UK REGULATORS PREPARE FOR 'NO DEAL BREXIT' WITH A TEMPORARY PERMISSIONS REGIME

HM Treasury has proposed a Temporary Permissions Regime ("**TPR**") as a temporary measure to replace the passporting regime in Schedule 3 and 4 of the Financial Services and Markets Act 2000 ("**FSMA**") in the event of a no-deal Brexit. The legislative framework for the TPR is found in the EEA Passport Rights (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018 (SI 2018/1149), enacted on 6 November 2018.

Under the TPR, EEA firms which currently operate in the UK under the FSMA passporting regime may, after exit day, be treated as if they had domestic authorisation under Part 4A of FSMA to carry on the same regulated activities they currently carry on. The TPR is an opt-in regime: firms must, between 7 January and 28 March 2019, either make an application for authorisation under Part 4A of FSMA or notify the relevant regulator.

Notably, the TPR is a one-way street: it will enable EEA firms to continue to operate in the UK, but it will not enable UK firms to continue to operate in the EEA. At the moment there is no indication that the EU or individual member states generally are considering implementing their own reciprocal regimes.

In August, the Financial Conduct Authority ("**FCA**") and the Prudential Regulation Authority ("**PRA**") published papers outlining their approach to implementing the TPR. On 11 October 2018 the FCA published a consultation paper on the TPR for inbound firms and on 25 October 2018 the PRA published a similar consultation paper and an information webpage. Details of the proposed changes are described below. The FCA's proposed changes will be relevant to both insurers and insurance intermediaries ("**firms**") unless specified otherwise, but the PRA's proposed changes will only be relevant to insurers.

1. THE PRA'S CONSULTATION PAPER

In CP26/18, the PRA consults on amendments to its Rulebook to give effect to the TPR. The consultation closes on 2 January 2019. It further describes its approach on a dedicated TPR webpage.

1.1 Entering and exiting the TPR

In a Direction published on 7 November 2018 the PRA published details of entry into the TPR. Insurers can notify the PRA of their intention to enter the TPR on the FCA's Connect system by submitting a Temporary Permission Notification Form. The notification must be made between 9 am on 7 January 2019 and 28 March 2019.

The PRA requires insurers in the TPR ("**TP insurers**") to apply for domestic authorisation under Part 4A of FSMA during the first two years of the TPR. TP insurers which do not do so may have their authorisation under the TPR cancelled by the PRA. TP insurers will exit the TPR when they obtain (or are denied) such authorisation or at the end of the TPR, which is three years from its start unless extended by HM Treasury.

Firms should also expect longer processing periods for their applications for authorisation: from six months (for complete applications) or twelve months (for incomplete applications) to three years from exit day.

1.2 PRA supervision

TP insurers will be treated as third country firms with Part 4A authorisation. The PRA will apply all its third country branch rules to TP insurers which operate in the UK on an establishment basis.

However, in respect of TP insurers which operate in the UK on a services basis, the PRA will apply the following, more limited provisions of its Rulebook: Fundamental Rules, Auditors, Change in Control, Close Links, Fees, General Provisions, Information Gathering, Interpretation, Notifications and Use of Skilled Persons, all rules relating to the SMCR, and all rules relating to the FSCS.

To ease the regulatory burden TP insurers will face at exit day, the PRA is considering providing transitional relief to them in respect of the following third country branch requirements:

(a) Branch Solvency and Minimum Capital Requirements for insurance branches, but not branch security deposit requirements;

(b) Certain reporting obligations involving the segregation of branch data and reporting and review of this data, where this is not already required; and

(c) Certain composite rules for insurance branches.

1.3 FSCS

At present, EEA insurers passporting into the UK are within the scope of FSCS protection. The PRA will continue to extend FSCS protection to TP insurers for all policies written before exit day. However, in respect of policies written after exit day, FSCS protection will only extend to certain policies:

(a) where a firm operates in the UK on an establishment basis, only policies written by that UK establishment relating to risks or commitments situated in the UK, Channel Islands or the Isle of Man; and

(b) where a firm operates in the UK on a services basis, only policies relating to risks or commitments situated in the UK.

The PRA has not addressed payment of FSCS fees.

FSCS protection (and associated fees) in respect of insurance mediation firms in the TPR is the responsibility of the FCA – see below.

1.4 SMCR

On 10 December 2018, the SMCR will begin to apply to insurers operating in the UK on an establishment basis. The PRA intends to apply the SMCR rules for third country branches to all TP insurers, including those which operate in the UK on a services basis. However, it is considering providing transitional relief to TP insurers operating in the UK on a services basis in respect of the Certification Regime, the Conduct Rules, and the Regulatory Reference Rules.

