Brexit planning: Changes to UK law

FCA CP18/28
Brexit: proposed changes to the Handbook and Binding Technical Standards – first consultation

What are the proposed changes to the FCA Handbook and EU technical standards?

Background to the consultation
Upon the UK’s exit from the EU next March, many EU-derived provisions in the FCA Handbook and in existing BTS (these are EU Binding Technical Standards, which equate to what are typically referred to as RTS) will not function correctly in the UK in their current form.

To avoid this outcome, the FCA is now consulting on a raft of amendments to its Handbook and to those BTS. Whilst BTS are EU legislation, the FCA has a time-limited permission granted by the EU Withdrawal Act (EUWA) to amend them provided its changes are limited to addressing deficiencies and dealing with any failure of UK law to operate effectively after the exit.

The FCA has been explicit that all changes proposed are intended to remedy deficiencies arising from the UK exiting the EU, and the FCA is not using this as an opportunity to introduce broader policy changes.

We can expect another consultation on further changes to the Handbook in the autumn.

This first consultation covers the changes required as a result of those Brexit-driven statutory instruments (SIs) which have been published so far and will be followed up once further SIs have been published.

The FCA has confirmed that firms are not expected to prepare now to implement the changes from exit day. The FCA is also prepared to use powers granted to it under the EUWA to waive or modify some requirements to allow for a smooth transition to the post-exit regime.

Of course, should a deal on transition be reached, the amendments proposed in the CP will not be effective from 29 March 2019 and future changes to the Handbook will depend on the outcome of the negotiations that follow.
What is the scope of the FCA consultation?

The core areas for Handbook change covered by this consultation are:

- Conduct of Business Sourcebook (COBS)
- Various Prudential Standards Sourcebooks
- Collective Investment Schemes Sourcebook (COLL)
- Investment Funds Sourcebook (FUND)

The consultation also includes:

- MiFID II-related Handbook changes (being consequential changes to legislation, definitions and references to EU institutions),
- the FCA’s approach to amending certain BTS, and
- the FCA’s approach to Level 3 materials such as ESMA Guidelines and Q&As, and the remuneration codes in Chapters 19A – 19D of SYSC, which are derived from the EBA’s Guidelines on remuneration.

Sourcebook-specific amendments

COBS

- **What is it?** It is the sourcebook containing a wide spectrum of conduct of business rules, many of them derived from EU legislation, e.g. MiFID II.

- **Territorial application:** If, after exit, an EEA firm were to obtain authorisation from the FCA or PRA, it is proposed that COBS apply to it in the same way it would apply to any other authorised firm. No preferential treatment or light touch is intended to be afforded because it is an EEA firm.

- **COBS 2 (agent as client):** The “agent as client rule” allows a firm to rely on information from an investment firm in the EEA. Post exit, it is proposed that only information from a UK firm that is subject to MiFID or equivalent requirements can be relied upon.

- **Client classification:** Territorial changes to the definition of a local public authority or municipality are proposed, meaning that such an entity in the EEA will be considered a public authority or municipality in a third country. This impacts upon which tests must be considered for it to be opted-up to elective professional status.

- **Appropriateness:** After exit, it is proposed that a product can only be validated as being non-complex (to determine that no appropriateness assessment is required) by a depositary services provider in the UK, and not in the EEA as is currently the case.

- **Investor protection:** The proposed rule changes maintain protection for UK retail clients but remove protections for EEA retail clients, by making disclosure of charges requirements (COBS 6), suitability report requirements (COBS 9) and various restrictions on the distribution of regulatory capital instruments (COBS 22) applicable only when the retail client is in the UK.

Prudential Sourcebooks

- **What are they?** These are rules covering the prudential requirements for different types of firms. In this consultation, the FCA mainly looks at BIPRU (for banks and significant investment firms, broadly) and INSIPRU (for insurers and friendly societies) requirements.

- **Prudential treatment of EU 27 exposures:** BIPRU sets out preferential capital treatment for certain types of exposures originating from EU member states (reflecting CRR). The UK’s version of CRR intends to treat EU member states as

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“Leaving the EU, and the amendments to legislation made under the EUWA, requires us to update our Handbook to reflect the UK’s new legal and regulatory framework after exit day so that it remains functional

FCA, October 2018
third countries, and this will remove the preferential treatment for these states after the UK’s exit. Temporary transitional arrangements are being considered in this area.

> Changes to INSPIRU: There are proposed changes to conduct rules with prudential aspects for insurers, including in relation to the INSPIRU definition of "regulated market".

