Regs**) contains the so-called "MiFID II Safe Harbour Exemption". In brief, this provides that, in certain circumstances, an entity that provides services from its home jurisdiction to a client in Ireland is not to be deemed as operating there. This applies to the provision of investment services to eligible counterparties and/or per se professional clients.

2.16 The nomenclature of the exemption is accordingly aligned with the Markets in Financial Instruments Directive (**MiFID**) client categorisation framework. It would be desirable to likewise achieve more consistency between the OPE's terminology and MiFID's, while being careful to retain existing concepts that helpfully apply the regime more widely, given the latter has had a substantial impact on other areas of financial services regulation. This would not only better integrate the UK rulebook, but also make the OPE easier to navigate for overseas firms already familiar with EU regulation.

2.17 In addition, we understand the Irish Investment Intermediaries Act 1995, which governs the provision of certain investment services not otherwise covered by the Irish MiFID II Regs, contains a territorial safe harbour for an overseas firm with no branch in Ireland. This exemption generally only applies where the overseas firm provides services to corporate clients.

2.18 Although more limited than the OPE, the French "interdealer exemption" permits own account dealing with a prescribed set of French counterparties, subject to certain conditions. We understand it was expanded in 2019 to include a wider range of counterparties, and permitting third country firms to become members of French regulated markets, MTFs and OTFs.

2.19 UK Finance is also aware of the qualified institutional buyers or "QIBs" and accredited investors regimes in the United States, which in certain respects have a comparative effect to the OPE.

---

[10] See the Trade in FS Paper, p. 40, and "*Supporting Europe's Economies and Citizens: A modern approach to financial services in an EU-UK Trade Agreement*" (September 2017), pp. 58-61.

Q7: What changes do you think should be made to the operation of the OPE, and what would be the advantages and disadvantages?

2.20 As explained in UK Finance's Trade in FS Paper, the existing scope of the OPE should be maintained given it provides a vital gateway for both UK and overseas firms.[11] However, it could be expanded in certain areas. While any changes will require careful consideration, members wished to highlight the following:

(a) An overriding policy of the OPE is evidently that certain wholesale business can be excluded from the scope of regulation, as authorised and other sophisticated/high net worth clients are capable of managing their own risks, in contrast to the position with many retail customers. In UK Finance's view, the OPE could be simplified in certain respects while not diluting this principle.

(b) In particular, as the International Regulatory Strategy Group (**IRSG**) has suggested, it would improve the navigability of the OPE if the RAO were amended to include an additional specific exemption making clear that the OPE applies where an overseas firm carries on the regulated activities covered by the OPE with or for authorised persons, other "investment professionals" and "high net worth entities".[12] This would lead to a more consistent approach, as the tests are currently different for different activities.[13]

(c) Greater clarity on the circumstances in which an overseas firm will be deemed to have established "*a permanent place of business maintained by him in the United Kingdom*" for the purpose of the "overseas person" definition at Article 3(1) of the RAO would be welcome. For example, what level of regular business travel is permissible? Would maintaining a server in the UK in connection with electronic trading be sufficient, even if the sever merely transmits instructions to an overseas establishment? As explained at paragraph 3.2 of the appendix, the Court of Appeal's decision in *FSA v Fradley (t/a Top Bet Placement Services)*[14] has generated some anxiety that a minimal nexus with the UK may suffice for this purpose.

(d) As noted at paragraph 2.16 above, we believe a sensible change may be to more closely align the terminology used in the OPE/FPO and the MiFID client categorisation framework, where possible. The FPO is often relevant, given several of the OPE's limbs use the concept of a "legitimate approach". In essence, this is defined at Article 72(7) of the RAO as an approach that does not contravene the "financial promotion restriction" at s. 21 of FSMA. The current differences that exist (e.g. "investment professional" vs "professional client") can create unnecessary confusion.[15] Where concepts in the OPE and FPO are broader than their MiFID equivalent, care would need to be taken to maintain the existing breadth of the exclusion.

---

[11] Trade in FS Paper, p. 30.

