

Our Approach to International Firms

Consultation Paper

CP20/20***

September 2020

How to respond

We are asking for comments on this Consultation Paper (CP) by **27 November 2020**.

You can send them to us using the form on our website at: www.fca.org.uk/cp20-20-response-form

Or in writing to:

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1 Introduction

Why we are consulting

- 1.1** This Consultation Paper (CP) sets out our general approach to international firms providing or seeking to provide financial services that require authorisation in the UK. We are not proposing to change existing rules or other provisions in the FCA Handbook through this consultation.
- 1.2** We aim to explain, and hear views on, how we will assess these international firms against minimum standards when they apply for authorisation and during ongoing supervision by us, and our general expectations for these firms.
- 1.3** We also aim to set out, and hear views on, the circumstances where these international firms could present higher risks of harm and how those risks can be mitigated.
- 1.4** After consultation, we expect to publish a finalised document explaining our general approach to international firms. That document will supplement existing guidance, such as the publications on our approach to authorisation and our approach to supervision.

Who this applies to

- 1.5** This consultation applies to international firms that require authorisation, including:
- European Economic Area (EEA) firms that have applied for authorisation in the UK, or intend to seek authorisation in the future, including those which have notified (or intend to notify) for the Temporary Permissions Regime
 - international firms from non-EEA countries that have applied or intend to apply for authorisation in the UK, or are already authorised in the UK
- 1.6** Subject to what we say in the section headed 'The focus of this CP' below, this consultation does not apply to:
- Firms that do not require authorisation to operate in the UK. This includes, for example, persons relying on the Overseas Persons Exclusion at article 72 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.
 - Firms required to be authorised or registered under the Payment Services Regulations 2017.
 - Firms required to be authorised or registered under E-Money Regulations 2011 and have their registered office in the UK.
 - Depositaries, trustees and managers (also referred to as operators) of UK authorised funds (including UK UCITS schemes). The relevant on-shored legislation requires such entities to be incorporated in the UK, and for their affairs to be administered in the UK.

- International alternative investment fund (AIF) managers. After the transition period, only firms with their registered office in the UK can obtain permission to manage an AIF.
- International benchmark administrators. The relevant on-shored legislation does not allow non-UK entities to obtain permission for benchmark administration, but there will be a separate regime under which they can apply to be recognised.

The wider context of this consultation

- 1.7** The UK is and will continue to be host to a significant number of international firms engaged in the provision of regulated financial services. These firms make an important contribution to the UK financial services market and provide services to UK consumers and businesses. We are committed to maintaining open and vibrant markets in the UK.
- 1.8** Significant amounts of assets in the UK are held by international firms, and many international firms support the smooth and efficient functioning of wholesale and retail markets.
- 1.9** We believe that the approach to the authorisation and supervision that we have applied to international firms to date has been appropriate and proportionate. However, we believe it is helpful to set out how we approach the authorisation and supervision of international firms in a public document, and the factors we take into account.
- 1.10** This is especially because we anticipate seeing an increase in the number of international firms looking to be authorised in the UK. Currently, most international firms in the UK come from the EEA using an establishment or services passport, or through exemptions available under EU law. After the EU withdrawal transition period, EEA firms will no longer be able to operate in the UK in the same way.
- 1.11** EEA firms that have notified their intention to enter the UK's Temporary Permissions Regime (TPR) will be allowed to continue their UK business within the scope of their current permissions for a limited period after the transition period ends, if they meet the conditions to enter and remain in the TPR, while they wait to be called by us to submit their applications for full UK authorisation. We expect many of these firms will want to seek full UK authorisation where this is necessary for them to continue operating in the UK over the longer term. Over 1,500 have notified their intention to enter the TPR, and we expect this number to increase when the notification window for entering the TPR reopens on 30 September 2020. If an EEA firm does not notify for a temporary permission or does not obtain a permanent authorisation, it may be able to rely on the Financial Services Contract Regime to continue to service pre-existing contracts in the UK until they expire. The firm should check the requirements set out in the relevant legislation.
- 1.12** This CP and the document we publish after consultation are intended to provide guidance that will help international firms understand our expectations as they prepare for their applications for full UK authorisation. This could help inform firms' decision about how they might want to structure their businesses to provide regulated financial services in the UK.

The focus of this CP

- 1.13** Most firms applying for FCA authorisation will be seeking permissions under Part 4A of the Financial Services and Markets Act 2000 (FSMA). The relevant minimum standards these firms must meet are called threshold conditions. The threshold conditions are set out in Schedule 6 to FSMA and our guidance in the 'COND' part of the FCA Handbook. This CP focuses on international firms seeking this type of authorisation.
- 1.14** International firms that seek authorisation or registration under other regimes will need to meet the minimum standards set out in the relevant legislation. For example, international firms that need to be authorised under the Electronic Money Regulations 2011 will need to meet the conditions of authorisation or registration in those regulations. In our view, there will often be similarity between the threshold conditions in FSMA and the minimum standards in other legislation. As such, while this CP focuses on the FCA's objectives and the threshold conditions in FSMA, much of it may also be of interest for firms seeking authorisation under other legislation.

Solo-regulated firms and dual-regulated firms

- 1.15** For regulated activities that require a permission under Part 4A of FSMA, depending on the activities an international firm performs, it will either be solo-regulated by the FCA or dual-regulated by the FCA and the Prudential Regulation Authority (PRA).
- 1.16** The FCA authorises solo-regulated firms, and in the case of dual-regulated firms, the PRA is the lead authority for authorisation. The PRA has published details of its approach to the authorisation and supervision of branches of international banks and international insurers. Under FSMA, for the PRA to authorise any dual-regulated firm, we must also give our consent. To give consent, we will assess these firms against our threshold conditions for dual-regulated firms, taking account of our statutory objectives. Our threshold conditions for dual-regulated firms are different to our threshold conditions for solo-regulated firms – these differences are set out in Schedule 6 to FSMA and our guidance in the 'COND' part of the FCA Handbook. The focus of our assessment is also somewhat different to the PRA's. Therefore, dual-regulated international firms will wish to consider the issues raised in this CP, and the extent to which their structures and the scope of their operations could present the risks identified in this CP.
- 1.17** We recognise that there are differences in the regulatory and supervisory frameworks applicable to dual-regulated firms and solo-regulated firms. We will consider these frameworks and the impact they might have on a firm's ability to meet the threshold conditions when conducting assessments.

