

Financial Advisers and Passporting

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This factsheet contains help and information for financial advisers who wish to advise their clients who live in Europe.

The Markets in Financial Instruments Directive (MiFID) means that, for the first time, investment advice must be regulated in all EEA States.

The UK secured an 'opt out' from MiFID for financial advisers. This means that UK financial advisers are not automatically subject to MiFID obligations.

However where a UK financial adviser is advising clients located in another EEA state it must ensure it satisfies the legal requirements of that state. It can do that by 'opting in' to MiFID and obtaining a passport for such services. This will prevent it needing authorisation in other Member States for those matters covered by the passport. This factsheet explains that process and gives further clarification to a matter that the FSA first raised in the MiFID Permissions & Notifications Guide, issued in May 2007.

This factsheet is essentially aimed at 'Personal Investment Firms', that is firms of advisers to which chapter 13 of the Interim Prudential sourcebook for Investment Businesses (IPRU-INV) applies.

Firms are responsible for determining the regulatory requirements applicable to their business and ensuring they comply with those requirements.

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These pages are intended to help financial advisers who advise clients that are located in another EEA State. It is relevant even if you do not have an office in another EEA State. For example, one of your UK clients moves to another European country, permanently or temporarily, and your firm continues to advise him while he lives there.

If you are a financial adviser, please read through the following stages carefully to decide what actions, if any, you need to take.

We have broken these down into three stages (including a recap on the effect of the Insurance Mediation Directive) and added some general passport Questions & Answers at the end.

- **Stage 1:** Think about what business you are doing and what passports you need
- **Stage 2:** Think about how you are conducting business with your clients
- **Stage 3:** Decide what, if anything, you need to do next

For more details about the scope of MiFID, see our 'Perimeter Guidance relating to MiFID': www.fsa.gov.uk/pubs/policy/ps07_05.pdf.

Stage 1: Think about what business you are doing and what passports you may need

You may need different passports to be able to give advice on different products, depending on what the product is – even if you are advising the same client on a range of products, or a small number of clients.

You may need one or more of the following:

- the Insurance Mediation Directive (IMD) passport – so you can give advice on insurance-based products to clients based in another EEA state; and/or
- the Markets in Financial Instruments Directive (MiFID) passport to be able to give advice on investments to clients based in another EEA state; and/or
- a domestic authorisation in the EEA State in question for business you conduct that falls outside the remit of any passport.

Whether you will need a passport to advise clients in other EEA States is first and foremost a matter of the law of those other EEA States. We cannot give guidance on the law of those other countries, so you may wish to take professional advice if you think your business is likely to be affected by these issues.

Subject to this, we outline below and in Stage 2 some of the questions to consider in deciding what to do next.

Q1: I am advising on an insurance product. What do I need to do?

To give advice to clients on an insurance-based product, then you will generally need to make sure that you have the right to passport under the IMD:

Activities that fall under the IMD are:

- 1) introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance;
- 2) concluding contracts of insurance; and
- 3) assisting in the administration and performance of contracts of insurance, in particular in the event of a claim.

If you only advise on insurance-based products, and do not advise on investments, then you only need to have the IMD passport. To get this, email passport.notifications@fsa.gov.uk requesting an IMD services passport to the relevant EEA State(s). If you advise on investment products as well as insurance-based ones, then you will need to continue reading.

Q2: I am advising on investments. What do I need to do?

To give advice to clients on an investment-based product, then you will generally need to make sure you have the right to passport under MiFID.

Remember that MiFID does not include all investment products. Investments falling within MiFID include shares and collective investment schemes but not life policies (which fall under the scope of IMD). For more details about MiFID investments, see chapter 13.4 and Annex 2 table 2 of our Perimeter Guidance (PERG) relating to MiFID www.fsahandbook.info/FSA/html/handbook/PERG/13.

Q3: What happens if I want to advise on business that does not fall under the IMD or MiFID?

If you only do business that does not fall under the IMD or MiFID, then there is no passport as such. You will need to look at the requirements, if any, of the relevant EEA State(s) to assess whether you need separate authorisation and regulation of such business in that country.

Stage 2: Think about how you are conducting business with your clients

You now need to think about how you are dealing with your clients, as this may be relevant to whether you are carrying on cross-border business. There are two main ways in which your firm may be conducting business throughout Europe:

- it may itself (or by using an appointed representative) be providing 'cross-border services' from the UK; or
- it may have an establishment or have 'tied agents' that do business on its behalf in another EEA State.

Q1: Do your clients always visit your UK offices to conduct business?

