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## THIRD-COUNTRY RULES FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS

*In the referendum on 23 June 2016, the UK electorate voted to leave the European Union. This note provides a brief synopsis of third country rules in key European jurisdictions which may become relevant to firms in the UK after the UK has exited the EU. It focuses on the legal requirements applicable to credit institutions and MiFID investment firms*

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What has been controversially discussed for a long time has now become reality: In the referendum on 23 June 2016 the UK electorate voted to leave the European Union ("EU").

The decision to leave the EU, commonly referred to as "Brexit", will have significant consequences for businesses and financial markets in both the UK and EU. Unless the UK joins the European Economic Area ("EEA") (which seems unlikely<sup>1</sup>) or is able to negotiate an agreement with the EU ensuring access to the European market, the UK will become a "third country" for the purposes of much of the European financial legislation. As a result, UK-based firms will likely lose their ability to rely on their "European passport" when providing services on a cross-border basis. The same in principle applies for EU based firms targeting the UK market although this may be affected by the terms of exit still to be agreed between UK and the EU.

Against this background, this short note aims to provide a brief synopsis of third country rules in key continental European jurisdictions which may become relevant to firms operating from the UK post-exit. These rules apply equally to non-EU institutions (such as banks based in the US or Asian countries) which target the European market.

## ***Overview of the European Legal Framework***

### **Banks**

The current CRD IV / CRR framework<sup>2</sup> which applies to deposit-taking credit institutions contains only very few provisions relating to third country firms.

The CRD IV Directive requires that the rules governing branches of credit institutions having their head office in a third country should be analogous in all EU member states and stresses that such rules should not be more favourable than those applicable to branches of credit institutions from another member state.<sup>3</sup> The Directive acknowledges that the EU is able to conclude agreements with third countries providing for the application of rules which grant branches the same treatment throughout its territory. However, branches of credit institutions authorised in third countries do not enjoy the freedom to provide services or the freedom of establishment in member states other than those in which they are registered.<sup>4</sup>

As a result, a third country firm must, in principle, obtain a licence in the respective member state (and, if required by national law, establish a physical presence) if it intends to provide financial services or conduct banking activities in that member state. There is no "passport" for non-EU/EEA firms which would allow third country firms to provide services throughout the EU using their home-state authorisation. We have summarised the respective third country rules in key European jurisdictions which have to be observed by non-EU/EEA firms in a matrix below.

<sup>1</sup> The legal impact of Brexit will depend on the strategy that is adopted for the UK's future relationship with the EU. The most commonly proposed models for the UK's post-Brexit relationship with the EU are: (i) Membership of the EEA (so called "Norwegian" model), (ii) negotiating a bilateral agreement with the EU in order to secure single market access (so called "Swiss" Model) and (iii) total exit of the EU, relying on the rules of the World Trade Organization for trading access.

<sup>2</sup> The CRD IV / CRR framework consists of the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 ("CRD IV") and the Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms ("CRR").

<sup>3</sup> Recital (23) CRD IV.

<sup>4</sup> Recital (23) CRD IV.

## Investment Firms

Under the new MiFID II / MiFIR framework<sup>5</sup> (which will apply as from 3 January 2018), third country firms may under certain conditions provide investment services directly (i.e. on a cross-border basis without having to establish a branch or subsidiary in the EU) to eligible counterparties and professional clients if they have been registered as a permitted third-country firm.<sup>6</sup>

However, this requires that the European Commission ("**Commission**") adopts a so-called "equivalence decision" confirming that the regulatory and supervisory regime of the third country in which the firm is established is equivalent to the EU's supervisory regime. Furthermore, (i) the third country firm must be authorised in the jurisdiction where its head office is established to provide the respective services and must be subject to effective supervision and enforcement in its home state and (ii) the European Securities and Markets Authority ("**ESMA**") must have established a cooperation agreement with the respective competent authority of the third country.<sup>7</sup>

The respective guidelines and regulatory technical and implementing standards relating to the MiFID II/MiFIR third country regime have not yet been finalised and no equivalence decisions or cooperation agreements have been adopted. There is no deadline for the Commission to reach a conclusion on the equivalence of the regulatory and supervisory regime of the third countries and there is no certainty that the UK regulatory regime would be deemed equivalent.