The FCA's approach

- 1.18** We are committed to a competitive and open financial system. International firms are an established part of the UK's financial services landscape, and help the UK to maintain open markets. Open and vibrant markets, driven by the ability of international firms to efficiently conduct business in the UK, help us meet our objectives.

- 1.19** If an international firm meets the requirements to be authorised, and has good risk mitigation in place, then we will authorise it on that basis. However, some international firms could present specific challenges and we will not authorise them if, in light of these challenges, we consider that they do not meet the minimum standards for being authorised. We will pay particular attention to the extent to which we are able to supervise the conduct of the firm's UK business, the potential outcomes in an insolvency situation, the role and accountability of the firm's senior management, and the supervisory cooperation with the firm's home state regulator.
- 1.20** The approach set out in this CP takes account of our experience of regulating firms and managing firm failures, both domestic and international. Our aim with the approach is to act in a way which is proportionate and is consistent with our strategic and operational objectives, ensuring that standards are maintained, while not undermining our commitment to open markets.

Our objectives under FSMA

Our strategic objective is to ensure that relevant markets function well and our operational objectives are:

- to secure an appropriate degree of protection for consumers
- to protect and enhance the integrity of the UK financial system
- to promote effective competition in the interests of consumers

What we want to change through this consultation

- 1.21** This CP aims to set out, and obtain views on, the specific challenges in meeting the minimum standards that are more relevant for international firms.
- 1.22** There is no proposal to change the existing minimum standards, for example, the threshold conditions under FSMA or the equivalent conditions under other legislation.

Outcome we are seeking

- 1.23** We seek to ensure that international firms considering applying for authorisation are aware of our approach, and to give firms an opportunity to provide feedback ahead of publishing the guidance document where we will set out our expectations.
- 1.24** We also seek to ensure that international firms better understand how they may be able to satisfy the relevant minimum standards when applying for authorisation, and to continue to satisfy them. In doing so, we seek to enable international firms to operate in the UK in a way that also protects consumers and market integrity.

Next steps

- 1.25** We want to know what you think of the approach set out in this CP. Please send us your comments by 27 November 2020.

2 Our proposed approach: an overview

Minimum standards for authorisation

- 2.1** Firms that wish to be authorised in the UK need to meet the minimum standards set out in the relevant legislation – for example, firms seeking Part 4A permissions under FSMA need to meet the relevant threshold conditions. When deciding whether to authorise an international firm, we apply the same standards with the same statutory objectives in mind, as for UK firms. Once authorised, firms need to meet the minimum standards at all times.
- 2.2** In 'Our Approach to Authorisation', we explain how these minimum standards are designed to help prevent harm from occurring. That publication will remain relevant for international firms, but there are additional factors international firms need to consider. For example, the nature of their UK and overseas operations, their personnel or decision-making structures, and their systems and controls. We set out our expectations against some of these factors in paragraphs 3.3-3.14.
- 2.3** As part of that assessment of international firms against the relevant minimum standards, we also consider the firms' potential to cause harms and the mitigation available. We set out an overview of this in paragraphs 2.11 and 2.12.
- 2.4** This CP focuses on how we ensure that international firms meet these minimum standards for authorisation. However, international firms should also be aware of our wider approach to supervising the firms we regulate, as set out in 'Our Approach to Supervision'.

Choosing between branch and subsidiary

- 2.5** International firms have a degree of choice regarding the legal form of their UK presence. They can serve UK customers from an entity incorporated outside the UK, or they can do so through a UK-incorporated entity. In both cases, where an authorisation is sought, the authorisation covers the whole entity, including its UK and overseas offices, and we expect it to have an establishment or physical presence in the UK.
- 2.6** We refer to the UK establishment or physical presence of a non-UK entity as a UK 'branch'. The use of branches is an established part of the UK's financial services landscape. The ability of international firms to efficiently conduct business in the UK helps markets function well, in line with our objectives.
- 2.7** If an international firm meets the requirements to be authorised, and has good risk mitigation in place, then we will authorise it on that basis. However, we believe that, without appropriate mitigation, certain potential harms could be more likely to occur where the regulated activities are undertaken by international firms from branches rather than through UK-incorporated subsidiaries. This is in part because it might be more complex for us to take certain actions where international firms operate from branches.

- 2.8** In addition, jurisdictional differences may be an issue. International firms operating from branches may be subject to regulation and supervision in their home state that also cover aspects of activities in UK branches, thereby overlapping with UK rules and supervision by the FCA. It will not always be possible for the UK regulatory framework to take full account of the regulation and supervision in every home state, which could evolve over time. It may also be more difficult for us to influence risks to the customers of the UK branches from the actions and omissions at the firms' offices outside the UK.
- 2.9** In insolvency, a UK branch will usually be wound up together with its head office as part of the insolvency proceedings for the international firm in its home country. This may in some cases make protections of customers of that UK branch less effective.
- 2.10** To account for this, when assessing an international firm against the relevant minimum standards, we will have regard to whether there is a heightened potential to cause harm from the activities being undertaken from a branch and whether the risks can be adequately mitigated. We will also consider the nature and scale of the activities the international firm intends to conduct from outside the UK.

Risks of harm relevant for international firms

- 2.11** As part of that overall assessment of an international firm against the relevant minimum standards:
- 1.** We consider the international firm's potential to cause harm ('risks of harm') and the level of these risks. In this CP, we set out 3 potential risks that are more relevant for international firms, especially those operating from branches:
 - a.** Protection for the UK office's retail customers, through redress and supervisory oversight for example, could be less effective, especially if the international firm becomes insolvent or exits the UK ('**retail harm**').
 - b.** The UK rules that protect client money or custody assets safeguarded through the UK office and the home state insolvency regime which become applicable if the international firm fails may not be aligned. This misalignment could negatively impact the outcome for UK clients ('**client assets harm**').
 - c.** Shocks or risks that originate from the international firm's overseas offices could, in some circumstances, be more difficult to detect or prevent and could be passed easily to its UK office, affecting the stability and integrity of the UK markets in which it operates or to which it is connected ('**wholesale harm**').