**COLL**

> **What is it?** It is the sourcebook containing the rules for how UCITS funds should be managed.

> The proposed changes create an equivalent UK retail fund regime for the existing UK UCITS schemes, and for UK management companies who may wish to launch new funds of this kind in the UK.

> The changes permit continued cross-border marketing of UCITS, whereby EEA UCITS wishing to continue to market in the UK will be treated as third-country funds and will need to apply for individual recognition by the FCA, unless within the Temporary Permissions Regime.

> EEA management companies will no longer be permitted to manage UK UCITS, except within the Temporary Permissions Regime.

> The changes set out provisions for master-feeder arrangements, which will still apply to a UK feeder UCITS when it invests in units of an EEA master UCITS, although the FCA does not expect that EEA UCITS feeder funds will be allowed to invest in a UK UCITS master fund after exit day.

> FCA proposes to allow UK UCITS schemes to retain the same freedom to invest in EEA assets as they do now, on which proposal it seeks industry feedback.

> Depositaries of UK authorised funds will need to be UK incorporated entities, i.e., not branches of EEA firms. This is subject to a transitional period.

**FUND**

> **What is it?** It is the sourcebook containing the AIFMD rules.

> The proposed changes relate to the loss of AIFMD passporting rights and the replacement with a new UK AIFM regime.

> The changes allow for continued cross-border management by AIFMs, whereby EEA AIFMs managing unauthorised UK AIFs without carrying on a regulated activity in the UK will be subject to the same rules as third-country AIFMs (it will no longer be possible for an EEA AIFM to manage an authorised UK AIF if that AIFM is outside of the Temporary Permissions Regime.

> The proposals continue to permit the cross-border marketing of EEA AIFs but, to access the UK market, EEA AIFs will be subject to the National Private Placement Regime (NPPR) unless they have already notified the FCA to begin marketing before exit day and have applied to enter the TPR.

> The same proposed changes as noted above in COLL for depositaries will be made in FUND, however it will still be possible for branches of EEA firms to hold a permission to act as a depositary for unauthorised AIFs.

**Cross-cutting Handbook amendments**

In working through the SIs published so far, the FCA has identified several key areas for what it terms "cross-cutting" Handbook changes. These are changes whose need arises again and again throughout the different areas of the Handbook and in BTS. This need is a consequence both of Treasury’s approach to making SIs (being, at its simplest, the removal and replacement of EU-specific terms which cease to be appropriate or applicable) and because of concepts and terms whose applicability
spans many areas of FCA regulation. For this reason, the FCA glossary will be an area of significant cross-cutting amendment. The other areas identified by the FCA regard:

> the position of EU law and how it relates to the Handbook (e.g. references to provisions in EU legislation need to be amended to refer to their new UK equivalent, and many Glossary definitions are redundant with consequential impacts),

> loss of passporting rights,

> references to EU institutions, other member states, other EEA states and competent authorities, home and host state distinctions, and

> references to information sharing with the ESAs / other competent authorities.

**Proposed sectoral BTS amendments**

The following highlights the key BTS changes proposed in the consultation. By exit day, all the relevant BTS will be incorporated into UK law under the EUWA.

**Credit rating agencies**

> **Proposed changes:** The FCA has proposed amendments to the BTS dealing with the assessment of compliance of credit rating methodologies; the information for registration and certification of credit rating agencies; the periodic reporting on fees charged by credit rating agencies; and the presentation of information that credit rating agencies make available to ESMA.

> Most of the proposed changes are cross-cutting or consequential to the approach taken in the SI, for example, replacing references to the European Rating platform with references to a public rating database.

> Some of the substantial changes proposed include requiring credit rating agencies currently registered with ESMA that wish to register with the FCA to report information on all ratings issued to the FCA (rather than ESMA) by exit day.

> The FCA also proposes to remove the BTS that sets out disclosure requirements for structured finance instruments as this will be removed by the Securitisation Regulation which will come into force on 1 January 2019.

**Fund management**

> **BTS to be amended:** The FCA will remove a UCITS BTS that will not be applicable under the proposed UCITS SI as it related to sanction reporting requirements that will cease at exit day.

**EMIR (in relation to trade repositories only)**

> **Onshoring:** Our note on the published draft SI details how the BTS will be incorporated into UK law.

> **Proposed changes:** Consequential changes will be made to the two BTS associated with trade repositories in relation to the format and details of the application for registration. The FCA also intends to consult on RTS 151/2013 on data to be published and made available by trade repositories.

