UK Finance Response to FCA CP 18/29: Temporary permissions regime for inbound firms and funds

Introduction

UK Finance welcomes the opportunity to respond to the FCA's Consultation Paper on the temporary permissions regime (**TPR**) for inbound firms and funds (the **CP**). By way of background, UK Finance represents nearly 300 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance was created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

Summary

We consider that the policy approach underlying the rules dealing with the temporary permissions regime set out in the CP is appropriate. There will be significant challenges for inbound firms and funds in migrating to compliance with a change of regulatory ruleset, and the recognition that transitional relief will be needed to provide inbound firms with the time necessary to adapt to Brexit and to avoid disruption is welcome. We consider that the proposals could be improved upon in a number of respects, however:

1. Inbound firms using the TPRs need certainty that they will have the full window contemplated by the relevant Withdrawal Act statutory instruments (**SIs**) enacted under the powers granted under the European Union (Withdrawal) Act 2018 (**EUWA**) to wind down their business, should they choose not to apply for authorisation. It would be inconsistent with the position adopted by HM Treasury for the FCA to cancel the temporary permission of an inbound firm following the lapse of its landing slot, as suggested by paragraph 3.23 of the CP. We note that HM Treasury is expected to make provision for these firms to wind down their regulated business in an orderly manner in separate legislation (paragraph 3.24 of the CP) and we urge the FCA to liaise with HM Treasury so that appropriate arrangements are put in place that will ensure certainty that inbound firms and funds can exit the TPR in an orderly way without obtaining a full UK authorisation or registration.

2. The approach proposed to the application of the FCA ruleset to firms in the TPR under GEN 2.2 is complex. It will prove challenging for inbound firms to identify the applicable rules and implement them by 29 March 2019, should this prove necessary. We suggest below ways in which the rules could be improved so as to be simpler and to provide greater clarity to firms. In essence, we would recommend applying a simplified approach that would focus on TP firms using substituted compliance (without the other elements of the general approach set out in GEN 2.2) as the main tool with respect to activities in the UK during the TPR. Given the current alignment between the UK and EU rulesets, compliance with Home State rules in the areas covered by the EU directives as applied to their UK business should give sufficient comfort to the FCA during the TPR and allow EEA firms to transition to the post-Brexit UK regime in a smooth and orderly way. We note that this would reflect the approach set out by the FCA in the second bullet in paragraph 4.11 of the CP and the purpose behind the TPR referred to in the proposed GEN 2.2.36 G(4), and would reduce the significant compliance burden placed on firms resulting from applying the main elements of the general approach in GEN 2.2.

3. The proposed approach to applying the FCA rules to incoming services firms should be reconsidered in particular. It is unclear how beneficial it will be to apply UK rules to services firms given the likely practical difficulties in supervision and enforcement. It would be more proportionate and workable to subject incoming firms only to those EU rules which apply pre-Brexit on a substituted compliance basis. We would welcome further guidance on how the FCA intends to approach substituted compliance from an evidentiary and supervisory perspective. More generally, following the announcement by HM Treasury on 8 October 2018 confirming that it will bring forward legislation to allow regulators to grant some flexibility in applying new requirements under the EUWA, it is critical for all firms and funds, including inbound firms and funds, to understand how and where relief will be granted in respect of changes to the legislative ruleset. We would urge the FCA to announce its proposals in that regard as soon as possible.

4. Similar and significant issues apply with respect to funds. Whilst the principle that the existing marketing rules should continue to apply is welcome, the detail of the way in which the rules will apply will also introduce complexity – particularly where the EU and UK rules diverge in future. It would be preferable to subject TP AIFM and UCITS qualifiers only to the EU rules which apply pre-Brexit on a substituted compliance basis. We would also support the position of the Investment Association in its response to this consultation in relation to the process for recognising overseas funds under section 272 of FSMA and the general lack of clarity around how that regime will interact with the TPR.

5. The application of the various fees and levies to incoming services firms should also be reconsidered. It is likely to prove challenging for inbound services firms to identify their tariff base and/or interpret how the requirements will apply to them in a number of respects.

6. Finally, it is clear that the FCA has taken a different approach to the rulesets applicable to TP firms than the PRA. Whilst there may good policy reasons for this divergence, such bifurcation will cause significant compliance issues for dual-regulated firms. For example, it will become very difficult for firms to comply with the senior managers and certification regimes as they apply to EEA firms (as

proposed by the FCA) and to third country firms (as proposed by the PRA) at the same time. We urge the FCA to engage with the PRA to ensure a consistent supervisory approach is taken (and, at the very least to areas of supervision that straddle the remit of both regulators).

