

Focus on Brexit

The Passports in Perspective: Assessing Brexit's impact on Banks

Dr Andrew Henderson, Partner

September 2016



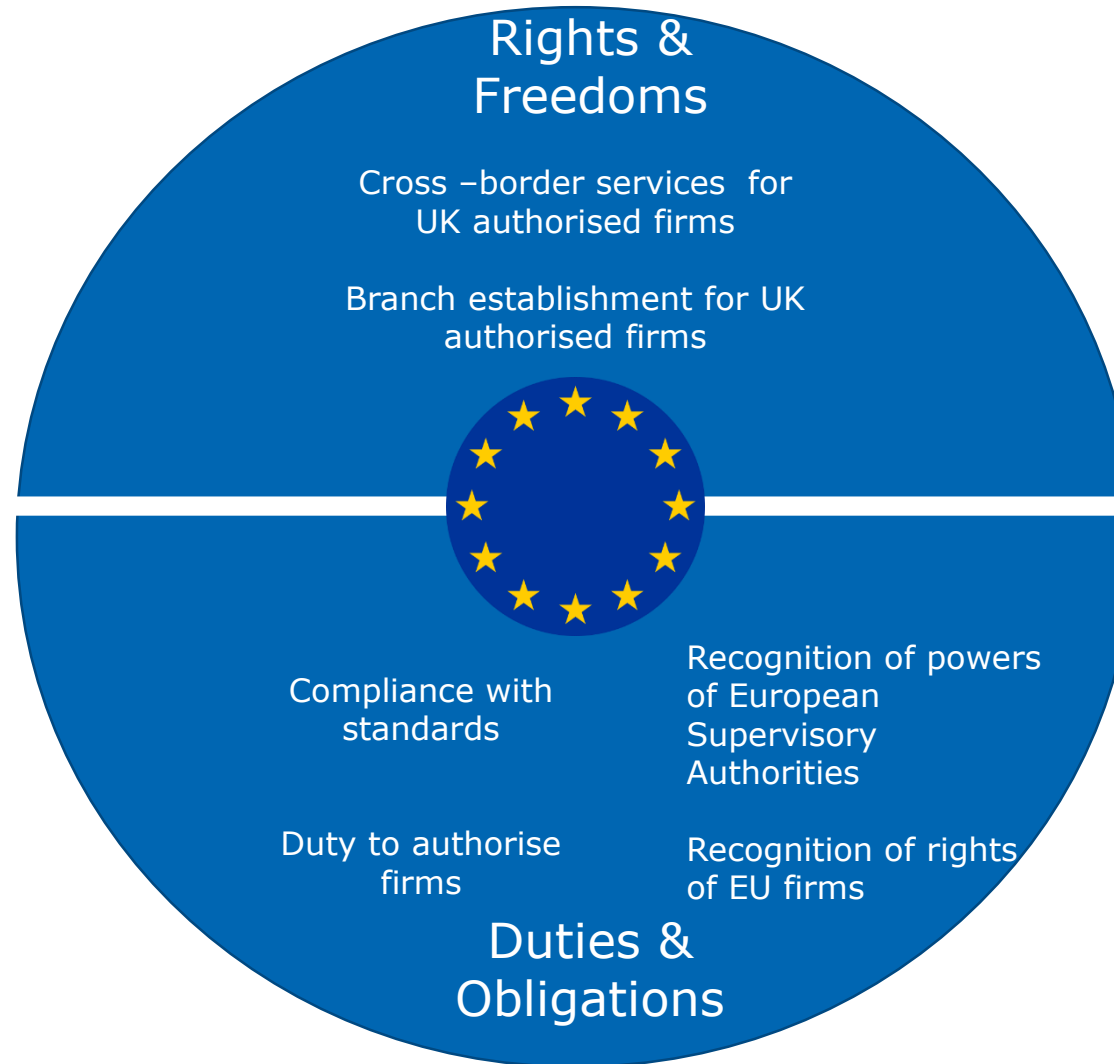
The Plan for this evening

- **The Freedom to Provide Services and The Passports**
- **The Immediate Impact**
- **The Longer Term Impact**