[12] The IRSG, "*Interim Report: The UK Regime for Overseas Firms*" (the **Interim Report**), pp. 9-10 (available here: https://www.irsg.co.uk/assets/Reports/201127-Final-Interim-report-UK-regime-for-overseas-firms.pdf).

[13] For example, the exclusion for "arranging deals in investments" at Article 72(3) of the RAO only applies to arrangements "*with an authorised person, or exempt person acting in the course of a business comprising a regulated activity in relation to which he is exempt*". Thus it would not apply if the party to the deal was sophisticated but not authorised.

[14] [2005] EWCA Civ 1183.

[15] See Article 19(5) of the FPO and COBS 3.5 of the FCA Handbook respectively.

(e) There would be value in the OPE being expanded to cover additional activities. We would welcome any review by HMT in this area. For example, the uncertainties about territorial scope in relation to deposit taking (which are explored in section 2 of the appendix) could be resolved through bringing this regulated activity within the scope of the OPE.

(f) Whilst some of the changes above would best be dealt with through amendments to the RAO, perimeter guidance should also be considered to supplement the amendments. Perimeter guidance is highly valuable as it represents the most flexible and user-friendly way in which to articulate the boundaries of the regime. It would be helpful to see perimeter guidance used to address some of the practical questions raised in paragraph (c), for example.

2.21 Making the OPE easier to navigate would enable overseas firms to more readily grasp the opportunities available to them in the UK. At the moment, they may not necessarily realise the UK is more liberal than many other comparable jurisdictions.

2.22 UK Finance would also stress that improvements to the OPE will not just benefit overseas firms, but also the UK firms with whom they do business. In this sense, the OPE facilitates exports as much as it does imports of financial services. For example, the OPE permits an overseas firm to purchase securities from a UK authorised broker-dealer when they might otherwise be dealing in investments as principal within Article 14 of the RAO.

Q8: Which aspects of the overseas framework are relevant to the conduct of your business, how easy they are to use and how well do they suit the nature of your business?

2.23 UK Finance's members wished to flag that the complexity of the UK overseas framework, coupled with the prospect of criminal liability and unenforceable contracts for those who make mistakes, generate a significant compliance burden.[16] The intricacies of the OPE, not least reliance on exclusions in the FPO, need to be reflected in firms' internal policies, staff training and ongoing systems and controls. These factors make the service provided to clients more cumbersome and expensive. The changes suggested above would help to address some of these issues.

Q9: Please comment on your current and future use of the OPE, ROIE and FPO exemptions specifically, as well as any other specific regimes under the access framework, setting out in particular:

2.24 As explained at paragraph 2.1 above, UK Finance represents a wide range of firms providing finance, banking, markets and payments-related services in or from the UK. We have therefore only addressed questions (n) and (q) below.

n) Are there specific aspects of the OPE which give rise to uncertainty, for example over its application in some circumstances, and how might these be remedied?

2.25 As discussed at paragraph 3.4 of the appendix, it is unclear why the limb of the OPE relating to arranging deals in investments does not apply where the overseas person has been the subject of a legitimate approach, unlike that for dealing in investments as principal.[17] It is

[16] For example, see ss. 23, 25 and 26 of FSMA.

[17] See Article 72(3) and (1) respectively of the RAO.

generally inferred this distinction is predicated on the principle that arranging takes place in the location of the arranger, i.e. overseas in this context. However, it would be helpful if this matter was clarified.

q) If you are a firm authorised in the UK, what business benefits do you get from dealing directly with overseas firms which rely on the OPE?

2.26 As mentioned at paragraph 2.22 above, UK Finance's members derive significant benefits from the OPE when dealing with overseas firms who rely on the exclusion. This is because the OPE provides a relatively straightforward means for these counterparties to navigate UK licensing issues in a wholesale context. This contrasts favourably with the position in jurisdictions that take a more restrictive approach.

If you have any questions relating to this response, please contact Angus Canvin, our Director of International Affairs.