These potential risks are explored in more detail in paragraphs 3.15-3.36, but they are not the only risks we will consider when we assess individual firms. We will also consider the risks relevant to the firm's sector and business model.

- 2.** We determine if the international firm can offer sufficient mitigation to address the risk(s) of harm. We will consider mitigation of these risks on a case-by-case basis. Examples of mitigants are set out in Chapter 4. The following factors are important in considering the mitigation of these risks:
 - a.** International firms planning to serve retail customers will need to demonstrate that they adequately mitigate the risk of **retail harm**. This may be more difficult

for firms whose business and operational models show a higher propensity for causing harms to consumers.

- b. International firms planning to safeguard client assets will need to demonstrate that they adequately mitigate the risk of **client assets harm**. The likelihood of this risk and mitigation measures depend on how home state laws treat client assets safeguarded under UK rules.
- c. International firms planning to provide wholesale financial services will need to demonstrate that they adequately mitigate the risk of **wholesale harm**. For most firms, this risk will be small, as they are unlikely to have the scale or scope to have an impact on wider market integrity.

2.12 Across these 3 types of potential harm, we will consider home state regulation and supervision where relevant, and the level of international cooperation. This includes information sharing and the firm's recovery and wind-down planning if applicable. We will also consider the firm's business model, personnel and systems. Our assessment will be commensurate to the level of risk posed and how it affects the firm's ability to meet minimum standards.

Decisions following an assessment

2.13 If having conducted the assessment, we take the view that an international firm meets the minimum standards, we will authorise the firm.

2.14 We may consider imposing limitations or requirements as part of any approval, for us to be satisfied that the firm will meet minimum standards on an ongoing basis.

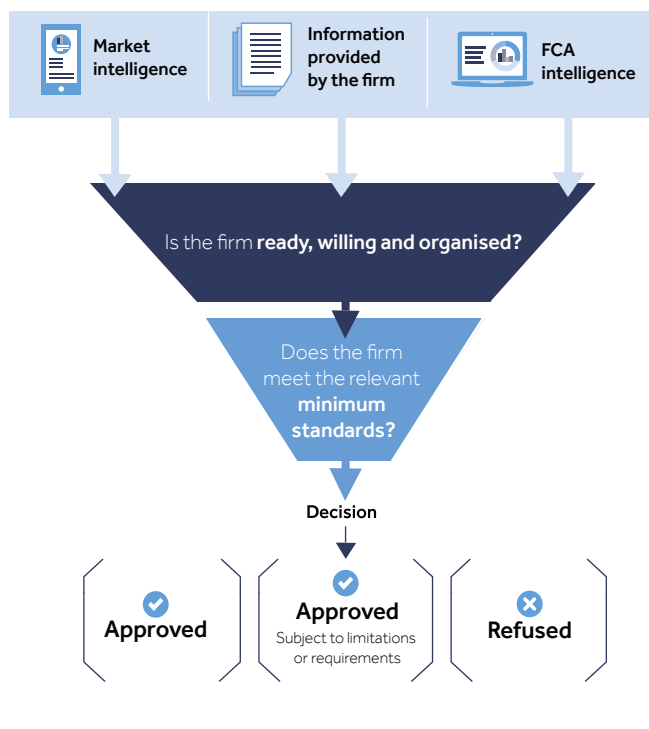
- a. A **limitation** is placed on a firm's permission to restrict its activities to reduce the potential for harm. For example, we might limit the number or category of customers a firm can deal with, or the number of specified investments that a firm can deal in.
- b. A **requirement** is placed on a firm to require it to take or refrain from taking certain action. For example, we might require a firm not to take on new business, or not to trade in certain specified investments.

2.15 The power to impose, vary or cancel a limitation or a requirement on a firm is an important tool, enabling us to reduce or prevent harm to consumers and markets. These can be accepted voluntarily by the firm or imposed on our own-initiative, following due process.

2.16 If we consider that the minimum standards are not met, for example where any risk of harm identified is not adequately mitigated, we may refuse to permit the firm to conduct the relevant regulated activities. Where the risk of harm cannot be adequately mitigated for an international firm applying to operate in the UK from a branch, but could be mitigated if that firm undertakes the relevant activity through a UK entity, we may invite the firm to apply for authorisation on that basis to undertake the activity in the UK.

Our approach at a glance

2.17 The approach we take when assessing an international firm is broadly shown in the diagram below:



An international firm that performs or plans to perform any activity that requires authorisation needs to demonstrate:

- It is **ready, willing and organised**.
- It meets the relevant **minimum standards**.

When assessing the firm against minimum standards we consider it against our **general expectations**, for example, around:

- the nature of the firm's operations
- the firm's personnel and decision-making
- the firm's systems and controls
- the factors relating to the firm's home state

We also consider the extent to which the firm presents and offers adequate mitigation against **the risks of harm** it poses, including the 3 risks described in this CP and any other relevant risks of harm relevant for the firm.

2.18 We set out what we mean by 'ready, willing and organised' in our [Approach to Authorisation](#) document (page 16) and on [our website](#). This step is relevant for firms applying for authorisation from us.

2.19 Firms must meet the relevant minimum standards to be authorised. Once authorised, they must continue to meet the minimum standards.

Q1: Do you have any comments on our general approach as set out in this paper?

3 Our proposed approach: main considerations

- 3.1** As mentioned in previous chapters, we assess firms providing or intending to provide services that require authorisation against the relevant minimum standards. We conduct these assessments when they apply for authorisation and during on-going supervision by us. For firms that wish to be authorised under FSMA, the minimum standards are the threshold conditions. Other equivalent conditions apply to firms seeking authorisation or registration under other regimes.
- 3.2** This chapter sets out in more detail some of the main considerations that are relevant for our assessment of international firms.