The freedom to provide services and the passports

Effect of Membership of EU: the “Single Financial Market” Passports

Not about access, about terms of access

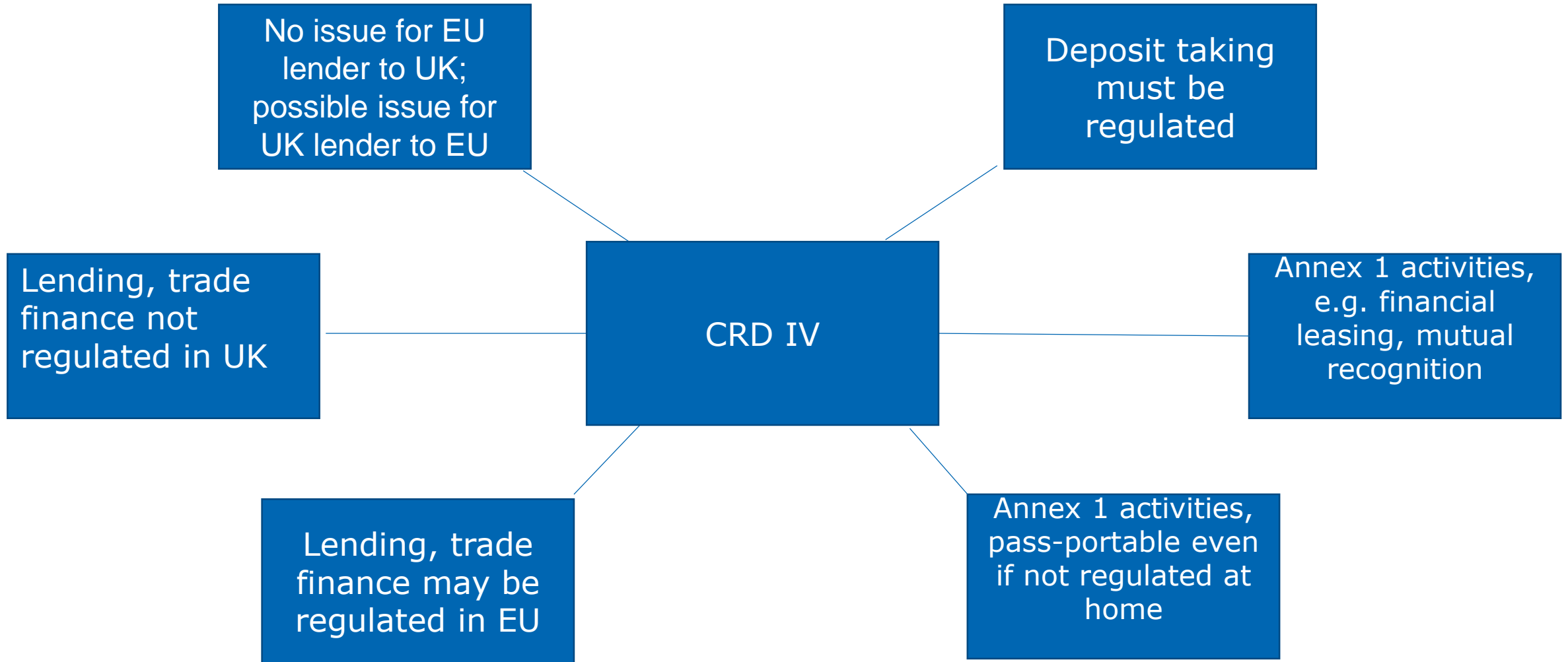


The Passports

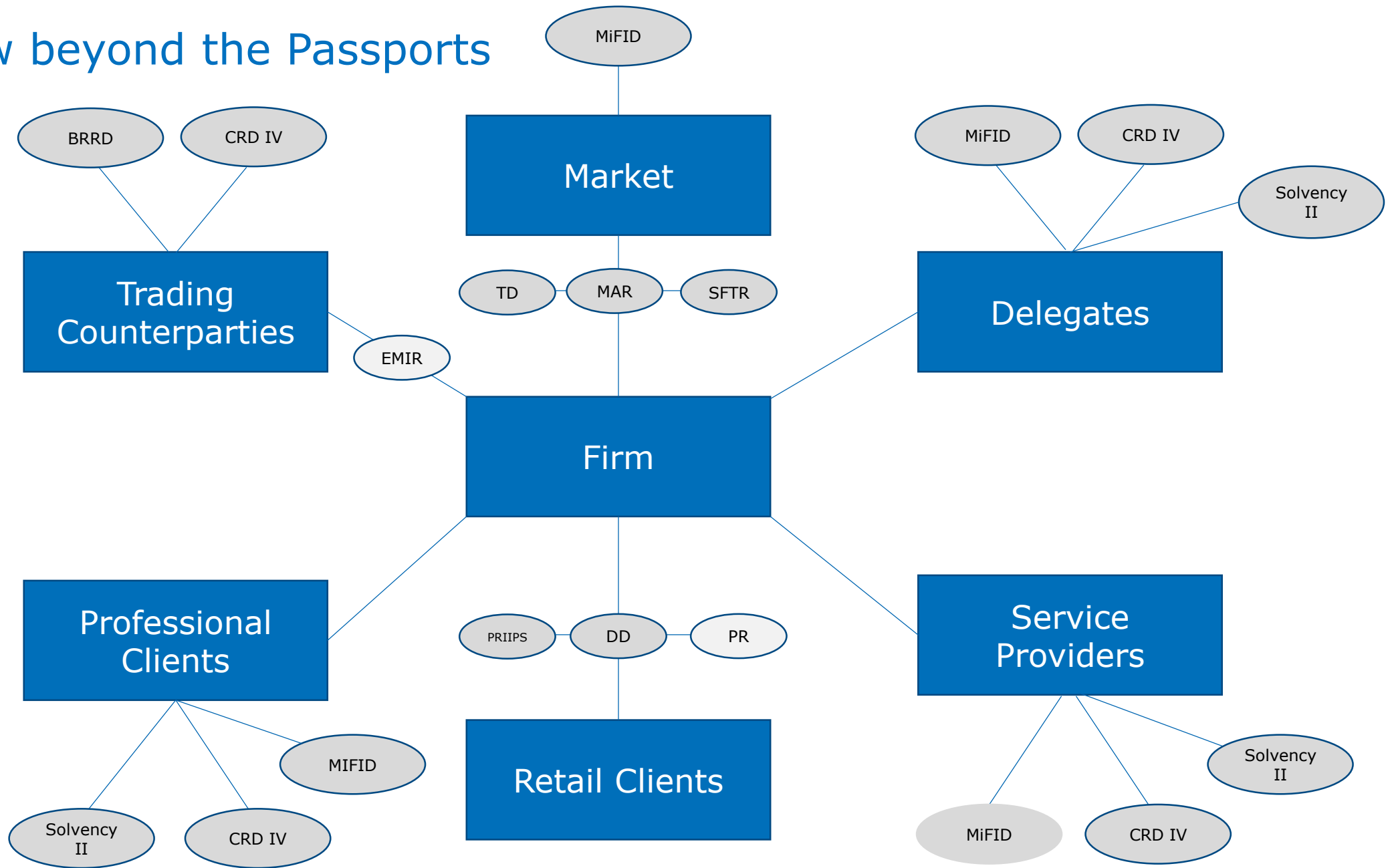
Financial Institution Type	EU Law Governing passport rights
Bank – deposit taking, lending, safekeeping, etc.	Capital Requirements Directive IV (CRD IV)
Bank, investment firm – underwriting, trading, portfolio management, safekeeping, etc.	Markets in Financial Instruments Directive (MIFID)
Bank, payment Institution – payment services	Payment Services Directive
Electronic money institution – issuing electronic money	Second Electronic Money Directive
Credit intermediary – mortgage broking	Mortgage Credit Directive (MCD)
UCITS management company – management and distribution of UCITS funds	UCITS IV Directive
Alternative Investment Fund Manager - management and distribution of non-UCITS funds	Alternative Investment Fund Managers Directive (AIFMD)
Insurer and Reinsurer – insurance and reinsurance underwriting	Solvency II Directive (Solvency II)
Insurance intermediary – insurance broking	Insurance Mediation Directive (IMD)