Response to CP questions

Question 1

Do you agree that our proposed rule changes give adequate effect to our general approach for TP firms? If not, why not?

General comments

The TPRs are a key tool in minimising disruption associated with a hard Brexit

As a general matter we endorse the approach taken by the UK authorities, including the FCA, to managing the regulatory risks associated with Brexit. By removing the possibility of criminal sanction and unenforceability of contracts associated with the performance of regulated activities without the requisite license, the introduction of the TPRs is a critical mitigant to the 'cliff-edge' risk of disruption to the provision of financial services in the event of a hard Brexit. The forthcoming UK legislation (and the draft proposals that have been announced in certain EU27 Member States over the last few weeks) dealing with contractual continuity will also be a mitigant; however, in order to deal with the significant and real financial stability concerns, it would be preferable to have a legislative solution at the European level allowing legacy business to be run down (with a longer grace period than those currently proposed).

Difference in FCA and PRA approaches to the TPR creates uncertainty for firms – the regulators should align their approaches to ensure an orderly transition

We are concerned about the difference between the approach to the TPR proposed by the FCA in this CP with that proposed by the PRA in Chapter 7 of CP 26/18. Whilst the FCA's proposed approach requires a (complex) line-by-line determination of rules as they apply to inbound EEA firms immediately before exit day in line with the proposed general approach in GEN 2.2, the PRA's approach would result in inbound EEA firms becoming subject to the same rules as those applicable to third country firms after exit day. This schism would result in uncertainty for firms trying to determine what rulesets will apply to them after exit day, and how to prepare to comply with such modified rulesets (particularly for dual regulated firms that will need to apply two seemingly mutually exclusive approaches in areas of overlap, such as the senior managers and certification regime). It would be helpful if the regulators could align their approaches to ensure firms can orderly transition from the current EEA passporting regime to a post-Brexit UK regime.

Brexit will involve (and already has involved) substantial legal, as well as regulatory, change for firms: the FCA should provide clarity as to how it will exercise its powers to minimise on-going disruption.

Both domestic and inbound firms will still face challenges associated with the change of law (the legislative ruleset) and of regulation (the regulatory ruleset) applicable to their UK activities following a hard Brexit.

In relation to the legislative ruleset, UK and inbound firms alike face considerable challenges associated with the substantial changes which onshoring will require. To this end, the announcement by HM Treasury on 8 October 2018 confirming that it will bring forward legislation to allow regulators to grant flexibility in applying new requirements under the EUWA is welcome. It is critical for all firms and funds, including inbound firms and funds, to understand how and where relief will be granted in respect of changes to the legislative ruleset, as implementation will potentially be resource intensive and in some cases unfeasible (for example in relation to changes which require significant operational changes). Guidance on how these powers will be exercised is needed as a matter of urgency in terms of introducing the relevant legislation, explaining the policy and providing guidance on the exercise of supervisory/enforcement powers by the regulators, in order for firms to understand the expectations of the UK regulators on exit day.

In this regard we note that the PRA has indicated that it intends to take an approach to the exercise of the transitional powers under which firms and FMIs generally will not need to prepare to implement onshoring changes by exit day (chapter 4 of PRA CP25/18). It would be helpful were the FCA to take the same approach with respect to legislation falling within its remit.

The FCA's approach to the rules for TPR firms introduces significant complexity

UK Finance understands the need for the FCA to balance the needs of consumers, firms and market stability when providing for how its rules should apply to inbound firms and funds during the term of the TPRs. We also support the policy outcomes which the FCA is seeking to achieve through the changes proposed. However, the current proposals are too complex and undermine the policy intent of providing a temporary regime to provide clarity in the event of a no-deal Brexit. For example, it is unclear if a firm can rely on substituted compliance to meet requirements under the FCA rules which implement a discretion afforded by an EU Directive to each Member State where the UK and the Home Member State of a firm differ in how such discretion is exercised. The current proposals would also result in significant compliance costs for firms, particularly as the UK and EU rulesets diverge.

The simplification of the proposed approach to the TPR would also contribute to the FCA's success in implementing the TPR (as referred in paragraph 1.29 of the CP) by allowing for a smooth transition for EEA firms and investment funds (and their UK customers), by making it clear to EEA firms and fund managers how the TPR will operate and, in particular, how the FCA rules will apply to them in the TPR.

