

Our Approach to International Firms: summary of responses

Feedback to CP20/20

Feedback Statement

FS21/3

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This relates to

Consultation Paper 20/20 website at
www.fca.org.uk/publications

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1 Introduction

Background

- 1.1** In the consultation paper CP20/20 we set out our approach to international firms providing (or seeking to provide) financial services that require UK authorisation.
- 1.2** We wanted to hear views on how we will assess international firms against our minimum standards when they apply for authorisation and during ongoing supervision by us, and our general expectations for these firms. We also wanted to hear views on the circumstances where these international firms could present higher risks of harm and how those risks can be mitigated.
- 1.3** The consultation was open for 9 weeks, from 23 September to 27 November 2020. We received 50 responses. The Financial Services Consumer Panel also provided feedback. Having taken account of the responses and feedback, we have amended the description of our approach. You can read it in the approach document.

Purpose of this feedback statement

- 1.4** In this feedback statement, we set out the main points raised by the respondents to the consultation. Where possible, we try to provide more clarity and to respond to the comments raised. We also explain where we have amended the approach following the consultation.
- 1.5** For an overview of our approach and for further details, please see the approach document. A list of the abbreviations used is available in Annex 2 of that document.
- 1.6** If you have any questions about your firm, you can reach out to your supervisory contact or to firm.queries@fca.org.uk.

Who will be interested in this Feedback Statement?

- 1.7** This feedback statement may be of interest to respondents to CP20/20. It may also be of interest to stakeholders who would like to find out more about what comments we received and took into account when finalising the approach we have set out in the approach document.
- 1.8** The target audience of the approach document is set out in paragraphs 1.5 to 1.7 of that document.

2 Feedback to responses to CP20/20

Consultation questions

2.1 In CP20/20, we asked respondents for their input on the following questions:

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

2.2 We set out below the main comments and queries raised, arranged by theme. Where relevant, we have included the paragraph references to the CP or the approach document.

The overall approach

2.3 In the CP, we explained that international firms that require authorisation need to show they can meet our expectations, and that provided our expectations are met, they may have some flexibility around, for example, their legal structure (paragraphs 2.5 to 2.10). We also explained our approach to factors like firms' operations, personnel and decision-making, systems and controls, and home state jurisdictions (paragraphs 3.4 to 3.14). We explained that we were not proposing to change existing rules or other provisions in the FCA Handbook through the consultation.

2.4 Most respondents welcomed our approach and our commitment to maintaining openness in market access to the UK. Some respondents said we should make it clear that our expectations will not result in firms needing to set up UK subsidiaries or to have a local presence in the UK. On the other hand, we also received views indicating that we could adopt a more assertive stance. Some respondents called for international firms to have to set up UK subsidiaries more often, and for us to strengthen our expectations about the extent of local presence we expect international firms to have in the UK, to ensure a level playing field between UK and international firms and avoid regulatory arbitrage.

2.5 We think the approach we have set out in the CP and the approach document reflects the right balance. It is intended to be broad enough to be relevant to firms from different sectors, operating different business models, subject to different rules, and from different countries. A one-size-fits-all approach would not be appropriate, and we have been clear that we will assess firms on a case-by-case basis. We are clear that we will only authorise firms if they can meet the relevant conditions for authorisation, and we may impose limitations or requirements where appropriate.

Further details on precise requirements

- 2.6** Some respondents asked for more specifics on the operational or financial changes we expect firms to make. On balance, we think we have set out the general approach at an appropriate level of detail, for reasons set out in paragraph 2.5 of this document.
- 2.7** Some respondents asked us to draw more of a distinction in our expectations for solo- and dual-regulated firms. We noted in the CP the difference in the process, for example the PRA being the lead authority for authorising dual-regulated firms. We have also made clear that being dual-regulated is a factor to be considered in the round but it is not determinative. We already point to factors which are more likely to apply to dual-regulated firms, but are not necessarily exclusive to them. These points are set out in paragraphs 1.16 to 1.18 of the approach document.

Firms that are in scope

- 2.8** Some respondents queried if the approach we have set out applies to firms that do not need UK authorisation to serve UK customers, for example, firms that serve UK customers without performing any activity that meets the 'characteristic performance' test, or firms that rely on available exclusions or exemptions such as the Overseas Persons Exclusion (OPE). The approach does not apply to these firms (see paragraph 1.6 of the approach document).
- 2.9** The approach is also not aimed at EEA firms that are running off their remaining UK businesses and are not seeking UK authorisation (eg firms under the Contractual Run-Off Regime). However, depending on the circumstances, we may expect firms in the Supervised Run-Off regime (which have 'deemed' Part 4A authorisation) to maintain an existing UK establishment where that is necessary for them to perform services under pre-existing contracts.