**MiFID/MiFIR**

> **Onshoring:** Our note on the published draft SI details how MiFID II and MiFIR legislation will be incorporated into UK law.

> **Proposed changes:** The consultation paper deals with most of the 44 BTS associated with MiFID II. The FCA did not find any significant deficiencies and has
largely dealt with these BTS using the cross-cutting approach. The FCA will consult on BTS covering transparency requirements and tick sizes (including RTS 1, 2, 3 and 11). The FCA has introduced a specific provision within each BTS to define its scope and application. It has based this on scope provisions in level 1 of MiFID II, together with a discrete provision setting out definitions used in the BTS.

> **Reporting (RTS 23):** The FCA has proposed that firms must still report reference data based on Central European Time. Firms will still be able to keep the date time format for reported data to Universal Time Coordinated to ensure consistency across different data sets.

> **Transaction reporting (RTS 22 and 23):** UK trading venues will need to report transactions on their venue by EEA firms since they will become third-country firms and will not have an obligation to report to the FCA. Such trading venues should not report for UK branches of EEA firms though as these will need to be reported to the FCA. UK firms will no longer meet the conditions for transmission if they transmit orders to an EEA firm and will therefore have to report transactions themselves or ensure arrangements are made with firms that have obligations to report to the FCA. These changes will also tie in with the scope of the onshored transaction reporting regime in MiFIR.

**Short selling**

> **Onshoring:** Our note on the published draft SI details how the short selling legislation will be incorporated into UK law.

> **Proposed changes:** Cross-cutting changes will be made to the three BTS which cover notification and disclosure requirements regarding net short positions, public disclosure of net position in shares and method of calculation of fall in value for financial instruments.

> Some other minor changes will be made to these BTS. These include references to ESMA’s obligation to publish a list of shares traded on EU venues that are exempt from the EU Short Selling Regulation due to being principally traded on venues outside the EU – the FCA will publish a list of shares principally traded outside of the UK.

> References to financial instruments in MiFID will also be updated to refer to the relevant category of derivatives listed in the UK Regulated Activities Order.

**Capital requirements**

> **Onshoring:** Our note on the published draft SI details how the capital requirements legislation will be incorporated into UK law.

> The FCA will share responsibilities with the PRA in relation to these BTS, with the intention that there will be separate but identical onshored BTS applying to PRA- and FCA-authorised firms. The FCA has told firms to have regard to the PRA consultation when this is published.

> **Proposed changes:** The FCA and PRA are proposing not to make line by line changes to reporting and disclosure templates and instructions contained in the BTS. The regulators will issue interpretative guidance on the approach they expect firms to take after exit day in cases where reporting and disclosure fields or definitions are based on EU concepts.
Changes to Level 3 Guidance materials
The FCA has stated that its approach is not to incorporate the broad range of non-legislative, Level 3 materials into UK law.

The European Supervisory Authorities (ESA) currently have powers to issue Guidelines and Recommendations which are subject to a "comply or explain" requirement. Although the ESA Regulations will be incorporated into UK law under the EUWA, the Government has proposed revoking them, meaning that the "comply or explain" requirement would no longer apply.

In light of this, the FCA intends to publish non-Handbook guidance on its approach to Level 3 guidance. This will be published on exit day, and a draft is provided in the consultation. In summary, it explains that firms should be aware of and follow the Level 3 guidance post exit as they did prior to exit. Firms are expected to interpret Level 3 guidance sensibly and purposively, taking account the UK’s changed circumstances.

Changes to SYSC 19 Remuneration code requirements
The requirement to discount variable remuneration in accordance with the EBA Guidelines, which refer to rates produced by Eurostat, is removed on the basis that the Eurostat rates may not be produced for the UK following exit day. Instead, firms are asked to either comply with the Guidelines or (in the event Eurostat rates are not available) use appropriate and verifiable alternative figures.

If you would like to respond to the consultation…
Responses to the consultation are required by 7 December 2018. The FCA is particularly interested to hear whether firms have identified situations where compliance with pre-exit requirements would not be possible post-exit, whether the proposed changes necessitate any systems changes or builds, and the lead times associated with them, and any other external dependencies that firms have identified.
Further resources

We have published a note on FCA CP18/29 (temporary permissions regime for inbound firms and funds). CP 18/29 was published alongside CP18/28 on proposed Handbook and BTS changes.

For more information on Brexit SIs, and Brexit generally, please visit our:

> Brexit Knowledge Portal
> Linklaters Brexit homepage

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