Reciprocity of Rights and Freedoms?

FCA, September 2016: 5,500 outward passporting firms; 8,000 inward passporting firms

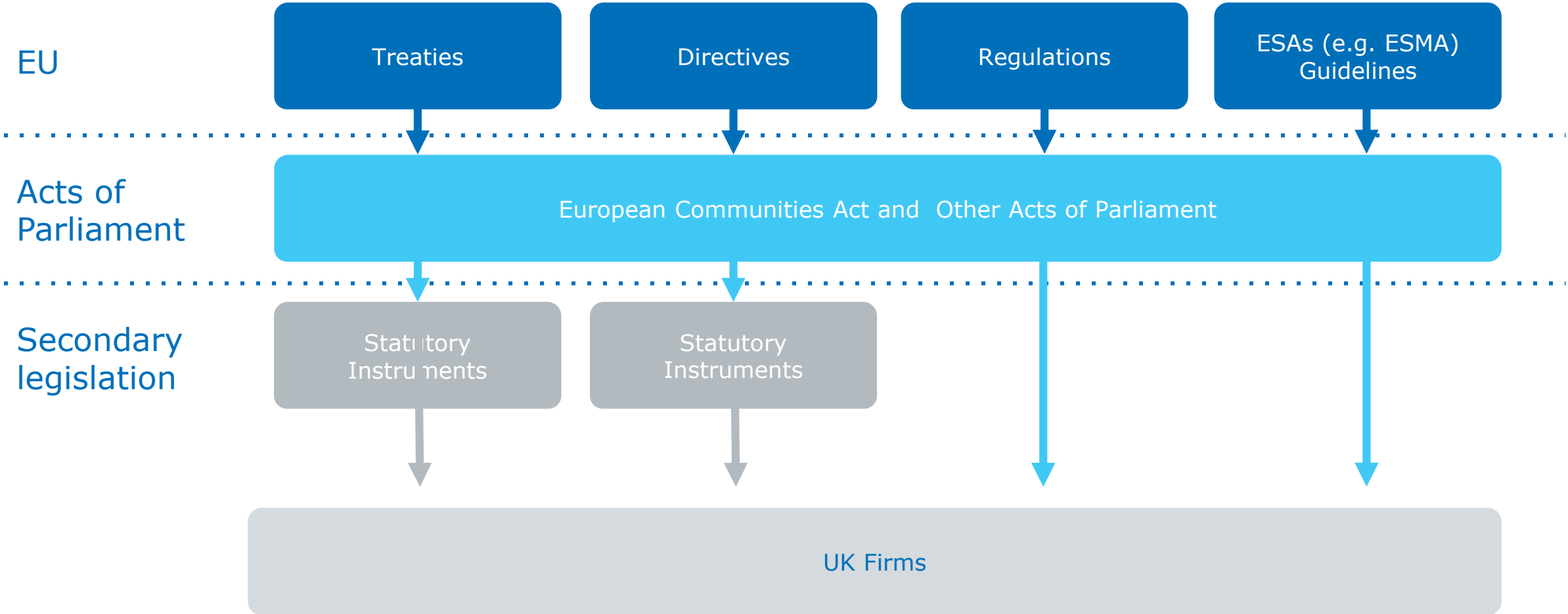


EU Law beyond the Passports



DD = AIFMD, MiFID, UCITS DIRECTIVE, IMD, MCD

Application of EU Law to UK firms



The Immediate Impact

No change until the UK leaves the EU?