In this scenario, even though your clients live abroad for some of the year, you only conduct business with them on their return visits to the UK. In this case, we would not generally expect this to be cross-border services, although you may wish to check that the regulator where your client lives thinks the same.

Q2: Are you actively contacting your clients while they are in another EEA State? For example, do you provide advice to them by letter, email, or telephone or send them marketing communications?

If the answer to any of these questions is 'yes' then your firm may well be providing cross-border services. As well as considering whether you are providing investment advice, you may wish to consider whether you are providing the service of reception and transmission of orders (see chapter 13.3 of our Perimeter Guidance Q13 and 14).

Q3: Do your firm's advisers travel out to visit clients in another EEA State?

If yes, then your firm may well be providing cross-border services.

Q4: Do you have advisers who are resident in another EEA State and provide services from premises (home or office) in that State?

If the answer is 'yes', then your firm may well have a 'branch' in that EEA State.

Q5: Will your firm be using 'tied agents'?

Under MiFID, a firm may use tied agents to carry on advice and some other limited activities on its behalf. Where that agent is established in another EEA State, it will generally be treated as if it were a branch of that firm (for further details, see article 4.1.25 MIFID).

Stage 3: Decide what, if anything, you need to do next

If you have arrived at Stage 3, you may have to choose whether to opt into MiFID in order to continue to advise clients based in other EEA States.

If you are an authorised firm that wishes to opt into MiFID then we would normally expect you to submit a Variation of Permission (VOP) application, requesting the addition of the new standard requirement for 'exempt CAD firms' as defined in our Handbook.

Before permitting MiFID-exempt firms to opt into MiFID, our Permissions team will first need to assess whether the firm has, among other things, adequate systems and controls and financial resources in place to meet the requirements under MiFID.

Set out below is an overview of some of the key consequences of opting into MiFID. There are numerous detailed differences across the Handbook and you should not rely on the brief summary

that follows as being exhaustive or a substitute for reading the relevant provisions of the Handbook. You will need to satisfy yourself that your firm can meet the requirements of MiFID.

Please note that if a firm chooses to opt in to MiFID, these requirements will apply, as appropriate, to its domestic business and its cross-border activities.

Q1: What will 'opting in' to MiFID mean for me?

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- By opting into MiFID in order to give investment advice to clients in another EEA State, we expect your firm will become an 'exempt CAD firm'. This is assuming that it does not, amongst other things, hold client money or client assets in relation to its MiFID business. The prudential requirements for a personal investment firm which is an 'exempt CAD firm' are detailed in our rules (IPRU (INV) 13) and should be considered carefully.

Initial capital/PII requirements

- For an 'exempt CAD firm' which is not subject to the Insurance Mediation Directive (IMD) this will mean holding initial capital of €50,000 or professional indemnity insurance (PII) with a minimum level of indemnity no lower than €1 million for any claim and €1.5 million in aggregate, as set out in our rules (IPRU (INV) 13).
- A firm can opt for an initial capital/PII trade off providing the combination gives a coverage equivalent to either of the requirements separately.
- For an 'exempt CAD firm' which is subject to the IMD, broadly it must meet at least the IMD's PII requirement, as set out in IPRU (INV) 13, and have additional resources in one of the following forms:
 - initial capital of €25,000
 - PII of €500,000 for any one claim and €750,000 in aggregate; or
 - a combination of initial capital and PII resulting in an equivalent level of coverage to the options above.
- Under all the options above, a firm must have initial capital of at least £10,000 and must also meet an ongoing own funds requirement which is equal to the requirement for initial capital.
- The level of PII may need to be higher, depending upon the firm's relevant income (see IPRU (INV) 13.1.4(5) E).
- Firms should check with their PII providers that they are covered to provide cross-border investment services.

Financial Resources Tests

- An exempt CAD firm will also need to consider the Financial Resources Tests in IPRU (INV) 13. Depending on the nature of the firm's business, this may include an adjusted net current assets test and an expenditure-based requirement (a "low resource firm" is not subject to these tests).
- The Financial Resources Tests for a firm that opts into MiFID when it would otherwise be exempt because of the article 3 MiFID exemption (see, for example, PERG 13, Q48-50) are set out in IPRU (INV) 13.9 to 13.12. These firms are called "opted-in exempt CAD firms" in our Handbook.

Financial Resources Requirement

- The financial resources requirement for a personal investment firm which is an 'exempt CAD firm' is the higher of the requirement arising under the initial capital/PII requirements and the Financial Resources Tests. (See IPRU(INV) 13.1A.2R for further details.)
- For a summary of the financial resources tests in IPRU (INV) 13.9 to 13.12 (excluding "low resource firms"), see Table 13B (after IPRU (INV) 13.9).

