FCA CP20/20: Approach to International Firms
AFME consultation response

27 November 2020

The Association for Financial Markets in Europe (AFME) [1] welcomes the FCA's intention to provide clarity and certainty for non-UK firms that are authorised, have applied for, or plan to seek authorisation in the UK. We welcome the FCA setting out its general expectations for international firms and how it assesses such firms against minimum standards when applying for authorisation and during ongoing supervision. We set out our comments on the proposed approach below.

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

Timing

1.1. It would be helpful to understand the FCA's position on timing of this consultation and any subsequent communications and how firms can plan and, if necessary, implement on that basis given that the end of the transition period is fast approaching. Should the FCA's expectations change as a result of this consultation, this would likely affect firms' planning and organisation at a time of significant uncertainty, particularly for firms already authorised or currently seeking authorisation.

1.2. For example, it is currently unclear how proposals around client insolvency disclosures and insolvency opinions interact with rule requirements for TP firms in CASS 14.5 which need to be managed by prime brokers and custodians before year end. Furthermore, it is not clear what steps, if any, firms should be taking pre-emptively given the broad nature of the consultation's identified mitigants, or whether expectations will be managed following the planned policy statement through supervisory dialogue bilaterally with each firm directly.

Application to branches and subsidiaries

1.3. It would be helpful to clarify how the considerations set out in the proposed general approach differ in application for branches and subsidiaries. Based on the identified risks and harms, as well as the comments in the CP related to reliance on home state rules and potential mitigants, a number of areas appear to be mainly aimed at branches of international firms as opposed to subsidiaries where different considerations may apply. It would be helpful to distinguish the application of the FCA's approach for branches and subsidiaries of international firms more clearly in the final policy statement.

[1] The Association for Financial Markets in Europe (AFME) represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

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Application to authorised firms

1.4. The consultation paper appears to be of general application to firms which apply in the future for authorisation, eg currently passported branches of EEA firms entering the Temporary Permissions Regime which would then seek authorisation and also other international firms, including those that are already authorised. While we support a consistent approach, it would be helpful to better understand how the FCA expects to apply the framework it sets out to those firms that are already authorised including clarity over if and where the FCA expects supervisory expectations to change.

Application to solo and dual regulated firms

1.5. We would welcome further clarity on how the FCA expects to apply the framework to PRA-authorised dual-regulated firms and how it aligns with, or complements, the PRA's requirements, for example its Supervisory Statement 1/18. While this might depend on a case by case basis, there might be more limited application for dual regulated firms and a clearer delineation of solo and dual regulated firms would be helpful to understand which requirements apply to which firms, including the calibration of requirements according to firm type and potentially location of incorporation of the firm. For example, firms have found the approach of SS 1/18 helpful in that it provides a flow chart with further detail on the PRA's approach to branch authorisation and supervision.

Oversight of activities not carried out through the branch

1.6. There is some uncertainty in the consultation paper with regards to the FCA's approach to services provided by the legal entity from its home jurisdiction, outside the scope of the activities of the UK branch. While we understand that authorisation applies to the legal entity and not only the UK branch, we believe that it is important to maintain a level playing field between international firms with a UK branch and international firms which do not have a UK branch. This is important in line with the FCA's stated objective of supporting competitive, open markets and the ability of international firms to efficiently conduct business in the UK.

1.7. In particular we are unclear of the implications in practice of the statement that the FCA will consider "the extent to which the UK branch has oversight of activities provided to UK customers from overseas" in the text box following section 3.14. We are concerned that this could potentially lead to significant additional obligations, including complex remediation exercises, for UK branches, for example to have oversight of activities being provided directly to UK customers from overseas which are outside the regulatory perimeter. UK branch senior management may not have oversight of inbound business that is outside the scope of the branch's activities, particularly for wholesale business provided under the overseas person exclusion and outside of the regulatory perimeter. We also understand that conduct of business rules under COBS of the FCA Handbook are not applied for such business, and that FCA governance requirements, eg SMR responsibilities, do not extend beyond the activities of the UK branch.