Issue	Right/ duty	Impact
Current EU laws	Both	No immediate impact – UK law giving effect to EU Directives such as MiFID, CRD, AIFMD, the UCITS Directive and Solvency II continue to apply. EU Regulations such as (a) EMIR, the ELTIF Regulation and (b) MiFID, AIFMD and UCITS Level 2 Regulations continue to apply.
Powers of EU authorities	Duty	Immediate impact unlikely – powers of European Supervisory Authorities (EBA, ESMA and EIOPA) to take action against FCA or PRA for non-compliance with EU law continue – extent to which ESAs would be willing to take action is less clear.
Passporting	Right	No immediate impact – rights of UK authorised firms to provide cross-border services into, operate branches in or market products in other EEA Member States and same rights for EEA Member State firms passporting into the UK continue.
Forthcoming EU laws	Both	Immediate impact unlikely – UK is obliged to implement EU Directives and enforce EU Regulations – the extent of the UK’s influence until BREXIT on negotiating the content of such laws is less clear.

Mechanism for leaving the EU

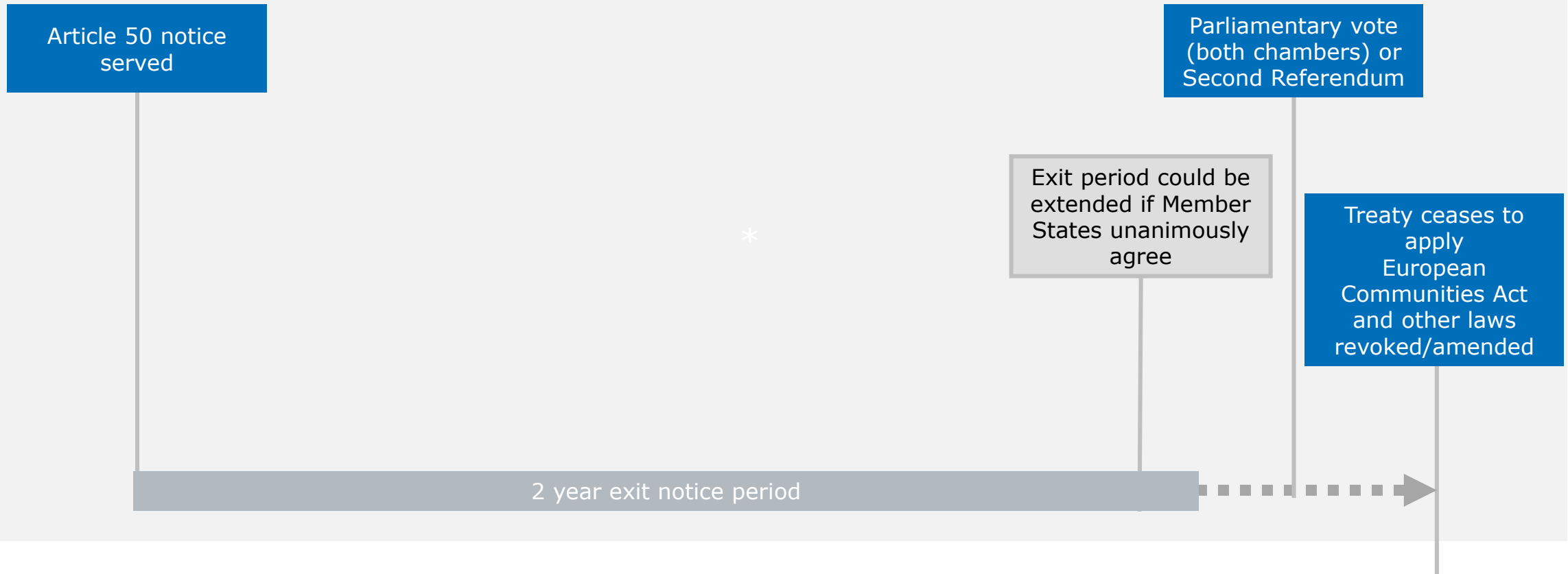
Article 50

- **“Any member may decide to withdraw... in accordance with its own constitutional requirements”**
- UK notifies European Council
- UK/EU negotiate agreement detailing exit plan and **“taking account of framework for future relationship”**
- The Treaties cease to apply to the UK from: Effective date of agreement; or two years after the notification unless unanimously extended by the European Council and UK
- One agreement or two?
- UK competence to negotiate trade deals before exit?
- Transitional provisions: to avoid default to WTO rules? to maintain continuity of EU Regulations in the UK?



What might an exit look like?

Potential steps (N.B. EU elections 2019; General Election 2020)



The Longer Term Impact

What might an exit look like?

Potential outcomes for UK firms

Increasing level of access



Outcome 1 'Lock-out'

UK firms' third country passport rights under certain Directives not recognised and UK not otherwise recognised as having an equivalent regulatory regime

e.g. like China



Outcome 2 3rd country access

UK firms' third country passport rights under certain Directives recognised but no EU single financial market passport rights

e.g. like the US under the AIFMD once third country passport 'turned on'