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- MiFID firms are subject to the "common platform" provisions in SYSC 4-10.
- It will be important for the firm to consider these provisions, in detail, before applying to become a MiFID firm, in order to ensure their systems are able to satisfy the necessary provisions.
- Although organisational and systems and controls provisions in the common platform apply to non-MiFID firms as of 1 April 2009, in many cases this extension takes the form of guidance rather than rules. So if you are thinking about making a passport notification, one of the points you should consider is that more of the provisions in SYSC 4 to 10 will take the form of rules rather than guidance.
- As regards the difference in provisions applying to MiFID and non-MiFID investment firms from 1 April 2009, SYSC 1 Annex 1 Part 3 provides a summary.

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- There are several detailed differences in the way that conduct of business requirements apply, depending on whether business falls within the scope of MiFID. The significance of these differences will depend on the nature of your business (for example, they tend to be less significant if a firm is advising a retail client on packaged products).
- One of the most significant differences relates to the appropriateness regime (COBS 10), which requires an evaluation of the client's knowledge and experience for certain non-advised sales. This regime only applies to the direct offer sale of warrants and derivatives in the case of a non-MiFID firm, while it has much wider scope for MiFID business.
- Another significant difference concerns the operation of the inducements regime (COBS 2.3). Here, the disclosure requirements have wider scope for MiFID business. There is also an additional requirement to show that inducements are designed to enhance the provision of the service to the client.
- There are also some differences in the way that the exemptions from various requirements operate under the regime for communications with clients (COBS 4) and additional information is required in some cases (for example, in relation to comparisons under COBS 4.5.6).
- In addition, there are areas in which MiFID firms will be required to maintain their records for five years, while non-MiFID firms will only be required to maintain them for three years (although there may be wider reasons for firms to maintain records for a longer period).
- The differences between MiFID and non-MiFID status are likely to be particularly significant where a firm deals with professional clients. For example, wider suitability, prior information and reporting requirements apply (e.g. COBS 2.2, COBS 6.1, COBS 9, COBS 14.3 and COBS 16) and the thresholds for classifying a client as professional are generally tougher (COBS 3).

Other

- For further details about the difference between 'exempt CAD firms' and non-MiFID firms and the conditions attaching to being an 'exempt CAD firm', see Q58 and 59 of chapter 13 of our Perimeter Guidance relating to MiFID.

The Next Steps

- We have launched a special purpose application form for financial advisers seeking to become a MiFID firm in order to provide cross-border services. The form has two parts: a Variation of Permission application and Passport Notification, and can be found on the 'Applying for a Variation of Permission' webpage on the FSA website – <http://www.fsa.gov.uk/Pages/doing/regulated/notify/permissions/index.shtml>
- Please complete the form and send it to us as soon as possible – together with an application fee of £250.

- If you wish to establish a branch (including where relevant appointing a tied agent) in another Member State, you will need to complete a separate VOP application and passport notification.
- We will endeavour to process your application(s) as quickly as possible.

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Q1: What is passporting?

Passporting rights arise under the EU single market directives, which include IMD and MiFID. Under the directives, a person whose head office is in the UK and who is entitled to carry on an activity in another EEA State may either establish a branch in another EEA State or provide cross-border services into another EEA State, as long as they fulfil the conditions in the relevant directive. Passporting rights can be exercised after following notification procedures.

If a UK firm wishes to exercise passporting rights it must notify us it intends to do so. The notification must state whether the firm intends to establish a branch or merely provide cross-border services.

Q2: What do you mean by 'EEA State'? What countries can I passport into?

There are 29 (not including the UK) EEA States with passporting rights: Austria, Belgium, Bulgaria, Cyprus*, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden.

***Cyprus** – although the whole of Cyprus became part of the EU in May 2004, EU legislation only applies to the Republic of Cyprus (the Southern part of the island) and so passporting rights only exist to this extent.

Channel Islands & Isle of Man – the IMD and MiFID do not apply in these territories, even though they are Crown dependencies. This means that firms based in these territories are treated in the same way as firms based in a non-EEA State and do not have passporting rights.

Similarly, UK firms do not have passporting rights in relation to the Channel Islands and the Isle of Man. As such, UK firms will have to apply direct to the relevant financial regulators in each territory for permission to conduct business there. We have no formal involvement in this process (although we would expect firms to keep supervisors here informed of their activities).

Gibraltar – Gibraltar enjoys a separate status to the Channel Islands and Isle of Man and the IMD and MiFID apply to it in full. The UK and Gibraltar have agreed special arrangements for passporting under the Gibraltar Order.

Switzerland – Switzerland is not an EEA State and so there are no passporting rights under the IMD or MiFID.