APPENDIX

1. INTRODUCTION

1.1 As explained at paragraph 1.8 above, UK Finance has produced this appendix to illustrate the approach taken by firms and their legal advisors to the issue of territorial scope. We hope it assists in showing some of the difficulties encountered under the current overseas framework. The intention is that this technical detail supplements the more general observations made in response to HMT's questions.

1.2 In legal terms, the UK does not have a single overseas "framework". Instead, the provision of cross-border financial services into the UK is governed by several regimes that exist in parallel under primary and secondary legislation. These include:

(a) the "general prohibition" at s. 19 of FSMA, which is relevant in connection with the majority of regulated activities;

(b) the prohibition on providing payment services in the UK without appropriate authorisation at regulation 138 of the Payment Services Regulations 2017 (**PSRs**); and

(c) the prohibition on issuing electronic money in the UK without appropriate authorisation at regulation 63 of the Electronic Money Regulations 2011.

1.3 This legislation contains little detail in relation to territorial scope, as explored further below. When express provision is made, it is often ambiguous. Firms and their legal advisors are therefore obliged to consult a variety of additional sources to ascertain the law's meaning and regulators' expectations. These materials primarily consist of the following:

(a) case law, although the bulk of perimeter issues are not examined by the courts;

(b) the regulator's rulebooks, principally PERG in the FCA Handbook; and

(c) other relevant guidance, e.g. HMT's "*Provision of cross-border financial services in the United Kingdom by firms from Switzerland*" (August 2011).[18]

1.4 We have provided examples below of how this structure is navigated in practice, with reference to areas particularly relevant to UK Finance's membership.

2. The general prohibition

2.1 s. 19 of FSMA contains the "general prohibition". This provides that no person may "*carry on a regulated activity in the United Kingdom*" unless they are authorised or exempt. FSMA provides no definition of carrying on a regulated activity in the UK, but specifies circumstances in which activities are deemed carried on in the UK in s. 418 (set out below). As a result, the expression's meaning is not clear. Meanwhile, ss. 23 and 26 of FSMA impose criminal liability and render agreements potentially unenforceable where the general prohibition is breached. The issue of territorial scope is hence a difficult, yet crucial, area for firms in practice.

[18] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/356887/memo_by_HMT.pdf (accessed 11 February 2021).

2.2 The term "regulated activity" is defined at s. 22 of the FSMA. For most purposes, it consists of a specified activity carried on in relation to a specified investment, with these terms in turn being given their meaning in the RAO. The RAO does not specify where particular regulated activities are regarded as being carried on. We have examined below the issue of territorial scope in relation to two areas covered by the general prohibition: deposit taking and the provision of investment services.

Deposit taking

2.3 Under the RAO, the acceptance of deposits is a specified activity under Article 5 and a deposit is a specified investment under Article 74. Neither of these provisions, however, expand on how the territorial scope of the general prohibition applies to this particular banking activity.

2.4 Other provisions of FSMA do concern territoriality. In particular, within Part XXIX (Interpretation), s. 418 prescribes three cases where a person who is carrying on a regulated activity, but would not otherwise be regarded as carrying it on in the UK, is to be regarded as doing so for the purposes of FSMA. As such, it expands the statute's territorial scope. These circumstances are:

(a) the person's registered office (or, if he does not have one, his head office) is in the UK and the day-to-day-management of the carrying on of the regulated activity is the responsibility of (i) his registered office (or head office, where relevant) or (ii) another establishment maintained by him in the UK;

(b) the person's head office is not in the UK, but the activity is carried on from an establishment maintained by him in the UK; and

(c) the person is carrying on the regulated activity of managing an AIF and the following conditions are satisfied:

(i) the AIF being managed (i) has its registered office in the UK or (ii) is marketed in the UK;

(ii) the person's registered office is in the UK or, if the person does not have a registered office, the person's head office is in the UK; and

(iii) the activity is carried on from an establishment maintained in a country or territory outside the UK.

2.5 For the purpose of s. 418 of FSMA, it is irrelevant where the person with whom the activity is carried on is situated.[19] The circumstances in (a) will be relevant in connection with deposit taking where deposits are held overseas, but the relevant firm nevertheless conducts day-to-day management of deposit taking activities from a registered office in the UK.