Our general expectations for international firms

- 3.3** This section describes some of our general expectations which are particularly relevant to international firms operating from a UK branch, though they may also be relevant for UK subsidiaries with overseas parents. We will authorise a firm only if it satisfies us that it meets, and will continue to meet, minimum standards.
- Nature of a firm's operations**
- 3.4** All authorised firms must be capable of being effectively supervised, taking into account the complexity of the firm's regulated activities, products and how the business is organised. In our view, effective supervision includes being able to access relevant information, monitor on an ongoing basis and make regulatory interventions to respond to specific harms or events.
- 3.5** To effectively supervise a firm's UK activities, we expect the firm to have an active place of business in the UK. It will typically not suffice if a firm's local presence has little or nothing more than a UK registered address.
- 3.6** In addition, we will need assurance that the personnel (including management and decision-making structures) and the systems and controls (taking into account any offshore or outsourcing dependencies) are adequate for the firm's UK activities to be effectively supervised. Where relevant we will also assess whether the UK operations are appropriately financially resourced by the firm as a whole, to avoid the risk that the firm cannot meet any legal and regulatory obligations arising from the operations of the branch.
- 3.7** In considering how effectively we can supervise the firm in the context of its wider operations, we will assess the degree of cooperation between the FCA and the home state supervisor. This includes the existence of cooperation agreements and the ability to exchange confidential information.

- 3.8** We also consider the firm's business model and assess whether the firm's strategy for creating value is implemented in a sound and prudent manner, and in the interests of the consumers it serves.

Personnel and decision-making

- 3.9** When considering the appropriateness of resources and suitability of the firm, we will consider the ability of the firm to comply with the rules which give effect to the Senior Managers and Certification Regime (SM&CR). In broad terms, these rules require firms to have effective governance structures and management oversight in place, with clearly defined individual senior management accountability. The SM&CR applies proportionately to international firms that have a UK branch.
- 3.10** Although decisions will be taken on a case-by-case basis, we would typically expect senior managers who are directly involved in managing the firm's UK activities to spend an adequate and proportionate amount of their time in the UK to ensure those activities are suitably controlled. We recognise that individuals at an international firm who have responsibilities for the UK branch that are purely strategic may not be based in the UK.
- 3.11** Before authorising an international firm to operate from a UK branch, we will need appropriate assurance over the adequacy of the firm's decision-making framework. This is both for its regulated activities carried on in the UK branch and at the wider, strategic level. We expect individuals responsible for the day-to-day management of the UK branch activities to have sufficiently independent decision-making powers and to exercise independent challenge over strategic decisions that affect the wider firm.

Systems and controls

- 3.12** Any firm authorised to operate in the UK must also have appropriate non-financial resources including systems, controls and human resources. Outsourcing arrangements should not impair the quality of the firm's governance and internal controls and our ability to supervise it. Where an international firm's UK operations are dependent on services provided from other locations of the firm, we will consider whether these arrangements could impair our ability to supervise the firm effectively.

Home state jurisdiction

- 3.13** The authorisation of a firm applies to the entire firm including its overseas offices. This means for an international firm, the authorisation will apply to the legal entity incorporated outside the UK, including its UK branch and its overseas head office. Firms operating from branches will also often demonstrate a high degree of interconnectedness between their UK and international establishments.
- 3.14** As such, we must have comfort over the jurisdiction where the firm is incorporated, and how the arrangements in that jurisdiction affect the ability of the firm to meet the relevant minimum standards for authorisation. For instance, to assess whether the UK operations are appropriately financially resourced by the firm and to avoid the risk that the firm cannot meet any legal and regulatory obligations arising from the UK operations, we will take account of the comparability of relevant home state regulation, wind-down plans and whether the home state has implemented and complies with relevant global standards. This includes, for example, whether the specific activities that the firm wishes to carry out in the UK from a branch are prudentially regulated in its home state. We will also take account of the supervisory cooperation with the relevant home state regulator(s).

International firms providing services from outside the UK

Where an international firm applies for authorisation, the whole firm must meet the minimum standards for authorisation and the whole firm, including its overseas offices, benefits from the permissions granted. If such a firm intends to provide some services to UK customers from overseas (ie anywhere other than a UK establishment), we will seek to ensure that we can effectively supervise services provided to UK customers in this way. In doing so, we will consider how much assurance we can take from our supervisory relationship with the firm's UK establishment. For example, the extent to which the UK branch has oversight of activities provided to UK customers from overseas.

Depending on firms' activities and how those activities are performed, some of our rules may not apply in the same way or to the same extent if the services are provided from the home state or anywhere other than from an establishment in the UK. This is notwithstanding the specific status disclosure obligations in GEN 4.4 for firms doing business with retail clients from non-UK offices.

This may present risks of harm in addition to those discussed in this CP, or make the harms discussed in this CP more acute. For example, business conducted from a UK branch may be covered by the Financial Services Compensation Scheme, whereas the same service provided to UK customers from the firm's home state may not. Where UK regulatory protections are not available, we will seek to understand the extent to which non-UK protections are available for UK consumers in their place.

Where we identify specific risks of harm arising from services being provided from an establishment outside the UK, in the first instance we will work with firms to identify mitigations which could include changing the way in which these services are provided. We may invite the firm to consider providing some or all of these services from the UK branch, or where appropriate we may agree limitations or requirements with the firm that sufficiently mitigate the risk.

For example, where an international firm proposes to continue to provide some services from its home state to a limited class of consumers (eg expatriates) and mitigates the risks sufficiently for that class of consumers, we may formalise this arrangement via a limitation on the firm's permissions.

Ultimately, if we are not content with the firm's plans, we may consider imposing a limitation or requirements using our own-initiative powers, or we may seek to refuse the firm's application for authorisation.