1.8. Firms would not expect services outside of the regulatory perimeter to be subject to FCA supervision, especially where risks are mitigated sufficiently, including at home state level. We are concerned that the above statement could potentially disadvantage banks operating branches in the UK in comparison with firms providing services purely through the overseas persons exemption, thereby also disincentivising setting up branches in the UK. We therefore encourage the FCA to confirm that it is not changing its current rules or supervisory expectations in this area and clarify the application to activities not provided through the UK branch.

Personnel and decision-making

1.9. Section 3.10 of the Consultation refers to the Threshold Conditions and the FCA's expectations for "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". Often, smaller branches/subsidiaries leverage overseas colleagues who have a part-time presence in the UK. While the CP recognises that individuals at an international firm who have purely strategic responsibilities may not be based in the UK, it is unclear how the concepts of *adequate* and *proportionate* would be applied. A broad interpretation to spend an adequate and proportionate amount of time in the UK could not only be challenging in the short term given Covid-19 and travel restrictions, but may also have a more significant impact on what longer term working arrangements are deemed acceptable going forward.

1.10. This also raises considerations with regards to the SMCR in terms of UK regulatory oversight and the extent of responsibility of UK SMFs, including, as raised above which entity and regulated activity the FCA is going to attach the obligation to.

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

2.1. The Consultation does not define UK client (or customer) and it is therefore not clear how the three material harms set out would be applicable to clients/customers. The CP uses the term "UK customer" in various instances. It would be helpful to understand if this relates to UK MiFID II definitions or FSCS eligible complainants, whether the UK CASS protections are within scope, and how the FCA would control and monitor the distribution of products and clients in the UK. With regards to the latter, it should be noted that a product manufacturer using a distributor and having certain MiFID II obligations may have no interaction with a UK end client.

2.2. With regards to client asset harm, we would like to challenge the perception in the paper that the risk of client asset harm is materially higher with a branch than a subsidiary structure. The risk is the same for assets sub-custodied overseas and many clients may prefer to transact with a better capitalised overseas entity than a UK subsidiary.

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

We have no comments in response to this question.

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

We have no comments in response to this question.

Q5: Are there any other mitigants we should consider?

5.1. We welcome the confirmation that the FCA will consider the relevant home state regulation and supervision. It is important to recognise the outcomes of home state regulation and supervision and to minimise additional local requirements to those which are strictly necessary. Where the outcomes of local supervision are consistent with the FCA's supervisory objectives, which for example should be the case for EEA lead supervised entities, this should be taken into consideration. We also welcome the recognition of the importance of international cooperation and information sharing with the home state supervisory and resolution authorities. We encourage the FCA to continue to pursue extensive cooperation arrangements with key international jurisdictions to support this and make maximum use of deference.

5.2. The three material harms, particularly client asset and wholesale, perceived of international firms could be mitigated to a large degree by continued and close supervisory and regulatory cooperation between the relevant authorities. In particular with respect to branches of EEA firms, we encourage the FCA and PRA to continue their close cooperation with EEA supervisory and resolution authorities. In this respect, equivalence and a continued consistent approach to prudential and other regulatory areas as indicated by the UK's Financial Services Bill would also enhance market integrity and financial stability, and the FCA to contextualise perceived harms within the broader regulatory safeguards at branch and group level in the area of wholesale banking.

5.3. With regards to mitigants identified for the risk of wholesale harm, and particularly section 4.22-27, it appears that this section solely focuses on mitigants where a firm has failed from a prudential perspective. The Consultation does not seem to take into account the wide-ranging and extensive mitigants which European banks have put in place over the past years to support good conduct, governance and the broader integrity of markets. This includes for example controls (at branch or group level) to detect and address money laundering, fraud and poor market conduct or market abuse.

5.4. As mentioned above, it would be helpful to understand how the FCA's concerns apply with regards to solo vs dual regulated entities. While it is clear that, as the Consultation states, size and nature of a firm as well as its interconnectedness with the wider market can have implications for the UK's market integrity, the very significant prudential and resolution measures implemented through the post-crisis framework have led to significantly higher levels of capital reserves and detailed resolution plans over the past decade.

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