No more passporting post-Brexit?

Financial Services Regulatory Alert

27 JUL 2016

By: Tony Katz | Sam Millar | Michael McKee | Puesan Lam | Queenie Chan

UK authorised financial institutions (banks, investment firms, fund managers, insurers, insurance intermediaries payment institutions and e-money issuers) can carry out their activities across the EEA without setting up a separate entity and/or obtaining authorisation in each EEA state (known as 'passporting'). Financial institutions have a choice to either set up a branch (which is subject to certain 'host state' rules) or provide services on a cross-border basis.

Passporting rights are set out in various directives, including:

- The Markets in Financial Instruments Directive (2004/39/EC) (MiFID) - the MiFID II Directive (2014/65/EU) (MiFID II) and Markets in Financial Instruments Regulation (Regulation 600/2014) (MiFIR) are due to apply from 3 January 2018
- The Capital Requirements Directive IV (2013/36/EU) (CRD IV)
- The Payment Service Directive (2007/64/EC) (PSD) - PSD II (2015/2366/EU) (PSD II) is due to apply from 13 January 2018
- The Second E-Money Directive (2009/110/EC) (2EMD)
- The Insurance Mediation Directive (2002/92/EC) (IMD) - Insurance Distribution Directive ((EU) 2016/97) (IDD) is due to apply from 23 February 2018, and
- The Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD).

Unless the UK retains EEA membership following Brexit or secures an EEA-like arrangement, UK financial institutions will likely lose their passporting rights (eg being treated as 'third country firms'). This may well prompt a need to establish a subsidiary in another EU member state.

This article considers Brexit's impact on passporting rights in these directives and addresses alternatives for UK firms to continue to operate across the EU.

1. MiFID II/ MiFIR

No passporting rights exist for third-country firms under MiFID, but the position is set to change when MiFID II and MiFIR comes into force from 3 January 2018. Since the referendum in the UK on Brexit, much attention has turned to the third country provisions in the MiFID II and MiFIR as a potential saving provision for the passporting rights. Article 46(1) of the MiFIR gives third country firms (which may include UK firms post-Brexit) the right to provide investment services to eligible counterparties and per se professional clients without the need to establish a branch or subsidiary in the EU and without being subject to supervision by an EU competent authority.

In order to benefit from the cross-border services passport available under Article 46, the following is required:

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as “Attorney Advertising” requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome. Copyright © 2021 DLA Piper. All rights reserved.

(i) the firm is authorised in its home country and subject to supervision and enforcement by the relevant regulator (eg by the FCA)
(ii) a positive equivalence determination from the European Securities and Markets Authority (ESMA) that the legal and supervisory arrangement of the third country have equivalent effect to the prudential and business conduct requirements under MiFID II
(iii) cooperation arrangements between ESMA and the third country authority specifying the exchange of information mechanism, the prompting notification for breaches and the coordination of supervisory activities, and
(iv) registration with ESMA (which is dependent on the above having occurred).

On 24 June 2016, the FCA confirmed that financial regulations derived from EU legislation will remain applicable until any changes are made by the UK Government and UK Parliament and firms must continue to work on the implementation of new EU legislations. Unless the terms of withdrawal are agreed before 3 January 2018 (i.e. when MiFID II is due to apply), it is likely that the transpositions would still need to take place according to the original timeframe and UK firms will continue to have to comply with MiFID II before the UK formally leaves the EU. Assuming that the MiFID II regime will remain largely intact post-Brexit, there seem to be no objective reasons why a positive equivalence determination should not be achieved.

There is however no certainty that the process will be straight-forward amid the political risks surrounding the Brexit negotiations. The respective guidelines and regulatory technical and implementing standards relating to the third country regime have also not been finalized and the equivalence determination process for the UK (given that it is still part of the EU) may be delayed until after the Brexit negotiations have concluded. Experience from a similar equivalence assessment process conducted under AIFMD also suggests that the process could take very long to complete (see below section on AIFMD).

Furthermore, MiFIR envisages a lengthy registration process for third country firms for what appears to be a simple exercise. According to Article 46(4), ESMA has to confirm whether the application is complete within 30 working days of receipt. It then has a further 180 working days to determine whether registration should be granted.

2. CRD IV

CRD IV largely implements the requirements of Basel III, to which the UK would still be committed even on an exit from the EU. It contains very limited provisions relating to third-country firms and there are no equivalent third country passports available to banking activities regulated by CRD IV.

