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Offering wealth management into the UK out of Asia after Brexit

Brexit will have significant ramifications for the Financial Services Industry in the UK, and will undoubtedly result in a number of regulatory changes for wealth management businesses involved in cross-border sales to the UK.

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A. Introduction

This article considers what banking and investment services a wealth manager based in an Asian country may offer into the UK or undertake in the UK irrespective of whether the prospect or client is a resident of the UK or not. Activity would take place "after Brexit", meaning the UK is not a Member State of the EU anymore and is a "third country" in EU parlance. It is assumed that any subsequent transitional phase has ended.

This paper thus outlines the regulatory situation for establishing business relationships between Asian wealth managers and UK clients. The possibility of using the UK as a gateway to the EU is briefly assessed, however, since the details of the future relationship[1] between the UK and the EU are still subject to negotiation, the conditions for establishing busi-

[1] The situation for the UK becoming a third-country to the EU is described in Bizzozero/McGrand/Bartels, After Brexit, Cross-border financial services from the UK into the EU, 2017.

ness relationships and providing financial services between the two parties may change.

B. Regulatory situation

1. CRITERIA FOR UK REGULATORY SCRUTINY OF THE ACTIVITIES OF AN ASIAN WEALTH MANAGER IN OR INTO THE UK

After Brexit the situation for Asian incorporated entities will not change significantly as the UK will continue with the current approach to cross-border activity. It is only EEA (EU plus Norway, Iceland and Liechtenstein) incorporated entities that will see a dramatic change as the various passports that allow such entities to conduct cross-border activity into the UK without UK authorisation will disappear. Similarly UK incorporated entities will not be able to passport into EEA countries. At the time of writing it seems unlikely that the EU and UK will agree a framework for passporting to continue after Brexit.

As a rule, a foreign wealth manager is prohibited from carrying on a regulated activity in the UK, such as taking deposits (if it is a bank), dealing in investments or arranging such deals, managing investments or advising on investments unless it is authorised or exempt. This is a result of the general prohibition contained in section 19 of the Financial Services and Markets Act 2000 ("FSMA"), the main UK legislation covering financial services.

The Regulated Activities Order (RAO) lists all financial services activity that is subject to restrictions under FSMA. Contravention of the general prohibition is a criminal offence and resulting agreements may be unenforceable (FSMA sections 26-30).

An assessment in relation to each activity that is regulated in the UK needs to be undertaken to determine whether the activity is undertaken in or outside of the UK. For example, deposit taking, asset management and securities broking activities are viewed by the UK regulator as taking place in the country where the provider of the service is based. In contrast, the provision of investment advice is seen as taking place in the country where the recipient of the advice is based. If a service is not being provided in the UK, then an Asian wealth manager does not need to be authorised there and, while the UK rules on solicitation and financial promotion requirements might apply, other requirements relating to the provision of services would not.

An Asian private bank would thus not be subject to a requirement for UK authorisation, nor to any conduct of business rules, where it is accepting deposits, managing funds or buying and selling investments in the course of business in its home country.

By contrast, an Asian entity providing investment advice to UK clients would, in principle, need to be UK authorised. In practice, however, foreign firms with no permanent UK presence may take advantage of the Overseas Persons Exclusion, which is set out in UK law (Art. 72 RAO) that inter alia covers investment advice. UK authorisation is not required for activities taking place in circumstances which are covered by this exclusion subject to an exclusion, so long as the firm complies with the rules on solicitation and financial promotions.

2. THRESHOLD OF REGULATORY TOLERANCE

2.1. Solicitation/marketing

Where an unauthorised wealth manager undertakes cross-border promotion into the UK, the UK regulator does not just focus on authorisation requirements; it also considers an overseas firm's ability to solicit and advertise its services in the UK.

This approach is not likely to change after Brexit. FSMA contains a basic prohibition on any person communicating a financial promotion. The concept of a Financial Promotion is defined in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 as amended ("FPO") as an invitation or inducement to engage in investment activity. A communication which does not have any element of persuasion or incitement would not be a financial promotion.

The purpose of the restrictions on financial promotions in the UK is to regulate communications which have a promotional element - "Such communications may be distinguished from those which seek merely to inform or educate about the mechanics or risks of investment" (FCA Perimeter Guidance). Communications made during telephone conversations, in written publications, letters and radio broadcasts can all be or contain a financial promotion.

There are two main types of financial promotion; "Real time communications" and "Non-real time communications": A "real time communication" is an interactive communication taking place in real time. It is defined as any communication made in the course of a personal visit, telephone conversation or other interactive dialogue. It could be an unsolicited approach to UK prospects/customers or solicited/initiated by the customer.