Outcome 3a EEA Membership

UK joins EEA and has access to single market. UK firms able to use EU passports but UK has limited ability to influence content of Directives and Regulations

e.g. like Norway



Outcome 3b Negotiated Access

Either as a member of EFTA or not, UK negotiates a special arrangement with the EU. UK firms have no EU single financial market passport rights but a special UK passport

e.g. similar to Switzerland (for insurers) currently but future proofed

Outcome 2 – the Extent of Third Country Passport Rights

Financial Institution Type	EU Law Governing passport rights	Third Country Rights
Bank	Capital Requirements Directive IV	No
Bank, investment firm	Markets in Financial Instruments Directive	Yes limited to sophisticated clients
Bank, payment Institution	Payment Services Directive	No
Electronic money institution	Second Electronic Money Directive	No
Credit intermediary	Mortgage Credit Directive	No
UCITS management company	UCITS IV Directive	No
Alternative Investment Fund Manager	Alternative Investment Fund Managers Directive	Yes limited to sophisticated clients
Insurer and Reinsurer	Solvency II Directive	No
Insurance intermediary	Insurance Mediation Directive	No

Outcome 3a – EEA Membership: Some Points to Note

- “Rule-taker” not “rule-maker” – a loss of control rather than taking back control
- Financial contributions?
- Role of European Supervisory Authorities resolved through amendment to EEA Agreement?
- Politically realistic....?



Outcome 3b – Negotiated Access: Some Points to Note

- The more access to the EU market in financial services, the more compliance with EU law noting international standards, e.g. Basel III, G20 and derivatives BUT scope for beneficial alteration: bonus caps, capital rules for challenger banks?
- “Equivalence” (of outcome rather than of form and substance) as a test borrowed from current directive?
- Free movement of workers in financial services
- Decision making: standing regulatory committee similar to that for EEA?
- Parallel court, role of the European Supervisory Authorities?



MiFID II Update

September 2016

Andrew Henderson, *Partner*



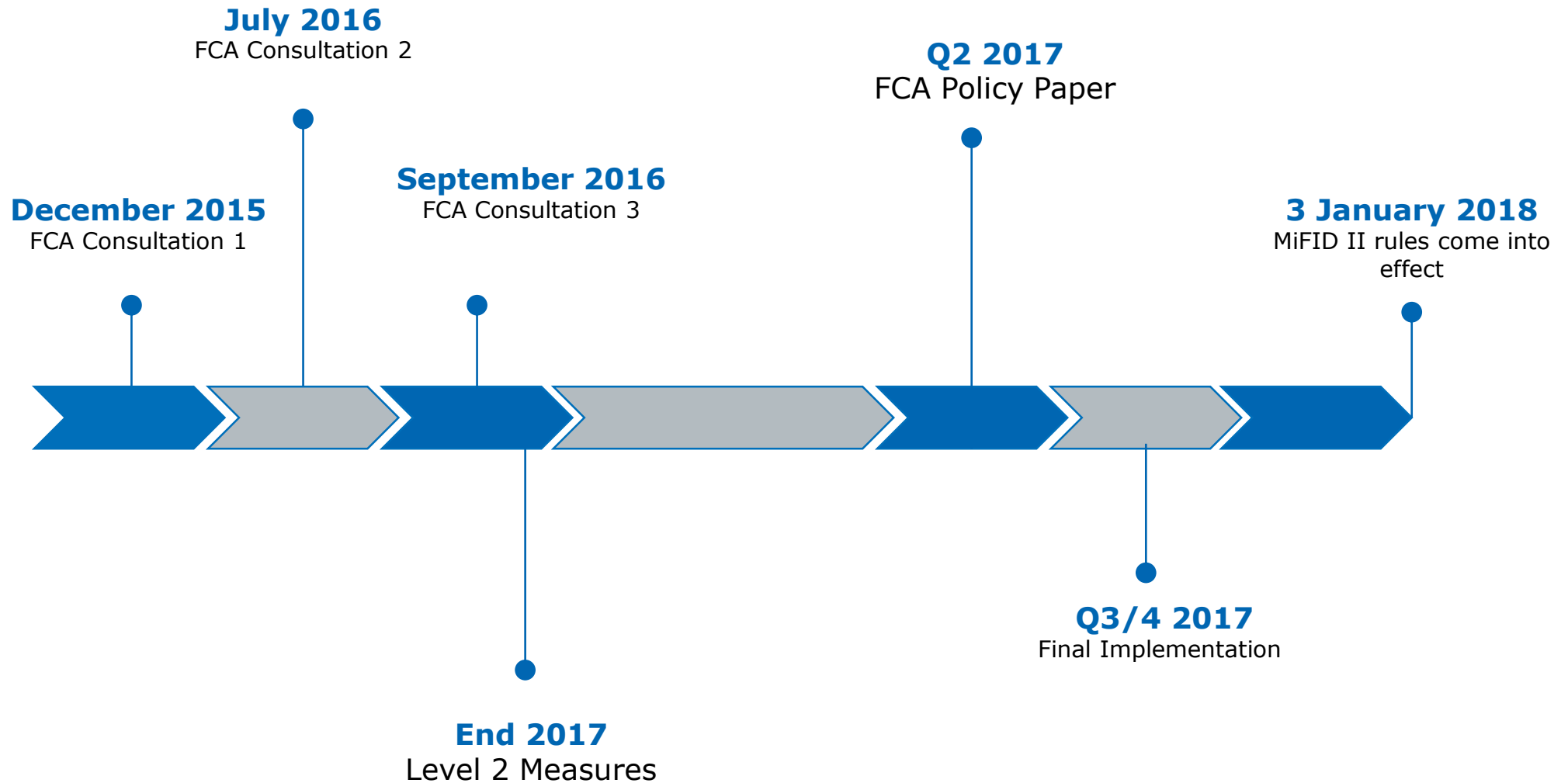
Topics for Today

- **The Context**
- **Risk Mapping**
- **Organisational requirements**
- **Distribution and product governance**