Where an insurer enters the TPR by making an application for full Part 4A authorisation, and it concurrently applies for Senior Manager authorisations, the PRA may in its discretion deem its Senior Managers as approved without undergoing the fitness and propriety test ordinarily required. Where an insurer enters the TPR by making a notification and has not applied for Senior Manager authorisations, it has a period of 12 weeks starting on exit day in which to obtain such authorisations.

2. THE FCA'S CONSULTATION PAPER

In CP18/29, the FCA consults on amendments to its Handbook to give effect to the TPR. The consultation closes on 7 December 2018.

2.1 Entering and exiting the TPR

On exit day the TPR will begin to apply to all firms which opt into it and whose relevant regulator is the FCA ("**TP firms**"). In a Direction published on 9 November 2018, the FCA set out details of its notification process, which is identical to that of the PRA.

Unlike the PRA, the FCA will allocate all TP firms a 'landing slot': a three-month period within which they must apply for full Part 4A authorisation. There will be six landing slots, the first commencing in October 2019. Firms will exit the TPR upon gaining (or failing to gain) such authorisation or by failing to apply for Part 4A authorisation during their allocated landing slot.

2.2 FCA supervision

TP firms will be treated as third country firms with Part 4A authorisation. While the FCA would ordinarily apply all of its rules to such firms, the FCA's proposed approach is to apply only the following rules to TP firms:

(a) Rules which currently apply to TP firms;

(b) Rules which implement an EU Directive requirement which is reserved to the firm's home state, albeit in such cases firms which comply with the home state rule will be deemed to comply with the FCA's rule ("**substituted compliance**"); and

(c) Certain other FCA rules necessary for consumer protection or funding.

As a result the FCA will apply all of Principles for Business to TP firms except Principle 4. To give effect to this approach, the FCA will introduce a new overarching rule in its General Provisions sourcebook rather than amend its individual sourcebooks. TP firms will need to apply this approach themselves to determine which FCA rules they need to comply with. As an exception to this approach the FCA will introduce a new Chapter 14 in its Client Assets sourcebook to include rules for TP firms which receive or hold client assets in connection with insurance mediation, implementing the Insurance Distribution Directive.

2.3 Fees

(a) FCA periodic fees

At present, EEA firms operating in the UK on an establishment basis pay FCA fees with a discount and EEA firms operating in the UK on a services basis do not pay FCA fees. This is the case for both insurers and insurance intermediaries.

The FCA proposes that TP firms, whether they operate in the UK on an establishment or a services basis, pay FCA periodic fees on the same basis as

UK firms. A TP firm which leaves the TPR by gaining full UK authorisation will then, as a UK-authorised firm, continue to pay those same fees. Further details of these fees rules are set out in Appendix 1.

(b) FCA authorisation fees

When applying for full UK authorisation TP firms will be required to pay authorisation fees on the same basis as UK firms. These fees are set out in the FEES Manual of the FCA Handbook and apply to both insurers and insurance intermediaries.

(c) Financial Services Compensation Scheme ("**FSCS**")

At present, most EEA firms operating in the UK are covered by home state compensation schemes rather than by the FSCS. To avoid the situation where UK customers of such firms become non-EEA customers and hence lose the protection of such schemes, the FCA intends to extend FSCS protection to insurance intermediaries in the TPR operating on an establishment basis. Such firms will accordingly be required to pay FSCS fees. The cover provided will be equivalent to the cover provided in respect of UK authorised firms.

The FSCS will not extend to insurance intermediaries in the TPR operating on a services basis and, as a result, such firms will not be required to pay FSCS fees.

2.4 Financial Ombudsman Service ("FOS")

At present, the FOS's compulsory jurisdiction and the FCA's complaints-handling rules apply to EEA firms with a UK establishment but not to EEA firms providing cross-border services. The FCA proposes to extend the FOS's compulsory jurisdiction and its own complaints-handling rules to all TP firms, whether they operate in the UK on an establishment or a services basis. As a result, EEA firms providing cross-border services which opt into the TPR will have to begin paying case fees and annual fees to the FOS.

2.5 Senior Managers & Certification Regime ("SMCR")

On 9 December 2019, the SMCR will begin to apply to insurance intermediaries operating in the UK on an establishment basis. Until this point the FCA's Approved Persons Regime (APR) will apply to them. The FCA proposes to continue to apply EEA branch rules (whether under the APR or SMCR) to TP firms. After TP firms exit the TPR, the FCA proposes to apply third country branch rules (whether under the APR or SMCR) to them.

The SMCR will not apply to insurance intermediaries operating in the UK on a services basis before or during the TPR.

Amol Chalisaonkar

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