This type of communication is tightly restricted to prevent customers being influenced by high pressure sales tactics during telephone conversations or meetings. A "non-real time communication" is any communication that is **not** a real time communication.

A breach of the financial promotion restrictions may constitute a criminal offence and therefore affect the enforceability of ensuing contracts. Exceptions to the prohibition on financial promotions relevant for overseas entities are where the content of the communication is approved by a UK authorised person; or where the communication is exempt under the FPO.

There is a relatively light touch in relation to advertising for **deposits** (provided these are not structured deposits), where the deposit is taken outside of the UK. Promotion is allowed for both solicited and unsolicited real-time promotions (Art. 23 FPO). Non-real time promotions are permitted if the communication contains (Art. 22 FPO) information on the full name of the bank, the bank's country of incorporation and principal place of business, the regulatory coverage of deposit taking activities, the applicability of any dispute resolution or compensation scheme, and certain details of the bank's capital.

Furthermore, there are numerous exemptions in the FPO which may be utilised in order to make a financial promotion covering **investment services** including structured deposits. Some of these exemptions apply to

particular categories of client and include communications to investment professionals, unsolicited real time communications to knowledgeable customers from overseas, any type of communication made to high net worth companies, unincorporated associations and trusts, and any type of communication made to sophisticated investors.

Each exemption and type of permitted communication is subject to specific conditions, warnings, disclaimers, etc. contained in the FPO. For example, the exemption in Article 33 of the FPO broadly applies where the overseas communicator:

- **has reasonable grounds to believe that the recipient is knowledgeable enough to understand the risks associated with the controlled activity to which the financial promotion relates;**
- **has informed the recipient that he will not gain the protections under FSMA in respect of the activity or of the making of unsolicited real time financial promotions; and**
- **has informed the recipient whether he will lose the benefit of dispute resolution and compensation schemes.**

The recipient must also have signified clearly that he/she accepts the position after having been given a proper opportunity to consider the information. There is no definition of a proper opportunity for this purpose, but it is unlikely that a time of less than 24 hours would be enough.

In relation to promotion following a client request, there are a range of exemptions in the FPO covering solicited real time and non-real time financial promotions.

A relevant example is Article 30 of the FPO which exempts any solicited real time financial promotion made by an overseas communicator from outside the UK in the course of, or for the purposes of, certain regulated activities which it carries on outside the UK. So staff working for an Asian wealth manager could respond to: (i) an unprompted telephone enquiry made by a person in the UK; or (ii) an enquiry which follows a financial promotion made by the overseas communicator and which was approved by a UK authorised person.

2.2. Providing services

Deposit taking cannot be carried out in the UK, but a foreign bank may promote the fact that it takes deposits in its country of establishment using the exemptions set out in Art. 22 and 23 of the FPO.

In relation to investment services the Overseas Person Exclusion is of relevance to a wealth manager with no office in the UK.

This group of exclusions applies, in specified circumstances, to the regulated activities of:

- dealing in investments as principal;
- dealing in investments as agent;
- arranging (bringing about) deals in investments and making arrangements with a view to transactions in investments;
- arranging a home finance transaction;
- operating a multilateral trading facility;
- operating an organised trading facility
- advising on investments;
- entering into a home finance transaction;
- administering a home finance transaction; and
- agreeing to carry on the regulated activities of managing investments, arranging (bringing about) deals in investments, making arrangements with a view to transactions in investments, assisting in the performance and administration of a contract of insurance, safeguarding and administering investments or sending dematerialised instructions.

An Overseas Person is defined as a person who carries on what would be regulated activities but who does not do so from a permanent place of business maintained in the UK. Where activity is carried on in the UK, exclusions are available, for regulated activities, other than those that relate to home finance transactions where residential criteria apply, in two broad cases.

The first case is where the nature of the regulated activity requires the direct involvement of another person and that person is UK authorised or exempt.

For example, this might occur where the person with whom an Overseas Person deals is a UK authorised person or where the arrangements the person makes are for transactions to be entered into by such a person. This means that intermediation through UK authorised entities is relatively straightforward where activity is covered by the Exclusion.

The second case is where a particular regulated activity is carried on as a result of what is termed a “legitimate approach”. An approach to an Overseas Person that has not been solicited in any way, or has been solicited in a way that does not contravene the restrictions on financial promotion in section 21 of FSMA, is a legitimate approach.

An approach that is made by the person in a way that does not contravene section 21 of FSMA is also a legitimate approach. In such circumstances, the Overseas Person can, without requiring UK

authorisation, enter into deals with (or on behalf of) a person in the UK, give advice in the UK or enter into agreements in the UK to carry on certain regulated activities.