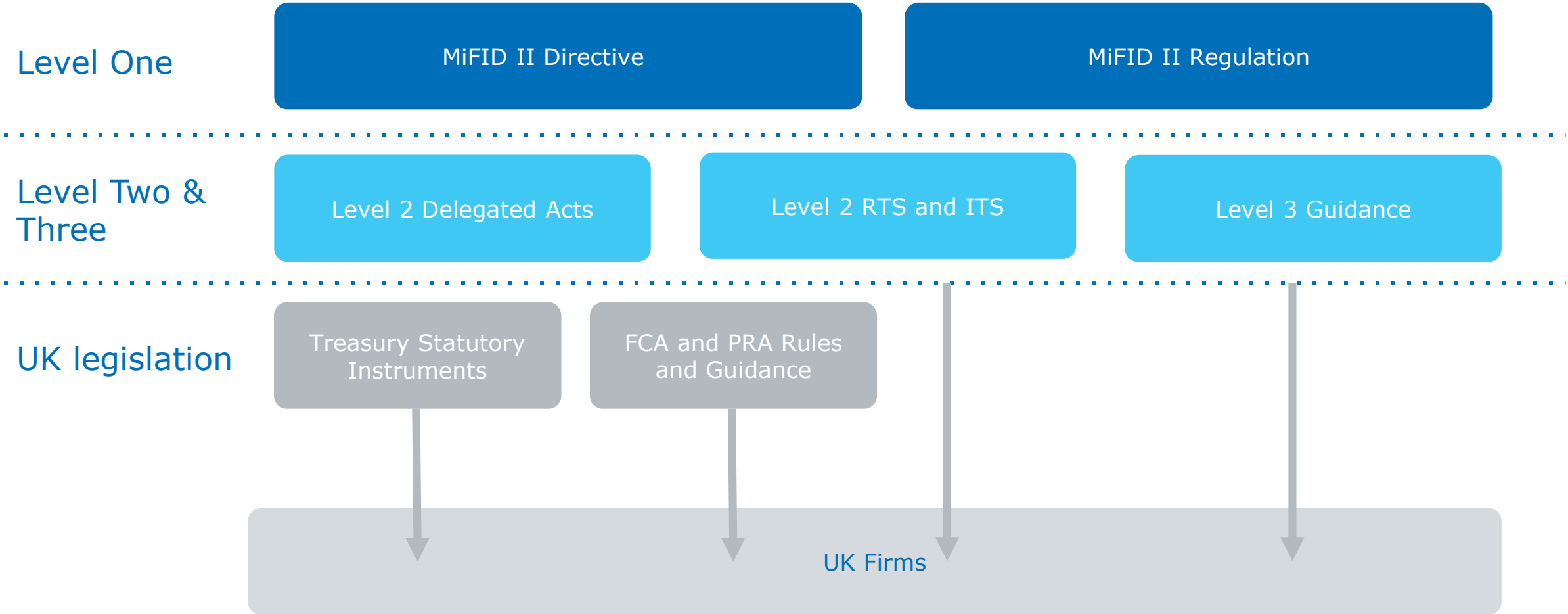


Some Context

Current Implementation Timeline



Application of MiFID to UK firms



Risk Mapping for Overseas Banks

Andrew Henderson

Risk Mapping – arranger/ adviser and limited agency / matched principal

Reporting	Organisation	Investor Protection	Distribution
Transaction Reporting	Voice Recording	Inducements	Product Governance
Best Execution	Governance *	Conflicts of Interest	Appropriateness
Outsourcing	CASS and Safe Keeping	Independence	
	Whistleblowing	Remuneration	
	Complaints	Client Categorisation	
	Compliance		

* Interplay with Senior Managers and Certification Regime

Risk Mapping – arranger/ adviser and limited agency / matched principal

Trading	Product Disclosure	Strategy and Change	Regulatory Process
Best Execution	Costs and Charges	Scope	Product intervention
OTF Derivatives	Services and Investments	Third Country Provisions *	
ET Derivatives	Fair, Clear	Research	
MTF, SI		Other MiFID II Changes	
Dark Pool Trading			