2.6 Beyond FSMA, firms and legal practitioners also have regard to the so-called "characteristic performance principle" when determining whether an activity is deemed to be carried out within the UK. This derives from Commission Interpretative Communication 97/C 209/04 (the **Interpretative Communication**). The Interpretative Communication contains guidance in relation to the EU's Second Banking Directive (**2BD**), but its analysis is taken to have a broader application. The 2BD required a credit institution wishing to "*[carry] on its activities*

[19] s. 418(6) of FSMA.

within the territory of another Member State" to notify the competent authorities in that jurisdiction.[20] In light of this, the Commission explained as follows:

> "*It is necessary, therefore, to 'locate' the place of supply of the future banking service in order to determine whether prior notification is required.*
>
> *Unlike other services, where the place of supply can give rise to no doubts (legal defence, construction of a building, etc.), the banking services listed in the Annex to the Second Directive are difficult to pin down to a specific location. They are also very different from one another and are increasingly provided in an intangible form. The growth of distance services, particularly those using electronic means (Internet, home banking, etc.), will undoubtedly soon result in excessively strict criteria on location becoming obsolete. […]*
>
> *[The Commission] considers it necessary to adhere to a simple and flexible interpretation of Article 20 of the Second Directive. Accordingly, in its opinion, only activities carried on* within the territory *of another Member State should be the subject of prior notification. In order to determine where an activity was carried on, the place of provision of what may be termed the 'characteristic performance' of the service, i.e. the essential supply for which payment is due must be determined*."[21] [emphasis added]

2.7 This characteristic performance principle remains helpful when analysing issues of territoriality. However, it is now historical in nature and, given the UK's withdrawal from the EU, of uncertain standing.[22] It would therefore be preferable if it were recast and located along with other guidance in a more central location with the UK's post-Brexit framework.

2.8 Firms and practitioners also consult the FCA Handbook, in particular PERG 2.4 which concerns the "*Link between activities and the United Kingdom*". Despite this area's complexity, PERG 2.4 consists of just eight paragraphs. Deposit taking is only addressed in passing at PERG 2.4.5 G in connection with situations where a firm has a representative office in the UK. This states:

> "*A person who is based outside the United Kingdom but who sets up an establishment in the United Kingdom must therefore consider the following matters. First, he must not, unless he is authorised, carry on regulated activities in the United Kingdom. Second, unless he is authorised, the day-to-day management of the carrying on of the regulated activity must not be the responsibility of the UK establishment. This may, for example, affect those UK establishments that in the context of deposit-taking activities were, before the commencement of the Act, treated as representative offices of overseas institutions. Such institutions will need to seek authorisation if the responsibility for the day-to-day management of the accepting of deposits by them outside the United Kingdom is nevertheless effectively that of their UK establishment. Third, such a person will need to ensure that he does not contravene other provisions*

---

[20] Article 20(1) of the 2BD.

[21] Interpretative Communication, Part One A(2)(a).

[22] The Interpretative Communication was not on-shored by s. 3 of the European Union (Withdrawal) Act 2018. However, the FCA has indicated that "*... we consider that the EU non-legislative material will remain relevant post-IPCD to the FCA and market participants in their compliance with regulatory requirements, including provisions in our Handbook*" (see paragraph 9 of the FCA's "*Brexit: Our approach to EU non-legislative materials*"; https://www.fca.org.uk/publication/corporate/brexit-our-approach-to-eu-non-legislative-materials.pdf (accessed 21 February 2021)).

of the Act that apply to persons who are not authorised. These include the controls on financial promotion (section 21 of the Act (Financial promotion)), and on giving the impression that a person is authorised (section 24)." [emphasis added]

2.9 The FCA also addresses the provision of cross-border services using the internet more generally at PERG 2.4.6 G, which given technological changes will now be relevant to many instances of deposit taking. This states:

> "*A person based outside the United Kingdom may also be carrying on activities in the United Kingdom even if he does not have a place of business maintained by him in the United Kingdom (for example, by means of the internet or other telecommunications system or by occasional visits). In that case, it will be relevant to consider whether what he is doing satisfies the business test as it applies in relation to the activities in question. In addition, he may be able to rely on the exclusions from certain regulated activities that apply in relation to overseas persons (see PERG 2.9.15 G).*"

2.10 As indicated at paragraph 1.3(c) above, it is often necessary for firms and their advisors to consult materials outside the regulators' rulebooks, many of which are relatively inaccessible and historical in nature. Deposit taking is a good example of this problem, as the following two publications remain relevant.