The ruleset applying to services firms should reflect their limited UK activities and the FCA's limited supervisory role

The points made above are particularly pertinent to services firms. It is likely that a large number of services firms will exercise rights under the TPR. For the majority of such firms, temporary authorisation will be obtained simply to service existing clients, and in many cases the services they provide could be provided without authorisation. In the face of an integrated EU/UK regulatory ruleset at the point of Brexit, it seems unreasonable to expect such firms to establish systems and controls to meet the UK implementation of directives with which

such firms already comply, and it would be challenging to require such firms to put in place systems and procedures to deal with subsequent changes in UK regulation, given the time-limited nature of the TPR.

It would be preferable for the FCA to provide a simple regime under which inbound firms' policies and procedures continue to apply, with additional requirements only where there are clear market failures associated with the post-Brexit position: we would see the only necessary requirements in this regard as being the Principles for Businesses.

TPR firms running off their UK business will need certainty that the TPR is available to them for its full duration

Inbound firms may use the TPRs as a bridge to authorisation or to provide them with time to manage an orderly wind-down of their UK business (albeit recognising that this is a complex decision that firm may need to assess and make during the period of the TPR itself). Firms in the latter category need certainty that they will have the full window contemplated by the relevant Withdrawal Act SI to wind down their business, should they choose not to apply for authorisation. Similarly, EEA firms that currently operate in the UK both through a branch and under a services passport may decide (again, recognising that this is a complex decision that a firm may need to assess and make during the period of the TPR itself) to become authorised for some but not all of their passported activities, with the remaining activities being wound-down – it is therefore important to ensure that firms have sufficient time to wind-down the relevant business in an orderly way and to ensure that such firms are not seen as conducting regulated business without appropriate approvals post-submission of the authorisation application within the assigned landing slot. Paragraph 3.23 of the CP suggests that the FCA may take unilateral action in relation to firms which have not sought authorisation by the end of their landing slot, without detail as to the timing or criteria of such action. It would appear inconsistent with the position adopted by HM Treasury for the FCA to cancel the temporary permission of an inbound firm following the lapse of its landing slot (whether in relation to all or some of the firm's activities).

Extension to statutory time limits for determination of authorisation applications

Once in scope of the TPRs, firms will be expected to submit a full authorisation application within a three-month "landing slot" that will be allocated to each firm by the FCA depending on the type of business undertaken by the firm. The first anticipated landing slot will be October to December 2019, with the last landing slot closing at the end of March 2021. The TPR SI will extend the statutory time limits for the FCA to determine applications from the usual six to 12 months to up to three years after exit day. This could result in firms that submit their applications in October 2019 having to potentially wait until March 2022 for the FCA to determine the application. If that were to happen, firms would be affected by the uncertainty of having their application in limbo for a period of potentially up to 30 months and would need to ensure that the application remains up-to-date throughout that time, adding additional burden for the firms in question. It would be helpful if the FCA could reassure firms that applications will be determined in a shorter period of time than the maximum time allowed under the TPR SI.

Allocation of landing slots

It will be important for firms to have sufficient time to prepare application documents to be submitted during the landing slots allocated to firms. However, there are no clear guidelines on how firms will be allocated to specific landing slots – the CP (in paragraph 3.14) merely states that allocation will be "*based on the type of business undertaken"*, though later confirming that the allocations will be published in a direction issued by the FCA shortly after exit day. Firms will have different needs in this respect – some will need additional time to prepare for authorisation, whereas others may wish to submit an application at the earliest opportunity. We would therefore suggest that the FCA allows firms to indicate a preference for a specific landing slot. This would allow a balanced approach to reconciling the policy objectives with firms' operational needs.

Impact on Payment Institutions (PIs) and Electronic Money Institutions (EMIs)

We note the FCA's approach regarding the need for payment and electronic money institutions to benefit from the TPR and welcome this clarification. We note that the TPR is, as with other types of firms, very beneficial for certainty and continuity, particularly for firms passporting in, but poses particular issues for firms that currently passport out of the UK.

We note that there are a number of issues for UK based PI and EMIs in gaining authorisation in the EU which impacts heavily on their business models. This includes impacts on safeguarding accounts, capital requirements and on regulatory approach, particularly around the holding of funds.