* Relevant to BREXIT

Organisational Requirements

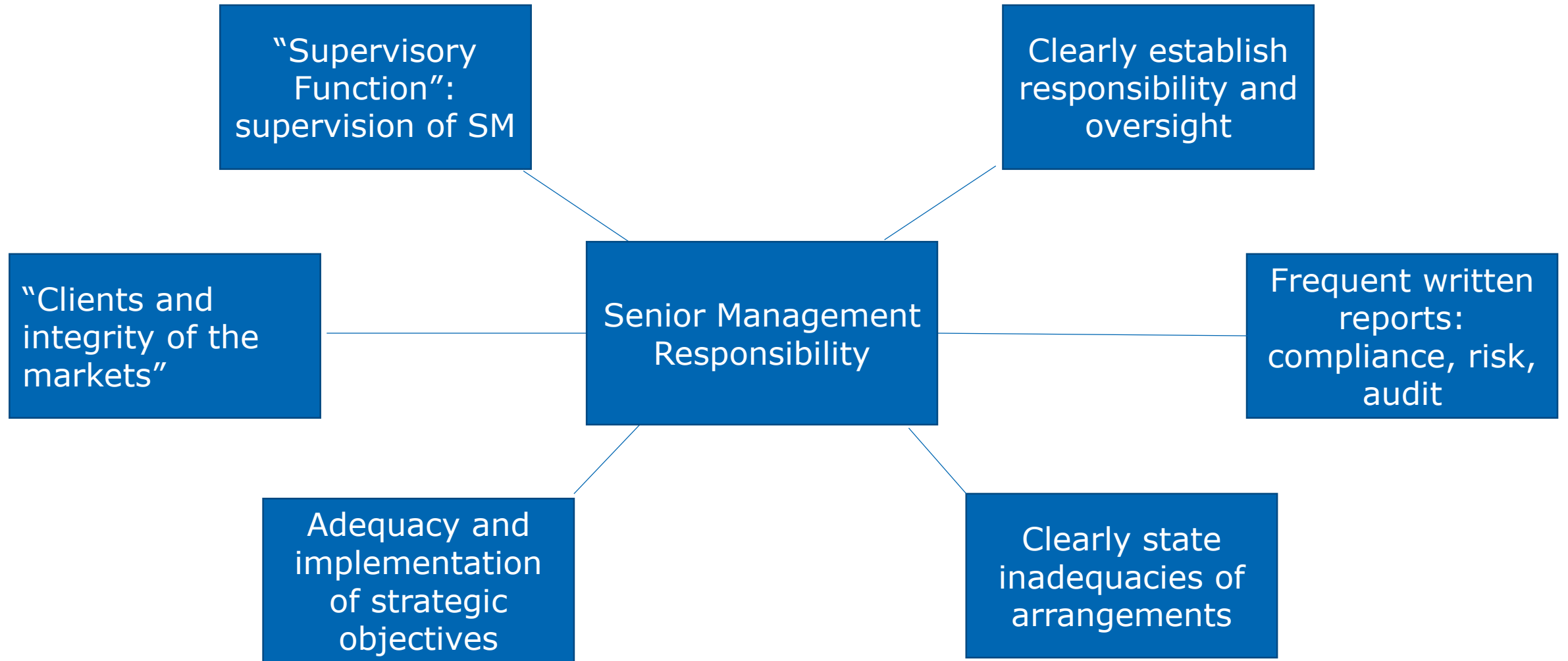
MiFID II and SYSC



Application to branches of third-country Firms

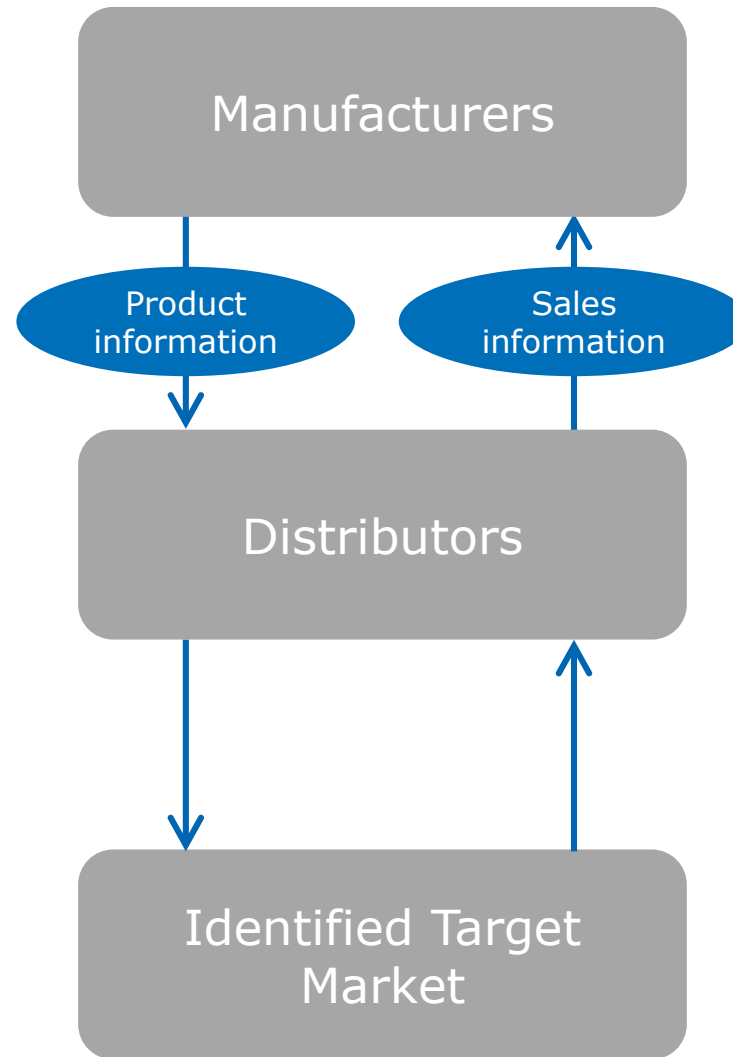
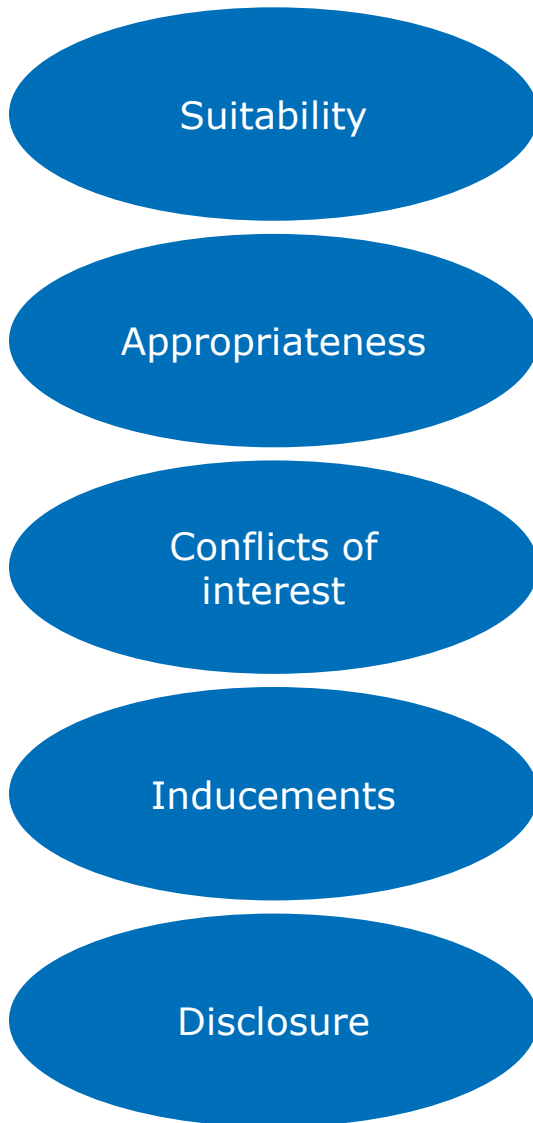
- Rules and guidance in SYSC and Level II Org Regulation to apply as if rules or guidance per SYSC 1 , Annex 1 3.2
- Rules in SYSC Table B includes as rules: general requirement to have robust governance arrangements, requirements for senior management
- Provisions of Level II Org Regulation Table C includes as rules: data security, senior management responsibility, outsourcing, conflicts disclosure as “measure of last resort”
- Org Reg, Art 32 Outsourcing to third country providers of portfolio management requires a co-operation agreement