Expectations for the whole firm

- 2.10** Some respondents asked whether the expectations we set out in the CP are relevant to the firms' activities that do not require UK authorisation. Some respondents suggested that we should not be concerned at all with the firms' activities that are outside of our remit. They argued that once a firm is authorised, there is little more that we would need to know about the other activities of the firm.
- 2.11** We do not agree with that view. A firm can only be and remain authorised if it satisfies us that the firm meets, and will continue to meet, minimum standards. In appropriate circumstances, we may need to consider information relating to the firm's activities that do not require authorisation. For clarity, we have made a few changes in the approach document (eg in paragraphs 2.10, 3.3 and 3.15), to emphasise that while our expectations are focused on ensuring that activities that require authorisation are appropriately conducted and capable of being supervised robustly, we will consider firms holistically when considering the firm's suitability to be authorised by us.

The FCA's authorisation process

- 2.12** We have received some comments that our authorisation process is not challenging or robust enough, and that permissions granted to firms are sometimes too broad or are not always used as intended at the time a firm is authorised. It was also suggested that applications by compliance consultants may conceal the true culture and suitability of the firms seeking authorisation.
- 2.13** These considerations are relevant for the authorisation process for all firms, not just international firms. In our response to the independent investigation into our regulation of London Capital & Finance, we have set out the steps we have taken and will be taking. We will take these factors into account when assessing international firms.

Authorisation duration

- 2.14** Some respondents asked if we would consider extending the duration for the authorisation process where a firm presents a risk but cannot mitigate it in the time available. In the CP, we did not specify the duration for authorisation. The relevant duration for us to determine an application is set out in legislation. As we have set out in the approach document, we expect firms to be ready, willing and able when they apply (see paragraph 2.18). While we will consider each application in its individual circumstances, we are likely to view firms' applications unfavourably if they cannot resolve issues within reasonable timeframes.
- 2.15** Some respondents suggested that the overall timelines for authorising firms in the Temporary Permissions Regime (TPR) should be postponed or extended following the end of the Brexit transition period and due to the impact of the Covid-19 pandemic. The duration of the TPR period is set out in legislation. For dual-regulated firms, firms should check with the PRA regarding their authorisation timeline. For solo-regulated firms, we will allocate firms a period (also known as a 'landing slot') during which firms will need to submit their application for UK authorisation if required.

Expectation of establishment in the UK

- 2.16** In the CP, we said we expect firms seeking FCA authorisation to have an establishment in the UK (eg paragraphs 2.5 and 3.5), to enable effective supervision by us. The exact scale or type of establishment that is needed may vary depending on the specific circumstances of the firm. This approach ensures that we can achieve proportionate outcomes.
- 2.17** Some respondents queried if we should have any such expectation of UK establishment at all and if such expectation could contravene the FCA's obligations. Some respondents requested "services passporting" to be introduced, similar to the freedom of services passport available within the European Union.
- 2.18** As we explained in the CP, we consider applications on a case by case basis, in light of all relevant factors and circumstances. Our expectation that firms seeking authorisation have a UK establishment is based on the existing standards for authorisation (which, in the case of firms seeking authorisation under Part 4A of the Financial Services Markets

Act 2000 (FSMA), are the threshold conditions) and in particular our need to be able to effectively supervise a firm's UK activities. We will of course continue to have regard to any new agreement or legislative developments in accordance with our obligations at law.

Regulated activities conducted on a cross-border basis

- 2.19** In the CP, we explained that while we expect a UK authorised firm to have a UK presence, on a case-by-case basis, we may permit a firm to conduct some regulated activity on a cross-border basis (see the box after paragraph 3.14). We explained that we will consider the assurance we can get from the firm's UK establishment (as well as the relevant home state regulator) when making that decision, to determine whether the firm can be effectively supervised for that activity.
- 2.20** Some respondents said their Head of Branch is not responsible for the cross-border services provided to the UK by the other offices of the same firm, and does not have any oversight or knowledge of those services. In these cases, the firm will be less able to rely on its UK branch to demonstrate to us that the regulated activity can be effectively supervised when it is conducted on a cross-border basis.
- 2.21** Some respondents asked what our expectation referred to in paragraph 2.19 above means for the responsibilities of the senior managers that are based in the establishment (eg the senior managers of the UK branch) under the Senior Manager and Certification Regime (SMCR).
- 2.22** Generally speaking, the territorial scope of the SMCR as regards an international firm is limited to the activities from its establishments in the UK (ie the UK branch) and does not cover activities in other offices. That said, there are rules that apply more broadly in respect of an FCA-approved senior manager in an international firm. For example, the individual conduct rules (in COCON) cover conduct by that senior manager in an overseas office as well as in the UK branch. Any misconduct carried on by an individual overseas can have a bearing on whether that individual is or remains fit and proper to carry on a senior manager function or certification function. We have amended the description in the approach document (see paragraph 3.9 of the approach document).