Assessing an international firm's risks of harm

3.15

As part of our assessment of a firm against minimum standards, we consider the potential for harm it may pose ('risks of harm'). International firms may cause harms depending on their business model and how their businesses are structured. In this section, we expand on the 3 broad categories of harms that are particularly relevant for international firms performing regulated activities from a UK branch and serving retail customers (**retail harm**), holding client assets (**client asset harm**), and conducting wholesale businesses (**wholesale harm**). As mentioned above, we will also consider other risks of harms that are relevant for the firm's sector and business model.

Retail harm

- 3.16** Our focus here is on international firms that conduct regulated activities with retail customers (which may include firms that manufacture products which are ultimately sold to retail customers).
- 3.17** We are concerned about the risk of harm from the non-payment of redress applicable under the relevant UK rules. This is because, although UK branches of international firms will generally be subject to the same regulatory redress requirements as UK firms and the same Financial Services Compensation Scheme (FSCS) cover, a person in the UK seeking redress from a branch of an international firm may be more dependent upon the cooperation of the international firm's head office or, in the case of the firm's insolvency, the position of UK consumers under the home state's insolvency rules and/or the FSCS.
- 3.18** This can pose a risk of harm to:
- a. 'eligible complainants' to whom the Financial Ombudsman Service ('the ombudsman') has made awards
 - b. 'consumers' who can claim redress through other routes (as per the first paragraph of the Handbook glossary definition, which defines consumer as a 'natural person acting for purposes outside his trade, business or profession')
 - c. 'eligible claimants' who could rely on the FSCS for compensation in the event of unpaid redress
- 3.19** Examples of harms that could occur with an international firm include where:
- a. The firm is solvent, but refuses to make payment of redress, and has insufficient assets in the UK to satisfy such claims. In such circumstances:
 - i. The FSCS would be unable to pay any compensation in circumstances where the firm is simply unwilling – rather than unable – to pay its redress liabilities.
 - ii. The consumer may have to seek enforcement action in the firm's home state, which will have different procedures and laws to the UK. Such enforcement action may be complex, expensive, and time-consuming. As a practical matter, it may require legal representation before the foreign court. The foreign court may also draw a distinction in the nature of the redress. For example, it may take the view that the ombudsman award is not a judicial decision and may require the dispute to be re-litigated from scratch.
 - iii. The firm may take defensive action to resist enforcement, such as by seeking judicial declarations or anti-suit injunctions in the courts of its home state. It may also seek to dissipate any assets it may have in the UK.
 - iv. It may be more difficult for UK regulators to take effective action. For example, if a fine is levied, but the firm refuses to pay, the foreign court may refuse to enforce the payment of the fine on the basis that the fine is the sovereign act of a foreign state.
 - b. The firm is insolvent, and so cannot make full payment of redress. Under these circumstances, where the firm is subject to home state insolvency laws, then:
 - i. Consumers with FSCS protected claims who are eligible will be able to claim compensation from the FSCS up to the relevant limits. However, this is not possible for certain claims that are not FSCS-eligible, such as – in general

- those relating to consumer credit or loan-based crowdfunding or where customers pursue their claim themselves where their claim exceeds FSCS limits.
- ii. Consumers whose claims are not FSCS-eligible or who pursue their claim themselves where their claim exceeds FSCS limits may have to prove their debts under the foreign court's insolvency procedures and the laws of the home state. This may add significant complexity, expense, and delay to the enforcement action. As a practical matter, it may require UK consumers to seek legal representation in the firm's home state to liaise with the liquidator and to pursue any disputes before the foreign court. If the firm is heavily insolvent, the additional expense may further reduce the funds available for unsecured creditors, to the point that it is uneconomic for the UK consumers to pursue their redress.
- iii. If consumers with non-FSCS eligible claims have already taken steps to secure redress in the UK before the firm became insolvent, they may need to start afresh under foreign insolvency proceedings.

3.20 In our experience, higher incidences of consumer harm resulting in complaints (which can lead to redress) are typically associated with recurring factors such as:

- poor quality of governance leading to inappropriate sales practices (including failing to establish customer needs, or conduct affordability checks)
- inadequate disclosure of product information resulting in consumers being unable to effectively engage with the product
- inadequate management of conflicts of interest between how firms generate revenue and consumer needs
- flaws in the design and implementation of systems and controls
- failure to hold adequate professional indemnity insurance and capital to meet liabilities
- inadequate arrangements to maintain technology resilience and cyber security
- failure to establish adequate controls to prevent financial crime such as scams

3.21 When assessing any firm – UK entity or international firm – we will pay close attention to factors such as these. However, as set out in paragraphs 3.17 to 3.19, international firms may pose increased risk relating to non-payment of redress. In addition, international firms are typically dependent on their head offices and other overseas offices, and the factors set out in paragraph 3.20 may be exacerbated if these firms have not appropriately adapted their business to suit the UK market or regulatory requirements, or if the supervisory oversight of the relevant overseas offices is not sufficient.

3.22 So when assessing an international firm, we will pay more attention to the risk of these factors occurring and what assurances can be provided by the firm to mitigate them.

Client asset harm

3.23 Our focus here is on international firms that safeguard custody assets or receive or hold client money (collectively referred to as 'client assets'), in particular, client assets subject to the FCA's client assets sourcebook (CASS). However, international firms that safeguard funds subject to the Electronic Money Regulations 2011 should also consider how this risk of harm might apply to them.

3.24 If an international firm safeguards client assets from a UK branch, it will generally be required to comply with UK rules on the protection of client assets while the firm is

a going concern (in particular, the CASS rules). There could be a mismatch between these UK protections and the home state laws and, depending on the home state laws, this could negatively impact the protection for the client.