According to the transitional provisions of MiFIR, third-country firms will be able to continue to provide services and activities in the member states in accordance with national regimes until three years after the adoption of the equivalence decision by the European Commission.<sup>8</sup>

It should be noted that the MiFID II regime expressly recognises a "freedom of passive service" exemption which applies if a retail client or a professional client established or situated in the EU "initiates at its own exclusive initiative" the provision of an investment service or activity by a third-country firm.<sup>9</sup>

Under the current MiFID I regime (comparable to the situation for banks under the CRD IV/CRR framework) there is no passport for non-EU/EEA investment firms, which must therefore seek local authorisation to establish a branch / incorporate an affiliate or (if the local laws do not require a physical presence in that member state) provide services on a cross-border basis. The respective third country rules in key European jurisdictions are summarised in the matrix below.

## AIFMD

With regard to alternative investment funds ("**AIFs**"), the Alternative Investment Fund Managers Directive ("**AIFMD**")<sup>10</sup> has set out the basis for a comprehensive passport regime which in principle shall also be available for

<sup>5</sup> The MiFID II / MiFIR regime consists of the Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 ("**MiFID II**") and the Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 ("**MiFIR**").

<sup>6</sup> With regard to services provided to retail clients, MiFID II provides that member states may require a third country firm to provide investment services or perform investment activities to clients in its territory through a branch authorised in that member state. Such branch authorisation may only be given by the member state's national competent authority if several requirements (as outlined in detail in Art. 39 ff. of MiFID II) are met.

<sup>7</sup> Art. 46 ff. MiFIR.

<sup>8</sup> Art. 54 MiFIR.

<sup>9</sup> Art. 42 MiFID II. In this situation the licensing requirements shall not apply. An initiative by such clients does, however, not entitle the third-country firm to market otherwise than through the branch, where one is required in accordance with national law, new categories of investment products or investment services to that client.

<sup>10</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011.

non-EU alternative investment fund managers ("AIFM"). However, non-EU AIFM will only be able take advantage of the AIFMD passport regime once ESMA has finalised its assessment on the equivalence of the respective non-EU countries.<sup>11</sup>

In its initial advice published in July 2015, ESMA has assessed the regimes of six non-EU jurisdictions (Guernsey, Hong Kong, Jersey, Singapore, Switzerland and the U.S.) and concluded that no obstacles exist with regard to the extension of the passport to Guernsey and Jersey, with Switzerland expected to remove all remaining obstacles soon. ESMA offered no advice relating to Singapore, Hong Kong or the US, but expressed concerns relating to certain regulatory issues as well as the lack of sufficient evidence required to assess equivalence.<sup>12</sup> The final advice relating to the equivalence of the regimes of the USA, Hong Kong, Singapore, Japan, Canada, Isle of Man, Cayman Islands, Bermuda and Australia is expected to be published by 30 June 2016.

### ***Third Country Rules for Credit Institutions and Investment Firms in the European Jurisdictions***

As there is currently no harmonised third country regime, non-EU firms which intend to target the European market must observe the local requirements of the respective member states. Against this background, the following matrix provides a brief synopsis of the third country rules which apply in key European jurisdictions.

<sup>11</sup> Art. 67 AIFMD.

<sup>12</sup> ESMA, Advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs, ESMA/2015/1236, 30 July 2015.