2.11 First, the Financial Services Authority's "*Applications for authorisation under the Banking Act 1987: Guidance Note for Applicants*" (December 1998) (the **FSA Guidance**).[23] This contains the following statement:

> "*Moreover, the prohibition [on deposit-taking] applies whether the deposits originate from overseas or from the United Kingdom, provided that they are accepted in the United Kingdom. In the FSA's view, a deposit may, as a matter of fact, be accepted in the United Kingdom if, for example, an overseas resident sends money by post in the form of a cheque to a deposit-taker in the United Kingdom who undertakes a contractual liability to repay the amount paid.*"[24] [emphasis added]

2.12 The FSA Guidance was published by the FCA's predecessor, relates to legislation that has now been repealed and is only accessible on the National Archive's website. The fact it is still being consulted today speaks for itself in relation to the problems in this area.

2.13 Second, HMT's "*Provision of cross-border services in the United Kingdom by firms from Switzerland*" (August 2011) (the **HMT Guidance**) also contains pertinent commentary.[25] It articulates the following principles:

> "*A deposit involves a payment of money together with the assumption of a liability to repay it. Accordingly a deposit is only made where the obligation to repay the deposit arises. So, for example,*

---

[23] https://webarchive.nationalarchives.gov.uk/20081112185645/http:/www.fsa.gov.uk/pubs/additional/bank-app-guide.pdf (accessed 13 February 2021).

[24] The FSA Guidance, Part 1 D.

[25] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/356887/memo_by_HMT.pdf (accessed 13 February 2021).

a) where a sum is sent from the UK direct to the overseas deposit-taker (for instance by cheque or bank transfer), and

b) the latter does not become liable to repay the sum until he has received it overseas

the deposit-taking activity does not take place in the UK.

A Swiss financial institution is able to accept deposits from UK depositors where the sum is sent direct to the Swiss financial institution, for instance by cheque or bank transfer, and the deposit is not booked until it reaches Switzerland."[26] [emphasis added]

2.14 Given the clarity of the above, the HMT Guidance remains very useful when considering issues of territoriality and deposit taking. This again points to the deficiencies of the existing framework: the HMT Guidance is relatively inaccessible, of no formal standing and was issued in specific circumstances relating to Switzerland (although it is taken to apply by analogy to other jurisdictions). As such, it would clearly be preferable if an equivalent statement appeared in the law, failing which formal regulatory guidance.

Investment services

2.15 The provision of investment services is subject to the general prohibition. The EU Markets in Financial Instruments Directive (**MiFID**) was transposed using FSMA's architecture, and the RAO specifies a wide range of relevant activities (e.g. dealing in investments as principal, arranging deals in investments and safeguarding and administering investments). As with deposit taking, the RAO does not make further provision regarding territorial scope in this area.

2.16 s. 418 of FSMA will be potentially relevant in connection with investment services. Furthermore, the characteristic performance principle is of some value. As a result of its application, the activities below are generally understood as follows:

(a) "dealing" takes place where the acceptance of the offer takes place, which in turn depends on the method of communication used (usually it will be deemed to take place where the client is located, as the offer would ordinarily be communicated by the relevant firm);[27]

(b) "arranging" takes place in the location where the arranging takes place;[28]

(c) "advising" takes place where the advice is received (usually where the client is located);[29]

(d) "managing" takes place where the investment decisions and management are actually carried on;[30] and

---

[26] The HMT Guidance, Section A, paragraph 7.

[27] Including "dealing as principal" under Article 14 of the RAO and "dealing as agent" under Article 21 of the RAO.