- 3.25** In insolvency, it is probable that a UK branch will be subject to the insolvency regime and procedures of the international firm's home state. An insolvency practitioner appointed in the home state may not be in a position to observe UK protections when distributing assets. As a result, the protections offered by the applicable provisions of CASS, in conjunction with UK property and insolvency law, might not be applied if the insolvency is administered in line with the home state's laws, might only be partially applied, or might be applied only if certain conditions are met.
- 3.26** There is a possibility that clients' assets will not be ring-fenced as CASS and UK law had intended. This could be an issue if, for example, the client assets are made available to the international firm's general creditors as part of the general insolvency estate of the firm, and clients for whom assets were safeguarded under CASS have to prove their claims as creditors rather than beneficiaries to property.
- 3.27** Insolvency regimes across different jurisdictions can vary considerably and there is little harmonisation of insolvency law at an international level. We will expect international firms to have considered the risks to client assets and how to address them. This could include seeking legal advice on the specific circumstances of the firm and its proposed UK branch in the context of the insolvency regime of its head office's jurisdiction, and assessing the implications of its recovery and wind-down plans (or resolution plans where relevant) on the customers of the UK branch.
- 3.28** When assessing whether these harms can arise in particular situations, questions that we are likely to consider include:
- **Recognition of property rights:** Will UK clients' rights to their assets be recognised under the home state insolvency regime? Will the segregation of client assets from the firm's general estate at the point of insolvency be respected?
 - **Client interaction with home state insolvency:** Will UK clients be treated in a way commensurate to UK expectations when exercising a claim to their client assets?
 - **Effectiveness of home state insolvency process:** Will client assets that were safeguarded from the UK branch be distributed in a timely fashion? What influence, if any, will the FCA or other UK authorities have over the protection of clients of the UK branch?
- 3.29** Even with specific advice, outcomes of insolvency proceedings are difficult to predict. In particular, for solo-regulated firms that operate in more than one country, there is little harmonisation at an international level on tools that authorities should use to ensure an orderly wind-down, nor is there always sufficient international cooperation to manage such insolvencies. We therefore have limited tools at our disposal to ensure protections and outcomes equivalent to those in the UK. In contrast, there is a degree of international harmonisation on the tools that resolution authorities should use for firms in the dual-regulated population, which we will factor into our case-by-case assessment for these types of firms.

Wholesale harm

- 3.30** Our focus here is on the potential risk of harm to UK financial markets and the UK economy that could be caused by an international firm operating in, intending to operate in, or otherwise connected to these markets.
- 3.31** While we are committed to maintaining a competitive and open financial system, this must not come at the expense of market integrity. In some cases, firms, particularly those in the wholesale market could cause disruption affecting the UK financial system if they are in distress or undergoing a disorderly failure.
- 3.32** It may be more difficult for us to effectively identify shocks or prevent risky behaviours that originate from an international firm's activities outside the UK but could cause significant negative impact in UK markets. This may be particularly the case if the firm's UK branch is highly interconnected with or reliant on its overseas offices, and if supervisory cooperation in oversight and information sharing is insufficient.
- 3.33** The common underlying factors that we believe can increase a firm's ability to impact UK markets, and so its potential to cause harm in them, include:
- a lack of substitutability of the products and services that the firm offers in the UK market(s) where it operates
 - the firm occupying an important position in the UK market, for example where it has significant market share in a niche market or otherwise has significant influence
 - the firm being interconnected to other firms in the industry, and spreads and amplifies risks in the system rather than reducing or absorbing them
- 3.34** We will pay more attention to international firms that display the factors above, and will assess their risk of harm taking account of the firms' specific circumstances.
- 3.35** As the PRA leads on the prudential supervision of dual-regulated international firms, we will discuss any relevant concerns we have about those firms with the PRA as well as with the firms themselves.
- 3.36** We are responsible for the prudential supervision of solo-regulated international firms. We believe that in general solo-regulated branches are less likely to reach a scale or scope that could cause market disruption or other related harms that undermine market integrity. However, we will consider this on a case-by-case basis.

Q2: Do you have any comments on the 3 harms we have set out in this CP?

Q3: What other harms may arise when international firms operate in the UK?

4 Our proposed approach: mitigating risks

- 4.1** As part of our assessment of an international firm, we consider whether it offers adequate mitigation against the risk of any harm identified. This chapter provides examples of the ways international firms might be able to mitigate the 3 risks of harm highlighted in Chapter 3: **retail harm**, **client asset harm**, and **wholesale harm**. If any other risks of harm are identified in an assessment, the firm should also seek to mitigate those risks as well.
- 4.2** All firms are different and so the actions one firm takes to mitigate its risks of harm might not be suitable for another firm.
- 4.3** As we have set out in Chapter 2, where we have concerns, we would in the first instance ask the firm to explain how risks of harm would be mitigated. Our assessment of mitigation will be commensurate to the level or risk posed. Where appropriate we may agree with the firm the relevant limitation or requirement to mitigate the risks.
- 4.4** If we still have residual concerns, we may decide to authorise the firm subject to a limitation or requirement that it must meet from the point of authorisation. This could include, for example, limiting the number or type of UK retail customers it can serve or requiring the firm to report specified information to us on an on-going basis or if certain triggers are met.
- 4.5** Ultimately, however, we will refuse a firm's application if none of those actions is sufficient to address our concerns and we do not consider that the minimum standards for authorisation are met. We will take the steps we consider necessary to advance our operational objectives.

Mitigating the risk of retail harm

- 4.6** Retail harm can arise where an international firm holds insufficient resources to compensate its UK retail clients during firm failure, or decides to exit the UK market without compensating its UK retail clients.
- 4.7** Some factors make retail harm less probable. We will take these factors into account when considering the firm's ability to mitigate the risk of retail harm and its impact on the firm's ability to meet minimum standards.
- 4.8** There may be firm-specific factors which might reduce the likelihood of the firm seeking to avoid its responsibilities. For example, if there would be a particularly adverse impact on the firm's reputation in other markets if it were seen to treat UK customers unfairly, or if the FCA could rely on the home state regulator to obtain compensation from the firm, then the firm may be less likely to try to avoid its responsibilities in the UK.
- 4.9** Factors that may reduce the likelihood of firm failure and of firms holding insufficient resources to compensate retail clients include, for example, the level of prudential scrutiny and supervision applied to firms in their home state, the extent of any ongoing

monitoring of recovery and wind-down plans (where relevant), and the degree to which UK authorities may be involved in the recovery and planning process. For firms with resolution arrangements, we will also take account of the extent of international cooperation for those arrangements.