Expectations for relevant senior managers

- 2.23** We said in the CP that 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 (eg in paragraph 3.10).
- 2.24** Some respondents have asked for clarifications on, for example, who exactly is in scope (whether it is only those with senior manager functions), what exactly we expect of them (in terms of the number of days they spend in the UK and whether they need to be actively managing the firm's UK activities on those days), and what alternatives might be available for senior managers that cannot be present in the UK. Some respondents pointed out that senior management presence in the UK has been made more difficult by travel restrictions due to Covid-19 and the move to remote working, which could outlast the pandemic.

- 2.25** We do not take a prescriptive approach to these questions. Our approach deliberately allows scope for determining what "adequate and proportionate amount of time in the UK" means in any given circumstances, giving flexibility to take account of firm-specific factors and (where appropriate) time-limited external factors such as travel restrictions.
- 2.26** Respondents also asked how much independence is expected where we said in the CP that individuals responsible for the day-to-day management of UK branch activities should have sufficiently independent decision-making powers and exercise independent challenge over strategic decisions that affect the wider firm (see paragraph 3.11). This expectation is intended to ensure that individuals operating branches have sufficient authority over the activities they perform. This could be demonstrated through the nature of branch personnel, governance and reporting structures, and decision-making arrangements. Once again, what is sufficient will vary depending on the specific circumstances of the firm.

Risks of harm presented by international firms

- 2.27** In the CP, we explained that as part of our assessment of an international firm against minimum standards, we will consider the potential for harm it may pose ('risks of harm'). We highlighted 3 risks but also mentioned that these firms may cause other types of harm depending on their business model and how their businesses are structured.
- 2.28** Some respondents agreed with our observations regarding the 3 risks of harm we highlighted. Others asked why we see higher risks of harm from a UK branch as opposed to a subsidiary. They stated that clients may prefer a better capitalised and well-operated overseas entity with a UK branch to a poorly capitalised or operated UK subsidiary. We have set out some relevant differences between branches and subsidiaries that may give rise to specific risks of harm, for example in their legal treatment, governance and operations (see eg paragraphs 2.5-2.10). We have also made clear that the branch-subsidiary consideration is one factor when we assess firms. Other factors include how well the firm is operated or capitalised.
- 2.29** We heard suggestions that financial crime is a major risk that we should consider when assessing international firms, in addition to the 3 risks we have highlighted in the CP. We do consider risks relating to financial crime, as well as other risks relevant to the firm's sector and business model. We have already mentioned that the 3 risks are not the only ones we consider but have made this clearer in the approach document (see paragraphs 2.11-2.12).

Retail harm

- 2.30** In the CP, we explained that protection for an international firm's UK branch retail customers, through redress and supervisory oversight for example, could be less effective, especially if the firm becomes insolvent or exits the UK (see paragraphs 3.16-3.22).
- 2.31** Some respondents asked what we mean by "retail customers" ie the scope of customers to which considerations of this retail harm apply, and asked about

using the MiFID definition of retail clients. We explained in the CP who we think this risk is relevant for, but we have made this clearer in the approach document (see paragraphs 3.18).

- 2.32** It was suggested that, while non-payment of redress is a potential concern, international firms already have strong incentives to maintain market access to the UK as it is a large and attractive market. While that may be the case for some firms, the attractiveness of continued market access may not always outweigh an outstanding redress bill, especially if the bill is large.
- 2.33** It was also suggested that when assessing an international firm's risk of retail harm, we could consider its international credit rating and the record of the firm's past performance or dealings in the UK. Credit rating is a type of information we can consider when assessing firms. We also take account of a firm's track record. A poor track record could show where the firm may have been deficient. However, we do not rely on a firm's historical performance as a conclusive indicator of its likelihood of causing harm in the future. We pay attention to whether the firm presents the factors which are typically associated with higher instances of consumer harm resulting in complaints, which can lead to redress (see paragraphs 3.20-3.21). We will also use our experience of firms with similar business models to inform our assessment of harm and mitigants (see paragraph 4.13).