UK Finance welcomes the UK governments approach to 'levelling up' on safeguarding, where firms can now benefit from being able to use a safeguarding account from beyond the EU. We do, however, note that firms will now be required to continue or gain authorisation in the UK and EU and therefore will be required to have multiple safeguarding accounts, which results in significantly higher costs for what are usually smaller firms, or those in high growth and with limited spare capital.

For a number of firms passporting into the UK, we note that in many instances they will be required to become authorised by their home competent authorities on an escalated timescale in order to take advantage of the TPR which can cause additional need for capital and can cause confusion for firms.

Furthermore, we would welcome clarification in particular around the approach to firms, who, for many years have passported into the UK under one structure (e.g. as a payment institution) but that are required to become an electronic money institution in the UK. Again, this has the effect of greater capital and safeguarding requirements.

Specific comments regarding question 1

We consider that the principles underpinning the TPR ruleset seem appropriate, but there are aspects of them which we consider could be improved. We would place these under the following broad categories:

(i) Complexity

As indicated in our general comments, the proposed rules determining application of requirements to inbound firms on the TPR are complex and appear challenging for firms to implement.

Taking the general rules applicable to TP firms as an example, the approach taken under GEN 2.2 would require TPR firms:

(a) with respect to existing rules:

(i) to identify whether the rule is 'switched off' by GEN 2.2.30;

(ii) for firms with existing Part 4A permission (i.e. a top-up permission), identify the rules that apply to that business and ensure that they are complied with as modified after Brexit;

(iii) to assess whether the rule may be modified by its continuing to refer to the EEA, rather than the UK;

(iv) to assess whether the relevant rule would contravene an EEA State rule to which it is subject (and therefore may be 'switched off'); and

(v) to put in place procedures to continue to apply the existing rule following deletion or amendment from the Handbook (and notwithstanding any changes to the Home State rules in the transitional period);

(b) to identify and apply new rules. This would require firms:

(i) to work through the rules individually to identify the rules implementing an EU directive;

(ii) to establish which of those rules are Home State responsibilities, and therefore apply;

(iii) to determine whether a new requirement is contradicted by an existing rule (and therefore may be 'switched off');

(iv) to determine whether substituted compliance is available, and if chosen to put in place systems and controls to demonstrate compliance with the relevant Home State requirement;

This approach would require a line-by-line compliance review by TPR firms, followed by an implementation process that could be relatively substantial.

Another example of how complicated compliance for TP firms could become is where the firm has different branches in the EEA, and where UK services are provided from such branches, GEN 2.2.26G(1) suggests that the TP firm will also need to consider which branch the relevant service is being provided from into the UK and what the applicable Home State requirement is for that branch and activity.

(ii) Territoriality – should services firms be subject to more burdensome regulation than third country firms?

One result of the application of Home State reserved matters to the UK business of TPR firms under GEN 2.2.26R(2) is that services firms would become subject to UK regulation with respect to all areas reserved to Home State authorities, including not only conduct obligations but also all other regulatory obligations under a directive (excepting those prudential requirements that are specifically switched off by GEN 2.2.30). Examples include the common platform requirements, which would apply to services firms. This would put TPR firms

under more burdensome regulation than third country firms with respect to services provided into the UK. We would query whether this is the FCA's intent.

(iii) Substituted compliance – the need to flex to accommodate rulechanges

In addition, by accommodating subsequent UK changes to existing rules from the point of Brexit, but not Home State changes, the rules would create frictional difficulties for firms where UK or EU rules change during the transitional period. This is because TPR firms' compliance frameworks would need to split to accommodate:

(a) changes to Home State rules following Brexit – so for example future amendments to MiFID would have to be applied to a TPR firm's EU business but could not be applied to its UK branch business, and could not be applied to its UK services business unless the EU requirement engaged GEN 2.2.28R(3); and

(b) potentially, changes to UK rules post-Brexit: GEN 2.2.27R(1)b) applies UK rules implementing EU directive requirements "as amended or replaced". It is not clear whether substituted compliance would be available following any amendment made to a UK rule: it would be useful to clarify that it will be.

Any bifurcation of rulesets arising post-Brexit for TPR firms is likely to present particular challenges for services firms, which will not be resourced to run separate compliance frameworks for non-UK services business and UK services business. We consider that it would be more proportionate to permit substituted compliance on the basis of Home State rules as they apply from time to time given that EU investor protections are likely to remain robust Should any EU rulechanges be considered to have material adverse effects on investor protection or market cleanliness, it would be open to the FCA to make further rules (assuming a no-deal scenario).