4.10 To assess the level of protection an international firm offers to UK customers, we will consider the firm's home jurisdiction to understand the comparability of redress rules and supervisory approach, consulting the home state regulator where appropriate. We will also consider the level of cooperation between the FCA and the home state regulator.

4.11 We will review each application on a case-by-case basis, including consideration of the nature and scale of the retail business. We will expect mitigants to be commensurate with the likely level of risk, for example, the size of the firm's retail business.

4.12 We will also consider the relationship between the branch and its head office, to identify whether we could gain additional assurance from how the branch is structured or resourced, for example, whether and to what is extent:

- a.** the branch has its own management in the UK or independent oversight as part of its governance structure, or is heavily influenced by executives at the head office
- b.** the systems and controls are well-suited to the operation of the branch in the UK (especially if they are derived from the policies and practices of the head office)
- c.** the people exercising control functions (for example for compliance, audit and risk) have adequate UK regulatory or legal experience and knowledge of the UK market
- d.** the products and services that are developed by the head office or by other overseas branches are suitable for the UK market
- e.** the conflict of interest and other relevant policies derived from the head office are sufficiently localised to ensure that expectations under UK laws and regulations are adequately met

4.13 We will use our experience of similar firms to inform our assessment of a firm's potential harms and its mitigants. When assessing whether its mitigants are adequate, we will take account of the history of redress and consumer complaint for firms with similar business models. This means, generally speaking, we consider that it is likely to be more difficult for firms to satisfy us that they can adequately and sustainably mitigate the risk of retail harm if we have seen significant concerns arising from firms with similar business models.

4.14 Where mitigants do not adequately address the retail harm, we will consider options such as limitations or restrictions on the business to focus on activities where we are more comfortable about the potential level of harm. In some cases, establishing a UK subsidiary for the relevant part of the business may help to reduce the risk of harm.

Mitigating the risk of client asset harm

4.15 The client asset harm can arise when there is a misalignment between the UK rules which apply for client assets safeguarded from a UK branch when the international firm is a going concern, and the insolvency laws which apply when the firm becomes insolvent.

- 4.16** We will expect firms to satisfy us that the risks are appropriately mitigated, including, where relevant, by providing us with information about their clients and how their assets are safeguarded from a UK branch would be treated if the firm enters into insolvency proceedings. We will expect firms to have considered the risk of harm and be able to explain the mitigations they will put in place.
- 4.17** We anticipate that we will need to consider these mitigations with reference to how client assets are held and safeguarded. We will consider the risk of harm for client money and custody assets separately. For example, one possibility that credit institutions can consider is to hold money that would otherwise be classified as client money as a deposit under the 'banking exemption' set out in CASS 7.10.16R of the FCA Handbook (as many such firms do already). In this situation the position of depositors in insolvency is likely to be more certain. For custody assets, in some cases, ensuring assets are registered in a manner consistent with both home and host state laws may be sufficient to mitigate the harm depending on the insolvency law position in the relevant jurisdiction.
- 4.18** In certain circumstances, clients of the UK branch may accept, and even have the expectation, that the insolvency law in the home state where the international firm is incorporated will apply. For example, an EEA-based insurance distributor may wish to establish a UK establishment to access the London Market and only seek to serve EEA-based clients through the UK branch. In such a situation, we may accept the relevant activities being undertaken through the UK branch, but it would be important that the firm makes suitable disclosure to its clients.
- 4.19** If we still have concerns after these considerations, one possible option an international firm could consider is to structure its arrangements so that client assets are not safeguarded from its UK branch, to the extent that doing so would better protect custody assets. The firm may wish to choose to conduct the custody asset activity from an establishment in the home country (such as the firm's headquarters) where the home state provides its own protections. Or the firm may wish to arrange for the client to appoint another person who has the appropriate permissions to act as its custodian in the UK (with the firm possibly retaining a mandate over the custody account so that it can still service the client's transactions). This could ensure that there is consistency between the safeguarding regime that applies during the life of the firm and the law that would apply in an insolvency.
- 4.20** Establishing a UK-incorporated subsidiary is another possible option for the international firm to consider, where this could ensure that there is consistency in the treatment of client assets in the UK between the safeguarding regime that applies during the life of the firm and the law that would apply in an insolvency.
- 4.21** We are mindful that these options may raise practical considerations for individual firms that they will need to consider, and that other kinds of mitigations might be available to adequately address the risk.

Mitigating the risk of wholesale harm

- 4.22** The wholesale harm can arise when shocks or risks that originate from an international firm's overseas offices, which may be more difficult for us to identify and prevent, have a negative impact on its UK branch and the integrity of UK financial markets.

- 4.23** As noted above, we believe there is in general less scope for the UK branches of solo-regulated international firms to reach a scale or scope that causes widespread issues of market integrity in the UK. We discuss with the PRA dual-regulated international firms, including those that are systemically important.
- 4.24** Where the size and nature of the firm as well as its interconnectedness with the wider market mean it could pose a significant risk to market integrity in the UK, especially if the firm were to become distressed or fail, we may discuss with the firm ways to maximise our ability to effectively supervise the firm or manage its risk of harm to the UK markets.
- 4.25** On a case-by-case basis, we will consider the extent to which this risk of harm is likely to become real and what mitigants are in place and whether they are adequate relative to the level of risk. Relevant factors include, for example, the level of supervisory cooperation, the prudential regime the firm is subject to, and the credibility and quality of its wind-down planning.
- 4.26** For an international firm subject to international resolution plans and arrangements (eg as a result of legislation which implements the Bank Recovery and Resolution Directive), we will consider how confident we are that respective resolution authorities can use a pre-agreed plan that will aim to minimise disruptions to wholesale markets should the firm enter financial difficulties. This is especially so where the plan intends to avoid failure in addition to managing its consequences.
- 4.27** We are also mindful that there may be additional steps the firm can take to reduce our concerns over any risk that it may pose to the integrity of UK markets. We will take those into account when assessing whether the risk is adequately mitigated. In scenarios where we consider the risk of harm would be mitigated only if the international firm were to operate through a UK entity or transfer the relevant activity to another entity, we may invite the firm to consider applying for authorisation on that basis.