[28] Article 25 of the RAO.

[29] Article 53 of the RAO.

[30] Article 37 of the RAO.

(e) "safeguarding and administering" takes place where the assets are held.[31]

2.17 These propositions are also supported by certain items of FCA guidance in PERG, as described in paragraph 2.20 below.

2.18 Turning to case law, although perimeter issues are rarely examined by the courts, some assistance is provided by *FSA v Fradley (t/a Top Bet Placement Services)*.[32] This authority concerned the operation of a collective investment scheme contrary to the general prohibition. The issue of territoriality was relevant as the appellant, Mr Fradley, had moved his business from the UK to Ireland. Giving the judgement of the court, Arden LJ stated as follows:

> "*The FSMA does not contain an exhaustive description of what constitutes the carrying on of business within the United Kingdom. All that section 418 (set out above) provides is that the requirement is to be satisfied in certain specific cases if it would not otherwise be so satisfied. This case is not within those cases. Accordingly, the Court is left with the question whether the activities described above (so far as not disputed), of themselves, constituted the carrying on of business in the United Kingdom. FSMA does not require that the entirety of a business activity be carried on in the United Kingdom. If it did, it would be open to obvious abuse.*
>
> *In my judgment, it is sufficient if the activities in question which took place in this jurisdiction were a significant part of the business activity of running the CIS (if any) constituted by the betting services offered by 147 and TBPS. In this case, the communications with clients and prospective clients, and the maintenance of a bank account and an accommodation address, all of which took place in the United Kingdom, were all business activities. In my judgment they were of sufficient regularity and substance to constitute the carrying on of business here even after Mr Fradley moved his own office to Ireland in April 2003 and gave instructions by post or internet from there. I leave open the question whether the requirement for carrying on business within the jurisdiction can be satisfied in any other case.*"[33]

2.19 Accordingly, in the absence of other relevant factors, if a "significant part" of the activities inherent in the provision of a regulated activity are undertaken in the UK, this is likely to constitute the "carrying on" of that activity there. This broad-brush test, in support of which Arden LJ only provided minimal reasoning, can be difficult to apply in practice.

2.20 In the absence of other clear guidance on territorial scope in relation to investment services, analogies are sometimes drawn with materials issued in the context of other regulated activities. For example, PERG 15.12.8 G explains the following about "arranging", "dealing" and "advising" in the context of insurance distribution:

> "*Otherwise, where the cases in [s. 418 of FSMA] do not apply, it is necessary to consider further the nature of the activity in order to determine where insurance distribution is carried on. Persons that arrange contracts of insurance will usually be considered as carrying on the activity of arranging in the location where these activities take place. As for dealing activities, the location of the activities will depend on factors such as where the acceptance takes place, which in turn will depend on*

[31] Article 40 of the RAO.

[32] [2005] EWCA Civ 1183.

[33] per Aden LJ at 52 to 53.

the method of communication used. In the case of advising, this is generally considered to take place where the advice is received."

2.21 While helpful, this again points to the uneven nature of guidance in this area, and the effort sometimes necessary to divine the FCA's expectations.

3. The Overseas Persons Exclusion

3.1 The OPE is contained at Article 72 of the RAO. This excludes an "overseas person" from the scope of certain regulated activities in specified circumstances. The term "overseas person" is defined at Article 3(1) of the RAO as follows:

> "*… a person who*
>
> *(a) carries on activities of the kind specified by any of articles 14, 21, 25, 25A, 25B, 25C, 25D, 25DA, 25E, 37, 39A, 40, 45, 51ZA, 51ZB, 51ZC, 51ZD, 51ZE, 52, 53, 53A, 53B, 53C, 53D61, 63B, 63F and 63J or, so far as relevant to any of those articles, article 64 (or activities of a kind which would be so specified but for the exclusion in article 72); but*
>
> *(b) does not carry on any such activities, or offer to do so, from a permanent place of business maintained by him in the United Kingdom*".