	France 	Germany 	Italy 	Netherlands 	Spain 	Portugal 	UK 
<b>1. Cross-border activities that trigger license requirements</b>							
Physical presence of employees (albeit not on a permanent basis)	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Soliciting potential clients	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Actually conducting financial services (e.g. signing contracts, accepting orders, giving advice)	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Providing client relationship services (post conclusion of the relevant contractual agreements)	No*	No*	No ("grey" area)*	Yes	No ("grey" area)*	No ("grey" area)*	Pure client relationship management should not, but arranging the exercise of contractual rights may trigger licence requirement
Advertising of financial services cross-border in public media (including Internet) or through mass mailing	Yes	Yes	Yes	Yes	Yes	Yes	Yes
General branding, image advertising	No**	No**	No**	Yes	Yes	No**	No**
Sponsoring (cultural, athletic, political) events	No***	No***	No***	No***	No***	No***	No***
Accessibility of website from your jurisdiction without an IP-filter	No****	No****	No****	Yes	No****	No****	No****

\* Provided that the client has taken the initiative of contacting the institution and no new financial services are rendered and, in the case of Italy, that the relationship services are strictly necessary to perform the agreements in compliance with the principles of reverse solicitation.








\*\* Provided that advertising does not refer to specific services / financial products (no "direct" marketing / only creating of "brand awareness") or, in the case of Spain, the advertising is not related to a public offering of securities or financial instruments/banking products.

\*\*\* Provided that no clients are solicited during the event / financial services are rendered or, in the case of Spain, the advertising is not related to a public offering of securities or financial instruments/banking products.

\*\*\*\* Unless due to specific characteristics of the website it constitutes solicitation of clients.








	<b>France</b> 	<b>Germany</b> 	<b>Italy</b> 	<b>Netherlands</b> 	<b>Spain</b> 	<b>Portugal</b> 	<b>UK</b> 
Has a passive freedom of services exemption ("reverse solicitation") been recognized?	No	Yes, but scope rather limited	Yes, but very limited scope	Yes ("initiative test"), but very limited scope	Yes, but only as one of the criteria to determine whether services are provided in Spain	Yes, but scope rather limited	Yes, although scope is limited and subject to conditions
Requirements of reverse solicitation exemption / comments	Banking license is required insofar as regulated activities are carried out in France.  Criteria for determining whether a transaction is carried out in France include, inter alia, place of effective use of funds.	Service must have been requested by a client domiciled in Germany on its own initiative. Client's initiative must be genuine. Exemption only applies if services are provided on a cross-border basis (i.e. not on German territory).	(i) The client's autonomous and unsolicited initiative; (ii) the client travelling to the territory of the credit institution/investment firm; (iii) no activities are carried out by the credit institution/investment firm outside their home country; and (iv) negotiation and execution of agreements governed by local law (not Italian law) in the home country of the credit institution/investment firm.	"Initiative test" only explicitly recognized for investment services. Initiative test cannot be relied upon if there has been preceding marketing activity by the firm targeting the Dutch market.	If provision of service has been initiated by the client, such service may be considered to be provided outside of Spain (i.e. would not trigger Spanish license requirements). However, solicitation test only used by Spanish National Securities Exchange Commission (not by the Bank of Spain).	Exemption not expressly mentioned in Portuguese law. However, no license requirements are triggered with regard to services provided on a cross-border basis by a foreign entity if such service has been requested by a client domiciled in Portugal on its own initiative. The client's initiative must be genuine. Exemption only applies if services are provided on a cross-border basis (i.e. not on Portuguese territory).	An "overseas person" exemption allows the provision of limited cross-border investment services in the UK, provided that (i) service provision follows reverse solicitation from a UK domiciled person (or other legitimate approach) and/or (ii) any dealing arrangements are made, or carried out, through a third party authorised in the UK.
<b>2. Cross-border license</b>							
Is there a special cross-border license available for third country firms?	No	No	Yes	No (but third country investment firm may request a dispensation from certain requirements)	Yes	No	No
Requirements for obtaining license	N/A	N/A	Requirements include, inter alia, (i) the submission of a business plan; (ii) certificate of the home regulator	N/A	Prior authorization must be granted by the Bank of Spain/CNMV, respectively, by indicating which kind	N/A	N/A