Q4: Do you have any comments on the mitigants we have identified?

Q5: Are there any other mitigants we should consider?

Annex 1

Potential impact of our approach

1. In this CP, we seek views on our general approach and on the risks of harm international firms might present. Because we are not proposing any changes to our rules, we are not required by statute to set out a cost-benefit analysis.
2. We believe it is helpful nonetheless for us to set out at a high level our views of the potential impact of the approach. In summary, we believe the approach achieves an appropriate balance and will deliver benefit for firms, consumers and our resources.
3. We are mindful, however, that it would be impracticable for us to attempt to precisely assess the costs and benefits. Our approach does not prescribe specific outcomes for international firms and allows firms flexibility to choose how they structure their businesses to provide regulated services in the UK, provided that they can do so in a way that that meets minimum standards and mitigates any risks of harm identified. The costs are highly sensitive to the specific circumstances of individual international firms and their clients, and depend significantly on the strategies those firms choose to pursue, which will be affected by factors beyond this CP.

Impact on firms

4. The approach will impact international firms applying to perform or performing regulated activities that require authorisation in the UK.
5. We expect these firms to have appropriate arrangements for their operations, systems and controls, and personnel and decision-making in relation to their regulated activities in the UK. We also expect that they have some form of UK presence, to ensure that we can effectively supervise them for the regulated services they provide. This will impact international firms that do not have any UK presence but wish to be authorised to operate in the UK in future, such as those currently relying on an EEA service passport to serve UK customers. Firms that already have an establishment in the UK are likely to be less impacted.
6. We also expect that these firms mitigate the three risks of harm outlined in the CP, in addition to any other risk of harm identified in our assessment of individual firms. The three risks of harm are relevant for international firms needing authorisation and carrying out or intending to carry out the following activities:
 - undertaking retail business, specifically business with a 'consumer', an 'eligible complainant', or an 'eligible claimant' as defined in Chapter 3;
 - safeguarding client money or custody assets from their UK establishment; and
 - undertaking business in wholesale UK markets in the UK.
7. To meet our expectations and mitigate the relevant risks, some of those international firms may need to make operational or financial changes to their businesses. Some may need to restrict or limit their businesses to activities that do not pose significant risks. The costs will depend on the level of risks the firm poses and its existing

arrangements. They may include one-off costs from restructuring, for example from changing its systems or transferring its businesses to another firm, and ongoing costs from the relevant requirements that being authorised will entail. Some firms may choose not to enter the UK or may choose to reduce their existing UK footprint if they cannot adequately mitigate the risks they pose in a way that is commercially viable, which could affect competition.

8. We cannot know for sure what proportion of firms will present which risks and what proportion will elect to do which of the above. We also cannot know whether a firm's decision to restructure or exit the UK will be in response to our approach or other factors that affect the cost of doing business. As we have made clear, our approach allows for a range of possible outcomes, and we will refuse to allow an international firm to operate in the UK only if we consider that it cannot meet minimum standards.
9. For EEA firms providing services that will require authorisation once passporting falls away, the Government has legislated to establish a Financial Services Contracts Regime (FSCR) in addition to the TPR. This means that EEA firms that do not enter the TPR or seek authorisation, or those that have entered the TPR but have their applications for authorisation refused, can rely on the FSCR to continue servicing existing contracts with UK customers without authorisation, and to wind down their existing UK business in an orderly way.
10. By setting out our approach publicly, as we have done in this CP, international firms that plan to perform activities that require authorisation will have a better understanding of our expectations. This is likely to help firms decide how best to structure their businesses before they apply for authorisation and facilitate the application process, which could reduce the costs to the firms and the time the process would take. This will reduce the likelihood of an unsuccessful application, for example one that is refused because of risks that could have been mitigated before the application was made. This will minimise the expense and effort that come with making a new application.
11. The approach will not affect international firms that are not providing, or not intending to provide, financial services that require authorisation.

Impact on consumers

12. Consumers could benefit from our expectation that international firms consider the impact they may have on UK clients throughout the life of the firm including during recovery, wind-down or insolvency. This reduces the risk of consumers facing additional costs and delays when seeking to recover redress or retrieve their client assets, because only international firms which can demonstrate an ability to adequately mitigate these risks will be permitted to operate. Consumer confidence in the overall market is likely to improve as a result. Consumers may also become more confident in using the services provided by international firms authorised by us, which could promote competition in the relevant markets.

Impact on our resources

- 13.** The FCA will be able to refer to our published approach in discussions with firms about applications for authorisation and on-going supervision, which could allow us to use our resources more efficiently and discharge our functions more effectively. By reducing the risks of harm when we assess firms, we also reduce the likelihood that the risks materialise to cause harms to consumers and markets which would likely be more costly to address.

Annex 2

List of questions

- Q1:** Do you have any comments on our general approach as set out in this paper?
- Q2:** Do you have any comments on the 3 harms we have set out in this CP?
- Q3:** What other harms may arise when international firms operate in the UK?
- Q4:** Do you any comments on the mitigants we have identified?
- Q5:** Are there any other mitigants we should consider?

Annex 3

Abbreviations used in this paper

AIF	Alternative Investment Funds
CASS	Client assets sourcebook (FCA)
CP	Consultation paper
EEA	European Economic Area
EU	European Union
FCA	Financial conduct authority
FOS	Financial Ombudsman Service
FSCR	Financial Services Contracts Regime
FSCS	Financial Services and Compensation Scheme
FSMA	Financial Services and Markets Act 2000
PRA	Prudential Regulation Authority
SM&CR	Senior Managers and Certification Regime
TPR	Temporary Permissions Regime
UCITS	Undertakings for Collective Investment in transferable Securities Directive
UK	United Kingdom



We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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