(iv) Substituted compliance – clarity around scope and discretions

More specifically, we consider that the substituted compliance framework, whilst welcome, leaves open some questions which it would be helpful to have addressed should the FCA apply the proposed approach:

(a) scope – gold-plating: it will not always be clear where a rule "deals with a matter which… was reserved to the Home State under an EU directive" as per GEN 2.2.26R(2): Whilst the last sentence in GEN 2.2.37G(4) states that a rule that goes beyond what is necessary to implement a directive does not apply as a result of GEN 2.2.26R(2), it does not clarify the position with respect to gold-plating expressly permitted by a directive: it would be helpful to clarify that in such cases any gold-plating can be disregarded.

(b) exercise of discretion under EU directives/implementing legislation: in many cases differences will exist between the UK and Home State implementation of EU directives or implementing legislation. Whilst we note that GEN 2.2.37G(4) does clarify that a rule imposed by virtue of national discretion under an EU directive is to be taken as a rule implementing that directive, it would be helpful to make

it clear that where there are such discretions, complying with the rules based on the Home State (rather than UK) exercise of that discretion amounts to substituted compliance.

(c) supervision and enforcement: it would be helpful for firms to understand the supervisory and enforcement approach of UK regulators with respect to the use of substituted compliance arrangements by firms in order to comply with the FCA rules during the TPR. This would enable firms to plan effectively for operating within the TPR.

(v) Continued application of deleted provisions

It is unclear why the rules that are deleted on exit day should continue to apply to TPR firms when they will not apply to other firms. As a matter of principle, TP firms would be subject to rules that are deleted from the FCA rulebook as a result of the UK exiting the EU. It would be helpful to understand the policy rationale behind this anomaly resulting from the application of the FCA's proposed general approach in GEN 2.2.

(vi) Preferred approach

In light of the comments above, it would be preferable to take a simple approach to the obligations of TP firms by way of substituted compliance based on their continued compliance with Home State rules in the areas covered by the EU directives, as applied to their UK business. Whilst we appreciate that the general proposed approach (as set out by the FCA in the second bullet in paragraph 4.11 of the CP) already envisages reliance on substituted compliance to an extent, we believe that substituted compliance should be the focus of the proposed approach backed up by reliance on the FCA's Principles for Business. Together, these should be the entirety of a TP firm's requirements under the FCA rules during the TPR. In effect, in this simplified approach substituted compliance and compliance with the Principles would replace the general approach proposed in GEN 2.2. We note that this would reflect the purpose behind the TPR referred to in the proposed GEN 2.2.36 G(4) and would reduce the significant compliance burden placed on firms resulting from applying the other elements of the general approach in GEN 2.2 We appreciate that this sacrifices a degree of clarity as to obligations but consider it is likely to be more easily operationalized, and raise fewer concerns around unintended consequences, than the highly technical approach contemplated by the draft rules. We believe that this approach would strike a balance between the various factors considered by the FCA in paragraph 4.9, in particular:

Consumer protection: given the fact that the UK and EU regimes are and will be aligned at the point of Brexit, we believe that consumers will be afforded appropriate protections where TP firms comply with the Home State requirements (as is currently the case),

Compliance: as described above, we consider that the proposed regime would become unreasonably burdensome on TP firms and could have an adverse impact on customers and to competition in the UK, as the compliance burden could result in EEA firms being unable to justify maintaining operations in the UK.

Nature of the regime & time and resources: considering the temporary character of the regime, and its role as a bridge to the full application of the Handbook for TP firms, it would seem to us that a simpler regime would

be more appropriate in order for firms to dedicate resources at ensuring compliance with the third-country regime instead of navigating a complex TPR regime for a short period of time.

How the FCA will supervise TP firms: designing a simpler regime that will only apply for a relatively short and limited period of time would be easier to supervise and allow the regulators to focus on the key areas of supervision.

We note that, based on paragraph 4.10, this option does not seem to have been considered by the FCA, although we note that the FCA already contemplates substituted compliance as a means of satisfying firm's obligations under the FCA rules applicable as a result of the operation of the FCA's proposed general approach.

We also note that the simplification of the proposed approach to the TPR would contribute to the FCA's success in implementing the TPR (as referred in paragraph 1.29 of the CP) by allowing for a smooth transition for EEA firms and investment funds (and their UK customers) and by making it clear to EEA firms and fund managers how the TPR will operate and, in particular, how the FCA rules will apply to them in the TPR

Question 2

Do you agree with our approach to applying the Principles? If not, why not?

