The UK's overseas framework: HM Treasury's call for evidence

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The UK government's economic and finance ministry (HM **Treasury**) on December 15, 2020, published a call for evidence (**Call for Evidence**)[1], its stated goal being to understand how the UK's current overseas framework supports the UK's position as a global financial centre. Although addressed to "all interested stakeholders", including UK firms and consumers, the Call for Evidence is arguably geared towards firms using, or considering using, the UK's overseas framework.

What do we mean by the UK's overseas framework?

Non-UK firms (**Overseas Firms**) wanting to provide financial services in, or in connection with, the UK must currently come to grips with a patchwork of UK-issued rules and legislation. In order to facilitate their cross-border operations, legislators in the UK have put in place certain carve-outs that allow such firms to do business without, for example, the need to become authorized in the UK. The following are key elements of the overseas framework:

- the Overseas Persons[2] Exclusion (**OPE**); and
- the Financial Promotion Order (**FPO**)[3].

This is because both the OPE and FPO will be relevant to a great number of Overseas Firms, regardless of the regulated activity and/or services they offer. The overseas framework encompasses other significant carve-outs and legislation, such as the investment services equivalence regime under the UK's version of the Markets in Financial Instruments Regulation (**UK MiFIR**), and the regime for recognized overseas investment exchanges (**ROIE**s). It also includes other elements beyond mere carve-outs and legislation, such as the overseas branching policies operated by the UK regulators – the Financial Conduct Authority (**FCA**) and Prudential Regulation Authority (**PRA**).

This Client Alert takes a closer look at the two key elements of the overseas framework identified above and their interplay with UK MiFIR. We invite you to get in touch with us if you would like to discuss specific aspects of the overseas framework not covered here, including the treatment of insurance distribution under the FPO.

The OPE

To carry on "regulated activities"[4] in the UK, businesses, including Overseas Firms, must normally become authorized by the FCA (or, in the case of banks and insurance companies, among others, by the PRA).[5] As the Call for Evidence explains, whether or not an activity is regarded as being carried on in the UK depends on many factors, which are set

out in law and in FCA guidance[6]. Those factors may include, in particular, the location of both the client and the business, and the type and location of the activity itself.

The OPE offers a key potential solution for Overseas Firms looking to carry on certain cross-border operations without the need to obtain UK regulatory permission. It is available in respect of some UK-regulated activities, which include "dealing in investments as principal", "arranging deals in investments", and agreeing to do those activities. As summarized by the Treasury, the overseas person must ensure one of two conditions is met in order to benefit from the OPE:[7]

- The regulated activity is done 'with or through' an authorized or exempt person. Entering into a transaction 'with or through' an authorized or exempt person can involve entering into a transaction 'with' an authorized or exempt person as a counterparty, or 'through' an authorized or exempt person as an agent or arranger.
- The regulated activity is carried on as a result of a 'legitimate approach', which is an approach to, by, or on behalf of an overseas person that does not contravene section 21 of FSMA (the restriction on financial promotions).

If the OPE is available, the Overseas Firm will be able to carry on its relevant business without the need to become authorized. The OPE has become a go-to solution for a wide range of businesses as it is available regardless of the Overseas Firm's registration status in its home state (if any), or the UK regulators' level of comfort with that country's regulatory standards.

The FPO and the restriction on financial promotions

Whereas the OPE concerns the ability to carry on regulated activities without authorization, the restriction on financial promotions targets the invitation (or inducement) to engage in investment activity. In short, unless a financial promotion falls within an exemption listed in the FPO, it must be made by a UK-authorized firm, or – if it is made by, for example, an Overseas Firm which is not authorized in the UK – it must be approved by a UK-authorized firm. Breach of the restriction on financial promotions is a criminal offence.

The scope of this restriction is notoriously wide, and catches financial promotions originating outside the UK that may have an effect in the UK – regardless of whether they actually have that effect, or whether the possibility of having that effect was intended. Most Overseas Firms making financial promotions that may have an unintended effect in the UK will do well to obtain reassurance that that promotion falls under the FPO exemption for communications to overseas recipients, which covers financial promotions made to or directed only at overseas persons. Depending on the nature of the financial promotion and the means by which that promotion is made, there are various strategies that Overseas Firms may use to fall on the right side of this exemption and the restriction on financial promotions.

Where this exemption is not available – e.g. because the communication is directed at UK would-be investors – other exemptions can be of particular use to Overseas Firms, particularly in the case of communications made to investment professionals, or regarding securities and derivatives business where the communication is made only to high net worth companies, unincorporated associations, and/or trusts.