The financial promotion exemptions listed in the FPO will be relevant to the question of whether UK promotional restrictions have been contravened. In summary, if a prospect approaches a wealth manager of his own accord without any prior solicitation by the wealth manager, any resulting activity in the UK may be exempt under the Overseas Person Exclusion.

The UK will continue with the relatively liberal approach under the Overseas Person Exclusion for the foreseeable future. This is likely to suit the UK and EU as it preserves EU client access to UK financial services and of course would also mean that Asian firms could continue to use the UK Exclusion. It is UK Government policy to make the City of London open to cross-border business. Note that corporate lending is effectively unregulated in the UK although consumer lending is tightly controlled.

THIS IS LIKELY TO SUIT THE UK AND EU AS IT PRESERVES EU CLIENT ACCESS TO UK FINANCIAL SERVICES AND OF COURSE WOULD ALSO MEAN THAT ASIAN FIRMS COULD CONTINUE TO USE THE UK EXCLUSION.

Note that as part of MiFID 2 and MiFIR implementation from 2021 the UK will suspend the Overseas Persons Exemption for investment firms established in non-EU countries which ESMA and the European Commission have decided are equivalent for the purposes of the new third country regime in MiFID II.

The UK has fully implemented the MiFID 2 package as it will remain in the EU until at least March 2019 and its rules will most likely correspond with MiFID 2 requirements going forward after Brexit. However, it seems unlikely that the UK will continue with the MiFIR third country regime and so the suspension of the Overseas Persons Exemption may not continue beyond 2021.

Under the MiFIR third country regime investment firms in equivalent non-EU countries are able to provide investment services to eligible counterparties and per se professional clients in the EU by registering with ESMA. There have been no equivalence determinations as yet by the EU authorities so this option is not yet of any practical use but it is possible that some Asian jurisdictions such as Hong Kong and Singapore may be judged equivalent in the future and so the MiFIR regime may provide an entrée for Asian firms into the remaining EU 27 countries after Brexit.

2.3. Lasting presence

From a supervisory law point of view, habitual or significant presence by employees of an Asian wealth manager on UK territory, even in the absence of any financial promotions, may give rise to risks that the wealth manager would be considered as having a de facto branch in the UK. The UK regula-

tors have not defined any formal thresholds of tolerance in this area. As a general principle, the more the foreign wealth manager has its employees travelling to UK, the more these visits imply a long-term systematic presence and the more the local authorities will consider that the wealth manager has a permanent establishment in the UK.

An Asian wealth manager may open a representative office in the UK. There are no specific licensing requirements in this regard in FSMA, however, as such an office is not UK-authorised it is not permitted to conduct any regulated activities in the UK and must limit itself to liaison activities.

For the purposes of UK taxation, a company is resident in the UK if it is incorporated in the UK or the central management and control of its business is in the UK.

THE PROBLEM IS THAT THE ISSUE OF REGULATORY EQUIVALENCE HAS BEEN WRAPPED UP IN THE POLITICS OF BREXIT AND SO WE HAVE THE POSSIBILITY THAT THE UK AFTER BREXIT AS A THIRD COUNTRY WILL NOT BE JUDGED EQUIVALENT.

C. The UK as a gateway to the EEA

If the UK becomes a third country to the EU just like any other third country, market access via EU third-country regulations (particularly MiFIR, AIFMD) would not necessarily put the UK in a better position than any Asian country. The problem is that the issue of regulatory equivalence has been wrapped up in the politics of Brexit and so we have the possibility that the UK after Brexit as a third country will not be judged equivalent. Since the UK and the EU legislative and regulatory frameworks regarding financial services will be largely identical/aligned after Brexit and for the foreseeable future, it will nonetheless be easier to access the EU market from the UK than from any other third country.

Alternatively, it would be pragmatic and sensible for the UK and EU to recognise that regulatory cooperation could be based on the principle of mutual recognition. A new model of enhanced cooperation could be developed and could address one of the major shortcomings of the existing EU equivalence regime, which is that an equivalence determination can be rescinded unilaterally with a relatively short notice period of a few months.

There is also the - currently however still not very likely - possibility that financial services will be subject to a UK-EU FTA.

Any Asian wealth management groups which currently use the UK as an EU hub will need to consider their options and may need to open a subsidiary in one of the remaining EU 27 countries if passporting within the EU is important to the operation of their business model.

D. Conclusion

The UK will remain as one of the most liberal jurisdictions in relation to cross-border financial services. Current mechanisms for Asian access to the UK market are most likely to continue for the indefinite future. ■