In general, we agree with the proposed approach to apply the Principles, with the exception of Principle 4, to all TP firms. As noted above, we believe that the Principles could act as the key tool in ensuring appropriate functioning of a simplified regime for TP firms based on rules currently applicable to TP firms and the continued compliance with Home State rules in the areas covered by the EU directives.

In relation to Principle 11, we note paragraph 4.23 suggests that Principle 11 notifications would be required for matters where a notification requirement does not apply to a TP firm or where such requirement can be satisfied by notifying a Home State regulator using the substituted compliance approach. Instead, it would be preferable for the FCA to specify what notifications requirements would apply to TP firms for the duration of the TPR, noting that this would not limit the scope of Principle 11 but allow TP firms to focus on areas that the FCA wishes to monitor in a uniform manner (e.g. using the forms prescribed in SUP rather than general reporting under Principle 11).

Question 3

Do you agree with our approach to applying the Prudential sourcebooks to TP firms?

We agree with the proposed approach to applying the Prudential sourcebooks to TP firms.

Question 4

Do you agree with our proposed legal drafting to apply our general approach to fund marketing activities in the TPR? If not, why not?

The approach taken to fund marketing under the proposed rules broadly mirrors the TPR, and accordingly raises some of the same issues as discussed under Question 1. Again, the principles underpinning the marketing regime seem appropriate, but there are aspects of them which we consider could be improved. We would place these under the following broad categories:

(i) Complexity

The proposed rules determining application of requirements to funds marketing under the TPR are complex. The approach taken under GEN 2.2 would require TP AIFM and UCITS qualifiers:

(i) to identify whether a rule is 'switched off' by GEN 2.2.34(1);

(ii) to assess whether the rule may be modified by its continuing to refer to the EEA, rather than the UK;

(iii) to assess whether the relevant rule would contravene an EEA State rule to which it is subject (and therefore may be 'switched off'); and

(iv) to put in place procedures to continue to apply the existing rule following deletion on exit day, and to comply following amendment from the Handbook (and notwithstanding any changes to the Home State rules in the transitional period).

(ii) The need to flex to accommodate rulechanges

In the same way as for the rules applicable to TPR firms generally, by accommodating subsequent UK changes to existing rules from the point of Brexit, but not Home State changes, the rules would create frictional difficulties for firms where UK or EU rules change during the transitional period. This is because TP AIFM and UCITS qualifiers firms' compliance frameworks would need to split to accommodate:

(a) changes to Home State rules following Brexit – so for example future amendments to the AIFMD or UCITS Directive would have to be applied to a TPR firm's EU business but could not be applied to its UK funds marketing, and could not be applied to its UK funds marketing unless the EU requirement engaged GEN 2.2.34R(2); and

(b) potentially, changes to UK rules post-Brexit: GEN 2.2.33R(1)(b) applies UK rules implementing directive requirements "as amended or replaced".

We consider that it would be more proportionate to apply Home State rules as they apply from time to time by way of substituted compliance, given that EU investor protections are likely to remain robust. Should any EU rulechanges be considered to have material adverse effects on investor protection or market cleanliness it would be open to the FCA to make further rules (assuming a no-deal scenario).

(iii) Continued application of deleted provisions

It is unclear why the rules that are deleted on exit day should continue to apply to TP firms when they will not apply to other firms. As a matter of principle, TP firms would be subject to rules that are deleted from the FCA rulebook as a result of the UK exiting the EU. It would be helpful to understand the policy rationale behind this anomaly resulting from the application of the FCA's proposed general approach in GEN 2.2.

(iv) Preferred approach

In light of the comments above, we consider that it would be preferable to take a simple approach to the obligations of TP firms by way of substituted compliance based on their continued compliance with Home State rules, as applied to their UK marketing (for the reasons set out in response to question 1). We appreciate that this sacrifices a degree of clarity as to obligations but consider it is likely to be more easily operationalized, and raise fewer concerns around unintended consequences, than the highly technical approach contemplated by the draft rules.

Question 5

Do you agree with our proposals on protecting client assets held by firms in the TPR? If not, why not?

We recognise the need to ensure that client assets are appropriately protected by TP firms. However, we believe that this is achieved by such firms complying with the relevant MiFID II requirements as implemented in the Home State of the TP firm. Therefore, it would be preferable to apply the general approach in GEN 2.2.26R to the activities of safeguarding and administering assets by TP firms for UK clients. We set out below our rationale for this below.