3.2 The term "*permanent place of business*" is accordingly key in relation to the OPE. Unfortunately, however, there is not any substantive guidance on what it means in this context. This leads to uncertainty for firms and their advisors, e.g. in relation to the frequency of business travel permissible into the UK. The situation was not improved by *Fradley*, which, although concerned with the distinct issue of whether a regulated activity was being "carried on" within the UK, was suggestive of the authorities taking a conservative approach to such issues.

3.3 The OPE is available in relation to the following regulated activities:

(a) dealing in investments as principal;

(b) dealing in investments as agent;

(c) arranging (bringing about) deals in investments and making arrangements with a view to transactions in investments;

(d) arranging a home finance transaction;

(e) operating a multilateral trading facility;

(f) operating an organised trading facility;

(g) advising on investments;

(h) entering into a home finance transaction;

(i) administering a home finance transaction; and

(j) agreeing to carry on the regulated activities of managing investments, arranging (bringing about) deals in investments, making arrangements with a view to

transactions in investments, assisting in the performance and administration of a contract of insurance, safeguarding and administering investments or sending dematerialised instructions.[34]

3.4 The distinction between the regulated activities which are within the scope of the exclusion, and those which are not within the scope of the exclusion but for which agreeing to carry on the relevant activity is excluded, is obscure. There appears to be no good policy rationale why, for example, dealing as principal should be permitted for an overseas person based on a legitimate approach, but arranging deals should not. The distinction appears to be derived from the (regrettably unexpressed) basis that the latter is undertaken in the place of the arranger. It would be helpful to clarify this.

3.5 With the exception of regulated activities related to home finance transactions, where available the OPE generally applies in the following two cases:

(a) where the overseas person is dealing with another person who is either authorised or exempt, and in the latter case acting in the course of a business comprising a regulated activity in relation to which he is exempt[35]; or

(b) where the regulated activity is carried on as a result of what is termed a "legitimate approach".

3.6 The concept "legitimate approach" is defined at Article 72(7) of the RAO as follows:

"*(a) an approach made to the overseas person which has not been solicited by him in any way, or has been solicited by him in a way which does not contravene section 21 of the Act; or*

(b) an approach made by or on behalf of the overseas person in a way which does not contravene that section."

3.7 In practice, this gives overseas persons two channels for accessing UK business. First, it is possible to do so on a so-called "reverse enquiry basis", where their client initiates contact to procure the overseas person's services. Second, it is possible for an overseas person to contact UK clients provided this does not contravene the financial promotion restriction at s. 21 of FSMA, which is a criminal offence.[36]

3.8 In light of the above, overseas persons – who are by definition less likely to be familiar with the UK regulatory framework – are obliged to navigate FSMA's complex financial promotions regime. s. 21 of FSMA states, among other things, that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity.[37] However, this prohibition does not apply where:

(a) the person is authorised;[38]

---

[34] Article 72(1) to (6) of the RAO; PERG 2.9.15 G.

[35] See Article 72(1)(a) of the RAO.

[36] s. 25 of FSMA.

[37] s. 21(1)(a) of FSMA.

[38] s. 21(2)(a) of FSMA.

(b) the content of the communication is approved for these purposes by an authorised person;[39] or

(c) the communication is covered by an exemption.[40]

3.9 Where an exemption is not available, the need to get communications approved by an authorised person means that overseas firms without such an entity in their group can encounter difficulties. The exemptions for the purpose of (c) are prescribed by HMT in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the **FPO**). These permit communications to certain categories of recipient, e.g. investment professionals and certified high net worth companies.[41] Relying on FPO exclusions is the biggest problem area in practice when relying on the OPE, both in terms of navigating the legislation and implementing the necessary compliance arrangements. As noted above, the fact that the FPO's terminology is not aligned with that of MiFID, as used elsewhere in UK regulation, also makes it less accessible.

3.10 In terms of the guidance available in connection with the OPE, PERG 2.9.15 G to PERG 2.9.17B G of the FCA Handbook do contain some pertinent commentary. However, this largely amounts to a summary of Article 72 of the RAO – not unhelpfully given its complexity – which does not begin to address the areas of ambiguity in relation to which supplementary guidance from the regulator would be desirable, e.g. the meaning of a "permanent place of business".