	France 	Germany 	Italy 	Netherlands 	Spain 	Portugal 	UK 
			confirming the financial soundness / suitability of the credit institution/investment firm (iii) equivalence of the third country regime (iv) cooperation agreements between the Italian and the home country authorities; (v) reciprocity conditions in the home and host countries.		of activities will be provided on cross-border basis. The Bank of Spain/CNMV, respectively, will be entitled to request additional information or grant authorization only upon fulfilment of additional requirements.		
<b>3. License for branches</b>							
Are there special licensing requirements for branches?	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Requirements for obtaining license	Comparable to full license	Comparable to full license	Requirements of cross-border license apply; further conditions include (i) payment of an endowment fund of at least €10 million, and (ii) commitment to adhere to a deposit guarantee scheme (with regard to credit institutions).	Requirements (relating to credit institutions) include, inter alia, (i) suitability / integrity of (co) policy makers; (ii) minimum number of persons determining the daily policies of the branch, (iii) controlled and sound business operations; (iv) prudential supervision in the home state; (v) minimum capital, solvability and	For credit institutions, inter alia, the following requirements apply: (i) Minimum share capital of €18 million; (ii) certain limitation regarding the permitted activities / corporate purpose (iii) properness of internal organisation / internal control procedures - compliance with capital requirements that would apply to a Spanish credit institution (this requirement may be	In addition to the information and documentation which is typically provided for the establishment of branches of institutions based in other EU Member States, this authorisation request must be supported by (i) evidence of possibility of the branch ensuring the safety of funds entrusted to it, as well as the sufficiency of technical means and financial resources regarding the type and amount of transactions	Comparable to a full licence.








	France 	Germany 	Italy 	Netherlands 	Spain 	Portugal 	UK 
				liquidity requirements (requirements comparable to full license).	alleviated if the parent house assumes certain undertakings).	it intends to carry out, (ii) indication of geographical location projected for the branch, (iii) projected accounts for each of the first three years of activity of the branch, and (iv) declaration of commitment to deposit the allocated capital	
Additional Comments (exceptions available etc.)	French Prudential Control and Resolution may grant exceptions relating to certain regulatory requirements (general licensing requirement continue to apply).	The Federal Ministry of Finance may under certain requirements grant exemptions by way of an Ordinance relating to certain regulatory requirements (including licensing requirements).  To date, the Federal Ministry of Finance has granted exemptions relating to specific regulatory requirements for branches of credit institutions domiciled in the USA, Japan as well as Australia.*		Third country investment firm may request a dispensation from certain requirements (see above)			Generally possible to obtain authorisation for a third country branch only where it will carry on wholesale (non-retail) activities and is not of systemic importance. Regulatory attitude generally more favourable towards subsidiary models.
<b>4. Exemptions from License Requirements</b>							
Is there a specific exemption available to provide services without a license?	No	Yes	No	Yes	No	No	Yes (the “overseas person” exemption described above)

\* However, these exemptions only relate to specific regulatory requirements such as own fund requirements (general licensing requirements continue to apply).



	France 	Germany 	Italy 	Netherlands 	Spain 	Portugal 	UK 
Does the exemption only apply to financial services provided cross-border or also to services provided while being physically present in the territory?	N/A	Only on a cross-border basis	N/A	Both on a cross-border basis and while being physically present	N/A	N/A	Only on a cross-border basis
Does the exemption relate to the applicability of banking or financial services law (implementing CRD IV, MiFID) in general or to individual requirements (such as licensing, own funds, large exposure, corporate governance requirements) specifically?	N/A	Only individual requirements	N/A	Only individual requirements	N/A	N/A	Both, although any local requirements in the third country will apply.
Does the exemption also apply to the applicability of AML-requirements?	N/A	No	N/A	No	N/A	N/A	Yes, although any local requirements in the third country will apply.
Does the exemption only apply to certain groups of clients (e.g. professional clients, institutional clients) or subject to certain other requirements (e.g. use of local introducing agent)?	N/A	Yes  With regard to private clients the transaction must be brokered through a German licensed institution / EEA institution under the European passport. Following initiation of the client, future transactions can generally be conducted directly with the client.	N/A	No, but type of client is relevant.  Exemption from license requirements for investment firms established in Australia, USA and Switzerland available (certain ongoing obligations continue to apply). Exemption generally also applies to credit institutions from third countries which only wish to render investment services on a cross-border basis.	N/A	N/A	No, although the scope of the exemption is limited (as described above and is more straightforward to rely upon if the clients are institutional / professional only). Often the exemption effectively relies on the involvement in the transaction of a UK authorised firm.