(i) Complexity

The proposed rules determining application of CASS requirements are complex. The approach taken under GEN 2.2 would require TP firms:

(i) to assess if the existing CASS rule implements an EU requirement (and therefore whether GEN 2.2.26R is engaged);

(ii) to assess whether CASS 14 will apply and, if so, to what extent;

(iii) to assess whether the rule may be modified by its continuing to refer to the EEA, rather than the UK;

(iv) to assess whether the relevant rule would contravene an EEA State rule to which it is subject (and therefore may be 'switched off');

(v) to identify whether a rule is 'switched off' by GEN 2.2.28(1); and

(vi) to put in place procedures to continue to apply the existing rule following deletion on exit day, and to comply following amendment from the Handbook (and notwithstanding any changes to the Home State rules in the transitional period).

(ii) The need to flex to accommodate rulechanges

In the same way as for the rules applicable to TP firms generally, by accommodating subsequent UK changes to existing rules from the point of Brexit, but not Home State changes, the rules would create frictional difficulties for firms where UK or EU rules change during the transitional period. This is because TP firms' compliance frameworks would need to split to accommodate:

(a) changes to Home State rules following Brexit – so for example future amendments to MiFID II would have to be applied to a TP firm's EU business but could not be applied to its UK activities, and could not be applied to its UK activities unless the EU requirement engaged GEN 2.2.38R(3); and

(b) potentially, changes to UK rules post-Brexit: GEN 2.2.27R(1)(b) applies UK rules implementing directive requirements "as amended or replaced".

We consider that it would be more proportionate to apply Home State rules as they apply from time to time by way of substituted compliance, given that EU investor protections are likely to remain robust. Should any EU rulechanges be considered to have material adverse effects on investor protection or market cleanliness it would be open to the FCA to make further rules (assuming a no-deal Brexit).

(iii) Territoriality – should services firms be subject to more burdensome regulation than third country firms?

One result of the application of the new CASS 14, as set out in CASS 14.1.3, to the UK business of TP firms under GEN 2.2.26R(2) is that services firms would become subject to CASS for activities undertaken both in the UK and outside the UK. This would put TP firms under more burdensome regulation than third country firms with respect to services provided into the UK. We would query whether this is the FCA's intent.

(iv) Operationally separating money and assets held for UK clients from that held for other clients

TP firms will be required to separate money and assets held in reliance on any Home State authorisation from those held in reliance on the TPR, which will be operationally challenging and, in our view, disproportionate from a resource, time and cost perspective to the aims of the TPR given its temporary nature.

(v) Reporting

Given the differences in practices applicable in other Member States, it may be challenging for firms to be able to put in place systems for reporting under CASS from 1 April 2019, as currently proposed under the new CASS 14.

(vi) Audit reports

We do not object to the requirement for TP firms subject to MiFID II to provide an English translation of their client assets audit reports to the FCA immediately (or as soon as it is available to the relevant Home State

regulator) upon request or receipt of an negative audit opinion. However, where the report is prepared in a language other than English, it may not always be possible to obtain an English translation of this document within one month of creation. We therefore would welcome a provision that allows the FCA to extend this period upon reasonable request by the TP firm.

(vii) Disclosure

We note the proposal for TP firms holding client assets to disclose to UK clients information relating to treatment of client assets in the event of the firm's failure, including (i) the jurisdiction where the failure would be administered and (ii) (if applicable) a statement that client assets may be treated differently to money or assets belonging to other customers of the TP firm where that firm fails. In relation to (ii), it is not clear what level of disclosure would be required. If more than a simple statement that there may be a difference in how client assets are treated for different customers of the TP firm, we believe it will be challenging to provide a clear and concise explanation of how the different treatment of client assets and other money or assets belonging to clients would operate on a TP firm failure, given the complexity of insolvency regimes and lack of harmonisation thereof in the EU. Such a statement could potentially further confuse (particularly retail) clients. Furthermore, a separate statement would presumably be required for each jurisdiction where client assets may be held, and therefore could pose a material compliance obstacle for TP firms offering custody services in various EU jurisdictions. It would also impose additional costs on firms in obtaining legal opinions for the purpose of determining the contents of any statements that would be required under CASS 14.5.1R(2). Therefore, we do not believe that this requirement is necessary to ensure appropriate level of customer protection as the fact that compliance with the equivalent Home State rule should be sufficient to achieve that goal, and we therefore recommend removing this requirement altogether. We note that the closest comparable requirements that currently apply (under CASS 9.4 and COBS 6.1.7R) require a firm to disclose (where assets are held with a third party in a third country) if it is not possible under national law for client assets held with a third party to be separately identifiable from the proprietary assets of that third party or of the firm.