MiFID II and Governance: L2 Organisational Reg, Article 25 + SYSC 4



Distribution and Product Governance

Product Governance – Article 16



Understanding the main duties on distributors

Article 10(2), Level 2 Directive

– Duties to:

- have in place adequate product governance arrangements to ensure that products and services are compatible with the needs, characteristics, and objectives of an identified target market
- the intended distribution strategy is consistent with the identified target market;
- obtain information from MiFID II manufacturers to gain necessary understanding and knowledge of products and
- non-MiFID II manufacturers to ensure that products and services are compatible with the needs, characteristics, and objectives of an identified target market;
- use information obtained from manufacturers

Unpacking the Duties

A duty of compatibility

- Identification of group
- Contrast with duty of suitability
- Risk/reward, benefits to client

Duty to obtain information from non-MiFID II manufacturer

- Contractual undertakings
- Publicly available information.

Duty to use information

- Contractual undertaking to use information
- Reliance?
- Related duty to provide information back to manufacturers

The Product Intervention and Governance Sourcebook (PROD)

– PROD 1.3.4 PROD 3 applies to a firm with respect to activities from an establishment overseas

– PROD 3.1.2 Proportionality Principle

- nature of instrument or service
- target market

“relatively simple for simple financial instruments on an execution basis”

– PROD 3.3 Duties on Distributors

- Understand materials, request further information, do not distribute if you do not understand, consider other distributors in chain and needs of end client
- Consider support which clients will require to make an informed decision
- Action where instrument becomes very illiquid or very volatile
- Include information on sales made outside target market but only information necessary for manufacturer to review information is required

Third party payments & inducements

- Prohibition on inducements where firms provide independent advice or portfolio management
- Unless minor non-monetary benefits
- Differs from MiFID I and UK RDR
- Duty to pass on any third party payments as soon as reasonably practicable
- Duty to inform clients about monetary payments



IMPACT: Policy required, notification as part of regular reporting, client agreements

Permitted minor non-monetary benefits

- Permitted if: (1) capable of enhancing quality of service, (2) could not be judged to impair compliance with duty to act in best interests of client, and (3) clearly disclosed
- ESMA Technical Guidance: exhaustive list on NMB but only qualify if (1) reasonable and proportionate and (2) and of such a scale unlikely to influence recipient's behaviour in any way that is detrimental to interests of relevant client
- List: (1) generic information (2) conference participation (3) *de minimis* hospitality (4) other (satisfying test above)
- Clearly disclosed by investment firm

How Eversheds and Eversheds Consulting can assist

- Analysis of impact of the changes
- Reviews of:
 - governance frameworks, systems and controls
 - product and customer strategies;
 - product governance process and structure;
 - product review; and
 - management information and reporting
- Updates to/drafting of promotional material and product documentation
- Ad-hoc assistance in respect of ongoing compliance
- Training

EVERSHEDS

Dr Andrew Henderson
Partner
andrewhenderson@eversheds.com
+44 (0)20 7919 0698

One Wood Street
London
EC2V 7WS

eversheds.com

©2015 Eversheds LLP
Eversheds LLP is a limited liability partnership