Client asset harm

- 2.34** In the CP, we explained that in the event of an insolvency of an international firm, it is likely that resolution will be under the laws and procedures of the jurisdiction in which the firm is incorporated. In these cases, the protections offered by our CASS rules in relation to the client assets safeguarded in the UK branch may not be fully observed (see paragraph 3.23-3.29).
- 2.35** We received comments noting the possibility of initiating branch-level insolvency or resolution proceedings in the UK where the firm is incorporated overseas. While this may be possible, it is not certain and we are not aware of any precedent. Taking into account these considerations, we have made a small change to the approach document (see paragraph 3.25).
- 2.36** Some respondents suggested that we should derive more comfort from the various legislative and policy frameworks agreed at the international level, such as the EU Bank Recovery and Resolution Directive and harmonised safeguarding requirements under MiFID. We take these agreements into account, but note that the harmonised safeguarding requirements under MiFID are implemented separately in each state in accordance with their own laws. Also, the property and insolvency laws of the home and host states are not subject to the same harmonisation. That said, we are aware that for some firms, for example, Global Systemically Important Banks, there may be international agreement regarding how to handle insolvency or potential insolvency. In these cases, there may be a clearer view regarding the likely outcome of the client assets safeguarded in the branches.
- 2.37** Some respondents mentioned the difficulties around the timing and resources for obtaining legal advice, providing disclosures to clients (in relation to the applicable insolvency position), or becoming 'compliant' with relevant mitigants we

have suggested in the CP (see paragraphs 4.15 to 4.21). It was suggested that an international firm finding an authorised UK custodian may not be effective in mitigating this risk of client asset harm as the assets might in turn be subject to a sub-custody agreement overseas (see paragraph 4.19). The mitigants set out in the approach document are suggestions for firms to consider. We have made it clear that we are open to considering other mitigants that are not set out in the CP. We would only consider custodian arrangements appropriate where they can better protect custody assets or improve outcomes for customers.

- 2.38** We heard that, due to the complexities of cross-border securities holding, it would be better to have a single high-level standard of risk mitigation, rather than firms procuring their own legal opinions which would be of limited value in quantifying risks, though the respondent did not offer any example of what that single standard might be. There were also suggestions that we should require all safeguarding accounts for UK branches to be in the UK, to minimise any mismatch between the rules that safeguard assets when the firm is a going concern and the relevant laws and processes in insolvency. In both cases, we do not consider that a one-size-fits-all approach would be appropriate given the variety of firms that safeguard client assets as well as the different types of assets and customers.

Wholesale harm

- 2.39** In the CP, we explained that shocks or risks that originate from an international firm's overseas offices could, in some circumstances, be more difficult to detect or prevent and could be passed to its UK branch. This could affect the stability and integrity of the UK markets in which it operates or to which it is connected (see paragraphs 3.30-3.36).
- 2.40** Some respondents said we should not intervene in inbound wholesale businesses, as provided for in the OPE or otherwise falling outside the regulatory perimeter under FSMA. We agree that some wholesale businesses can be conducted without needing UK authorisation. As mentioned in paragraph 2.8 of this document, the approach we have set out is only relevant for firms that require UK authorisation.
- 2.41** Some respondents said by setting expectations on firms that require authorisation, we could disadvantage those firms where they conduct activities that could be also be conducted overseas without UK authorisation. This does not change our position that where a firm requires UK authorisation it must meet the relevant standards for authorisation (eg threshold conditions).

Relations with overseas regulators

- 2.42** In the CP, we mentioned that when assessing an international firm, we consider the firm's home jurisdiction to understand its rules and the home state regulator's supervisory approach, consulting with the regulator where appropriate (see paragraph 3.14). We also consider the level of cooperation between the FCA and the home state regulator. Some respondents noted this and called for us to continue to have good relations with overseas regulators, which we intend to do.

- 2.43** Some respondents requested that we defer to other regulators as much as possible when we assess an international firm, and take the supervision by the home state regulator as a substitute for direct supervision by us. We take account of the supervision by the home state regulator when assessing a firm. However, while the home state regulator may look at prudential soundness of the whole firm (and its subsidiaries), those regulators may not supervise a firm's activities in the UK or as regards its conduct relating to UK consumers. Supervision by the home state regulator cannot normally be a complete substitute for our own.
- 2.44** Some respondents asked for a list of 'acceptable' jurisdictions to be made available, so that firms seeking authorisation can understand their prospect of a successful application and the hurdle they need to clear to meet our standards. We do not plan to produce or publish such a list, given that the focus of our assessment is whether the firm (not the country) meets our expectations to receive or maintain its authorisation. However, there are some publicly available country assessments which firms may find helpful to consult while recognising that such assessments will not in themselves be determinative. They include, for example, the assessments produced by the International Monetary Fund under its Financial Sector Assessment Programme, or the assessments produced by European Supervisory Authorities on EU Member States.



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