(viii) Continued application of deleted provisions

It is unclear why the rules that are deleted on exit day should continue to apply to TP firms when they will not apply to other firms. As a matter of principle, TP firms would be subject to rules that are deleted from the FCA rulebook as a result of the UK exiting the EU. It would be helpful to understand the policy rationale behind this anomaly resulting from the application of the FCA's proposed general approach in GEN 2.2.

(ix) Preferred approach

In light of the comments above we consider that it would be preferable to take a simple approach to the obligations of TP firms by way of substituted compliance based on their continued compliance with Home State rules, as applied to their UK activities (for the reasons set out in response to question 1). We appreciate that this sacrifices a degree of clarity as to obligations but consider it is likely to be more easily operationalized, and raise fewer concerns around unintended consequences, than the highly technical approach contemplated by the draft rules.

Question 6

Do you agree that TP firms should be required to contribute to the SFGB costs on the same basis as UK firms from 30 March 2019 onwards? If not, why not?

In principle we agree with the approach taken by the FCA to the SFGB costs and IML levy payable by firms in the TPR, but would query:

(a) whether the approach to services firms is proportionate; and

(b) whether the proposed approach to fees applied to services firms is sufficiently clear.

There will be a large number of services firms with limited run-off business in the UK post-Brexit. For many firms the cost of putting place procedures to identify UK business and quantify the costs and levies may substantially exceed the costs and levies paid. Whilst the principle that all firms should pay for the SFGB and IML seems fair, we would query whether there may be a case for excluding services firms, or those below a de minimis level.

A key part of the likely difficulty for services firms will be identifying what UK business is in scope and how to apply the fee tariffs set out by the FCA. In a number of cases it appears potentially difficult for firms to understand the UK nexus of the requirements – for example for block A2:

(a) are mortgages on UK situs property granted to non-UK borrowers within scope;

(b) are mortgages on non-UK situs property granted to UK borrowers within scope?

Similarly, for block A10, which traders of a services firm should be included:

(a) all those that deal with UK clients;

(b) those that deal with UK clients for the majority of their time?

Further clarification would seem appropriate here.

Question 7

Do you agree with our proposals for the IML levy payable by TP firms? If not, why not?

See the response to Question 6 above.

Question 8

Do you agree with the proposed guidance in GEN 2.2.35G in how it applies to SUP? If not, why not?

Subject to our comments above under Question 1 we have no further comments on the proposed guidance in GEN 2.2.35G.

Question 9

Do you agree with our proposals for periodic fees payable by firms in the TPR? If not, why not?

We agree with the approach taken by the FCA to periodic fees payable by firms in the TPR, but would query:

(a) whether the approach to services firms is proportionate; and

(b) whether the proposed approach to fees applied to services firms is sufficiently clear.

As discussed above, there will be a large number of services firms with limited run-off business in the UK post-Brexit. For such firms the cost of putting place procedures to identify UK business and quantify fees may substantially exceed the fees paid, and we anticipate a fair degree of interaction will be needed between the FCA and services firms to enable them to meet their fee obligations. Whilst the principle that all firms should pay for the costs of regulation seems fair, we would query whether there may be a case for excluding services firms, or those below a *de minimis* level.

A key part of the likely difficulty for services firms will be identifying what UK business is in scope and how to apply the fee tariffs set out by the FCA. In a number of cases it appears potentially difficult for firms to understand the UK nexus of the requirements – for example for block A2:

(a) are mortgages on UK situs property granted to non-UK borrowers within scope;

(b) are mortgages on non-UK situs property granted to UK borrowers within scope?

Similarly, for block A10, which traders of a services firm should be included:

(a) all those that deal with UK clients;

(b) those that deal with UK clients for the majority of their time?

Question 10

Do you agree with our special project fees proposals for firms in the TPR? If not, why not?

We agree with the approach taken by the FCA to special project fees payable by firms in the TPR.

Question 11

Do you agree with our proposals for periodic fees payable by funds in the TPR? If not, why not?

We agree with the approach taken by the FCA to periodic fees payable by funds in the TPR.