Recital 23 of CRD IV acknowledges that the EU is able to conclude agreements with third countries providing for the application of rules which grant third country branches the same treatment throughout its territory, but it makes clear that branches of third country banks do not enjoy the freedom to provide services or the freedom of establishment in member states other than those in which they are registered. It follows that, unless otherwise agreed with the EU, a UK bank would need to establish a physical presence (if required by national law) and obtain the relevant authorisation in the EU member states in which it wishes to continue doing business.

3. PSD, 2EMD and PSD II

Passporting rights are available to a UK authorised payment service provider (PSP) and can be exercised by following the procedures set out in Regulation 23 of the Payment Services Regulation 2009. An UK authorised PSP is also able to provide services in another EEA State through an agent established in the UK or in another EEA State.

Similar passporting rights are available under 2EMD to UK authorised electronic money institutions (EMI) by following the procedures set out in Regulation 28 of the Electronic Money Regulations 2011. A UK authorised EMI can also provide payment services in another EEA state through an agent established in the UK or an agent established in another EEA State and may engage an agent or a distributor to distribute or redeem e-money in another EEA State in the exercise of its passporting rights.

There are no third country provisions in both the PSD and 2EMD. Without the benefit of the passports, UK PSPs and EMIs need to establish a payment or e-money institution in a EEA State post-Brexit.

PSD II comes into force by 13 January 2008, but no third-country provisions have been included.

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as “Attorney Advertising” requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome. Copyright © 2021 DLA Piper. All rights reserved.

4. IMD and IDD

The IMD contains procedures for insurance intermediaries to passport across the EU. The IDD, which will repeal and replace IMD and is due to come into force on 23 February 2018, contains a redraft of the passporting provisions. There are no provisions for equivalent third-country passports in both directives. Article 1 of the IMD and IDD expressly state that the directives do not affect a EEA State's laws in respect of insurance mediation business pursued by insurance and reinsurance intermediaries established in a third country provided that equal treatment is guaranteed to all firms that carry on insurance mediation activities in the market. The continuous provision of services by UK insurance intermediaries will therefore depend on national laws post-Brexit.

5. AIFMD

The AIFMD sets out a comprehensive passport regime for managers and marketers of alternative investment funds (AIFs) in the EU. The passport is available to authorised EU alternative investment fund managers (AIFMs) and should according to Article 35, 39 to 41 of the AIFMD, also be available to third-country alternative investment fund managers in equivalent jurisdiction. However, passports for third-country jurisdictions under AIFMD will also be conditioned upon ESMA completing and finalizing its equivalence assessment of the respective non-EU countries.

At present, a third-country fund manager can only access the EEA market under the relevant national private placement regime (NPPR). Article 42 of the AIFMD provides that a non-EU AIFM may market a non-EU AIF to EU professional investors on a private placement basis as long as:

(i) the non-EU AIFM comply with the disclosure and reporting requirements, requirements on portfolio company disclosure and asset stripping
(ii) appropriate cooperation arrangements for the purpose of systemic risk oversight and in line with international standards are in place between the home regulator and third country regulator, and
(iii) the non-EU AIF must not be established in a country designated as non-cooperative by FATF.

This process requires a country-by-country assessment and some EU member states impose stricter rules on non-EU AIFM as permitted under Article 42. It is envisage that the NPPR will be terminated after the passports for non-EU countries are activated provided that ESMA can conclude that there are no significant obstacles regarding investor protection, market disruption, competition or monitoring of systemic risk impeding its termination. (Article 68 of AIFMD)

ESMA has only recently published advice that there are no significant obstacles impeding the application of the passport to certain non-EU countries (following its first advice in July 2015, where no definitive views were given on the US, Hong Kong and Singapore). The advice is now subject to the approval and consideration by the European Commission, Parliament and Council as to whether or not to activate the relevant provisions to extend the passports to these non-EU countries.

AUTHORS

Tony Katz
Partner
London | T: +44 (0)20 7349 0296 [UK Switchboard]
tony.katz@dlapiper.com

Sam Millar
Partner
London | T: +44 (0)20 7349 0296 [UK Switchboard]
sam.millar@dlapiper.com

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as “Attorney Advertising” requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome. Copyright © 2021 DLA Piper. All rights reserved.

Michael McKee
Partner
London | T: +44 (0)20 7349 0296 [UK Switchboard]
michael.mckee@dlapiper.com

DLA Piper is a global law firm operating through various separate and distinct legal entities. Further details of these entities can be found at www.dlapiper.com. This may qualify as “Attorney Advertising” requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome. Copyright © 2021 DLA Piper. All rights reserved.