4. Payment services

4.1 Regulation 138(1) of the PSRs states that a "*person may not provide a payment service in the United Kingdom*" except where they fall into one of the permitted categories in paragraphs (a) to (j) that follow. The FCA's publication "*Payment Services and Electronic Money – Our Approach*" (June 2019) (the **Approach Document**) contains guidance on many aspects of UK regulation applying to payment services. However, it is largely silent on territorial scope, with its one statement being essentially tautological: "*The PSRs 2017 apply, with certain exceptions, to everyone who provides payment services as a regular occupation or business activity in the UK*".[42] However, the Approach Document does point readers to the guidance in Chapter 15 of PERG on the scope of the PSRs.[43]

4.2 Some assistance is provided at PERG 15.6 of the FCA Handbook in a question and answer format. The following question on territorial scope is posed:

> "*We are a non-UK payment institution providing payment services to UK customers from a location outside the UK. Do we require authorisation or registration under the regulations?*"

4.3 The FCA provides the following answer:

---

[39] s. 21(2)(b) of FSMA.

[40] s. 21(5) of FSMA.

[41] Articles 19 and 49 of the FPO respectively.

[42] Paragraph 2.2 of the Approach Document.

[43] Ibid., paragraph 2.3.

"*No. When considering whether you fall within the scope of the PSRs 2017, our starting point is to consider whether an EEA payment services provider would be providing cross-border services in analogous circumstances (for example, when it provides payment services to EEA customers in an EEA State other than the place in which it is located).*

As regards the provision of cross-border payment services between EEA States, in our view the Commission Interpretative Communication (Freedom to provide services and the interest of the general good in the Second Banking Directive (97C 209/04) provides a useful starting point, in particular because payment services form part of the CRD passport.

Accordingly, we would not generally expect a payment services provider incorporated and located outside the UK to be within the scope of the regulations, if all it does is to provide internet-based and other services to UK customers from that location." [emphasis added]

4.4 Within the Interpretative Communication, the FCA is presumably referring to the following statement:

"*… the provision of distance banking services, for example through the Internet, should not, in the Commission's view, require prior notification, since the supplier cannot be deemed to be pursuing its activities in the customer's territory.*"[44]

4.5 Confusingly, this view contradicts the FCA's more general guidance at PERG 2.4.6 G, quoted more fully at paragraph 2.9 above, which states:

"*A person based outside the United Kingdom may also be carrying on activities in the United Kingdom even if he does not have a place of business maintained by him in the United Kingdom (for example, by means of the internet or other telecommunications system or by occasional visits).*" [emphasis added]

4.6 In any event, the FCA's guidance at PERG 15.6 is taken by many practitioners as authority for the proposition that payment services can be provided on a cross-border basis into the UK without a licence. Although this position itself is clearly welcomed by many in the market, this is another instance where the structure of UK regulation is problematic. The matter of territorial scope would ideally be clear on the face of legislation, rather than requiring reliance on conservatively-worded guidance from the regulator that may be withdrawn at any time.[45]

4.7 These problems weigh particularly heavily in an area like payment services, where rapid technological developments can create uncertainty when relying on guidance issued only several years previously. For instance, the way in which banking services are provided via the internet has clearly moved on from when the Interpretative Communication was issued in 2004. Furthermore, by the FCA's own admission, its guidance does not bind the courts, meaning that PERG and other guidance does not always provide the most robust legal foundation for perimeter matters in any event.[46] Indeed, the FCA explains as follows:

---

[44] The Interpretative Communication, Part One A(2)(b).

[45] PERG 1.5.4 G.

[46] PERG 1.3.1 G.

> "*Anyone reading [PERG] should refer to the Act and to the relevant secondary legislation to find out the precise scope and effect of any particular provision referred to in the guidance and any reader should consider seeking legal advice if doubt remains.*"[47]

4.8 Yet as we have seen, a reader diligently returning to the primary sources would find little in the way of assistance on territorial scope. Nor could their legal advisor be expected to fare any better.

[47] Ibid.