Our regulatory practice in London and our Eurozone Hub work seamlessly to provide advice to international businesses facing the UK financial promotions regulatory landscape, whether because they are expanding, 'health-checking' existing marketing practices, or in the context of cross-border securities offerings.

The overseas framework: issues identified

The Treasury sets out what the overseas framework should accomplish. Among others, it should be transparent and predictable, and provide a stable and reliable arrangement for cross-border market access. In light of these policy requirements, the Call for Evidence hints at several shortcomings, which are generally related with the framework's complexity and the various overlaps within it.

One such shortcoming concerns the activities covered by the OPE (discussed above) and those activities covered by Title VIII of UK MiFIR.[8] Title VIII enables Overseas Firms to carry relevant business on the basis of successful registration with the FCA, rather than through full-blown UK authorization. Although there is considerable overlap between those activities covered by the OPE (e.g. dealing in investments as principal, advising on investments) and those covered by Title VIII (e.g. dealing on own account, investment advice), the conditions for taking advantage of the OPE and the Title VIII regime are different. For example, unlike the OPE, successful registration under Title VIII hinges on a determination (by the Treasury) that the overseas jurisdiction has equivalent legally binding prudential and business conduct requirements to the UK. Title VIII involves a registration process in the UK and authorization in the firm's home jurisdiction, whereas the OPE does not. This means many Overseas Firms will find themselves engaging with two routes to avoid the need to become authorized in the UK in respect of the same UK-linked business.

Significance and next steps

The immediate significance of the Call for Evidence should not be overstated, as the Treasury made clear it is "designed as an information exercise", a "learning exercise", and a means to "start a conversation". Note the Treasury has also indicated, in a statement delivered on November 9, 2020, by Chancellor Rishi Sunak, that the Call for Evidence would serve as a precursor to a new approach by the Treasury to the overseas framework, to be published later this year.

The Call for Evidence addresses real concerns, including in the investment industry, about the lack of transparency and complexity of some areas of the overseas framework. We do not consider, however, that there is an overwhelming appetite for legislative amendments to the framework.[9] In an era of pandemic and increasing regulatory divergence on both sides of the English Channel, Overseas Firms and other stakeholders may be wary of further disruption to their business models caused by a legislative rush to address its deficiencies. We believe additional clarity can be achieved by less disruptive means, including, for example, the expansion of relevant FCA guidance.

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1. The Call for Evidence – "Overseas Framework: Call for Evidence" – ran until March 11, 2021. Available here.↩
2. An 'overseas person' is, in short, a financial services firm that does not carry on regulated activities from a permanent place of business in the UK. ↩
3. Section 21 of the Financial Services and Markets Act 2000 (**FSMA**) states that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity or to engage in claims management activity unless the promotion has been made or approved by an authorized person or it is exempt. ↩
4. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) provides a breakdown of regulated activities in the UK.↩
5. A business that does not comply with this commits a criminal offence and is liable, on conviction on indictment, to imprisonment for up to two years and/or an unlimited fine. The UK has put in place a temporary permissions regime (**TPR**) for firms authorized in the EEA which, prior to 2021, carried on regulated activities in the UK under the EU's passporting regime. The TPR allows firms to continue operating in the UK for a limited period within the scope of their former passporting regime permissions while seeking authorization. Note that the notification window for

entering the TPR has now closed. Please let us know if you would like to discuss the TPR, the UK's financial services contracts regime (which is the alternative, run-off regime for firms outside the TPR), or indeed if you are considering growing your business into the UK and would like to understand if you need to become authorized. ↩
6. Namely, section 418 of FSMA and in the FCA's Perimeter Guidance manual.↩
7. The OPE works in a different way in respect of regulated activities related to home finance transactions.↩
8. While UK MiFIR mostly deals with transparency and other requirements on FSMA-authorized UK investment firms and credit institutions, Title VIII specifically concerns the performance of certain investment activities and provision of investment services by Overseas Firms in the UK without a branch or other physical presence.↩
9. We note the Treasury-sponsored Financial Services Bill proposes to introduce certain changes to the Title VIII regime, including more detailed requirements informing the Treasury's determination of equivalence - with a nod to the UK's anti-money laundering regime. The Financial Services Bill also proposes to give the FCA the power to impose temporary restrictions or prohibitions on Overseas Firms. ↩

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