	France 	Germany 	Italy 	Netherlands 	Spain 	Portugal 	UK 
<b>5. Booking Centers</b>							
Is it possible to introduce a third country firm/bank as contractual counter-party and booking center via a properly licensed agent in your jurisdiction without triggering license requirements for the booking entity?	No ("grey" area)	No ("grey" area)	No	No	No	No	Yes, in principle, subject to appropriate structuring.
Additional Comments	N/A	As a general rule, introduction of a third country firm as a booking center is only possible upon the client's request and initiative. "Grey" area in particular with regard to existing client relationships.	If the non-EU credit institution/investment firm sets up an Italian distribution network or cooperates with an Italian-based entity to acquire new clients, the activities carried out by the Italian entity on behalf of the foreign entity would be considered performed by the foreign entity. In such a case the latter must be duly authorised to promote and offer banking/investment services in Italy.	If the booking entity is rendering the financial services, license requirements will in principle be triggered.	According to the Spanish Securities Market Act, investment firms need to hold a licence and be registered with the CNMV in order to provide investment services, regardless such services are provided directly by the investment firm or indirectly through a licensed agent.	If the booking entity is rendering the financial services, license requirements will in principle be triggered.	Dependent on contractual arrangements but, in principle, it is possible for a UK authorised firm to enter into riskless principal (back to back) arrangements whereby a third country firm is used as a booking centre. Important to ensure that the third country firm does not hold itself out to the public market in such trades.
<b>6. Sanctions and Enforcement in case of a violation of the cross-border rules</b>							
Criminal offence	Yes, up to 3 years of imprisonment or criminal fine of up to €375,000	Yes, up to 5 years of imprisonment or criminal fine for individuals	Yes, imprisonment or criminal fine	Yes, up to 2 years of imprisonment (4 years in case of repeated offence), community punishment order or fine	No	Yes, up to 5 years of imprisonment (if the violation concerns taking deposits or other repayable funds from the public without due authorisation)	Yes, up to two years of imprisonment and an unlimited fine (plus potential liability for customer redress payments).

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Administrative offence	Yes, inter alia administrative fine of up to €100 million	Yes, inter alia administrative fine of the firm of up to €10 million	Yes, inter alia administrative fine ranging between €5,000 and €5 million	Yes, inter alia administrative fine, in principle up to €5million or 10% of the turnover of the past financial year	Yes, inter alia administrative fines or revocation of license	Yes, inter alia administrative fine ranging between €10,000 and €5,000,000.  If the economic gain doubled is more than the maximum amount of the applicable fines referred to above, then the highest value shall prevail.	Yes, inter alia regulatory fines unlimited. Generally calculated by reference to the size of the relevant business and any detriment to customers.
Invalidity of contract	No	Yes, depending on nature of the service / violation of the cross-border rule	Yes	No	No	No	Yes, contracts made through an unauthorised person are unenforceable against the counterparty unless determined otherwise by a court.
Potential civil law damage claims of client	Yes	Yes	Yes	Yes	Yes	Yes	Yes
What is the general attitude of your regulator when it comes to compliance with cross-border licensing requirements?	Neutral	Aggressive (possibly more tolerant with regard to institutional clients)	Rigorous	Aggressive	Rigorous	Aggressive (possibly more tolerant with regard to institutional clients)	Reasonably aggressive.

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