Government Response to The House of Lords' European Affairs Committee's Report

The UK-EU Relationship in Financial Services

Introduction

The Government welcomes the House of Lords' European Affairs Committee's Report on the UK-EU Relationship in Financial Services. We are grateful to the Committee and to the individuals who provided evidence for the report, and have considered the evidence, findings, and recommendations carefully.

Key Committee Conclusions and Government Responses

1. **The Committee asks the Government, in its response to this report, to provide a detailed breakdown of the figures for PAYE and corporate tax receipts for the previous five years, to support the Economic Secretary's view in his evidence that tax receipts from the financial services sector have been resilient since Brexit. (Paragraph 13)**

   Corporation tax receipts from the financial services sector have remained resilient over the latest five years for which official HMRC statistics have been published. Receipts from the financial and life assurance sectors totalled £10.6bn in 2020-21, £12.7bn in 2019-20, £10.5bn in 2018-19, £11.7bn in 2017-18, and £10.1bn in 2016-17. With regards to the reduction in receipts between 2019-20 and 2020-21, it is worth noting that onshore Corporation Tax receipts decreased across all broad industry sectors by an average of 17% over the same period; this can be substantially attributed to the impact that COVID-19 had on profitability, and the impact of a payment timing change for very large companies. A more detailed breakdown can be found at: https://www.gov.uk/government/statistics/corporation-tax-statistics-2021.

   PAYE receipts from the financial services sector have also remained resilient over the latest five years for which official HMRC statistics have been published. Receipts from Financial and Insurance activities accounted for 16.4% of Income Tax deducted from pay via PAYE in 2019-20, 16.6% in

2018-19, 17% in 2017-18, 17.2% in 2016-17, and 16.6% in 2015-16. Financial and Insurance activities account for the largest share of Income Tax deducted from pay. Statistics for employee National Insurance Contributions paid via PAYE by sector are not routinely published. Further detail can be found at: https://www.gov.uk/government/statistics/income-tax-deducted-from-pay-2000-to-2011/income-tax-deducted-from-pay-statistics-2018-to-2019-to-2019-to-2020.

HMRC also publishes detailed tax receipts from the banking sector, which forms a substantial part of the wider financial services sector. These receipts have remained resilient over the latest five years for which statistics have been published. Combined PAYE, Corporation Tax, Bank Levy and Bank Surcharge receipts from the sector totalled £28.8bn in 2020-21, £30.2bn in 2019-20, £30.1bn in 2018-19, £30.6bn in 2017-18, and £30.3bn in 2016-17. Further detail can be found at: https://www.gov.uk/government/statistics/paye-and-corporate-tax-receipts-from-the-banking-sector-2021.

2. **We welcome the fact that, overall, the UK financial services sector remains optimistic about its prospects for the future, and that significantly fewer jobs have so far left the sector than had been anticipated. This demonstrates both the continued strength and the resilience of the sector in the UK. (Paragraph 46)**

3. **We warn, however, against any complacency in this regard, as it is not clear whether the full impact has yet played out. We note that there are many factors, both ongoing and on the horizon, including EU regulatory and political decision-making, that may have a significant impact on the sector, with the risk that further jobs will move out of the UK. (Paragraph 47).**

As the Chancellor set out in his Mansion House speech on 19 July, the UK's financial services sector is fundamentally strong, and the Government is seeking to grasp the opportunities ahead to deliver its vision for a sector which is open, green, technologically advanced and globally competitive.

Over the coming years, the Government will implement a sweeping set of reforms to sharpen the UK's competitive advantage in financial services, making sure the sector continues to deliver for communities and citizens across the UK, and working internationally to set higher standards around the world. The Financial Services and Markets Bill, introduced on 20 July, will deliver on the Government's ambitious vision for the financial services sector to promote and enhance the UK's position as a global leader.

4. **The fragmentation of job moves across EU financial centres highlights that no single EU financial centre has so far emerged as a serious rival to London. Nevertheless, the Committee is concerned that fragmentation could raise cost and reduce liquidity for businesses served by the UK and EU financial services sectors. We urge the Government to work with the EU, and its institutions, to ensure that London is able to maintain the depth and liquidity needed in order to continue to function as the prime source of capital for the European market. (Paragraph 48).**

   The Government has been clear that the UK has an abiding interest in a prosperous and productive Europe.

   The Government continues to engage with the institutions and member states of the EU, and we stand ready to sign the Memorandum of Understanding on regulatory cooperation in financial services once the EU side is ready to.

5. **We note the movement of assets and infrastructure out of the UK. We ask the Government to set out what steps it is taking to monitor this and to ensure that it does not harm the competitiveness, profitability, or operational capabilities of the UK's financial services sector. We also ask the Government to set out in its response to this report what assessment it has undertaken of the costs and risks to the sector and the wider UK economy by the movement of assets and infrastructure out of the UK following Brexit. (Paragraph 51)**

   The Government and the financial services regulators continue to closely monitor Brexit-related restructuring in the UK financial services sector, including through a regular programme of engagement with financial services firms.

On asset relocations, as a comparison to EY's 1.3tn figure, New Financial estimated in April 2021 that more than £900bn of bank assets have been or are being moved (roughly 10% of the UK banking system), whilst more than £100bn in assets and funds have been moved by insurers and asset managers. On infrastructure, FIA statistics show that UK CCPs remain two of the three largest CCPs in the world, as measured by initial margin, which suggests that the UK continues to be a global leader in clearing.

6. **We support the Government's broad policy aims for the financial services sector, as far as they go, and hope that these will be enacted in a proportionate and evidence-based way. (Paragraph 59)**

7. **We ask the Government in its response to this report to set out the specific steps it has taken and is proposing to take to fulfil the ambition and promise of the aims set out in the Chancellor's 2021 Mansion House Speech and in 'A new chapter for financial services'. (Paragraph 60)**

At his Mansion House speech on 19th July, the Chancellor emphasised the Government's commitment to a sector which is open, green, technologically advanced, and globally competitive. He noted the importance for the sector of taking advantage of the opportunities afforded by Brexit.

The Chancellor highlighted the introduction of the landmark Financial Services and Markets Bill on 20 July – the most significant Financial Services Bill in over a decade – repealing retained EU law and introducing secondary growth and competitiveness objectives for the regulators. The Bill will also:

- Provide us with the powers to implement planned reforms to Solvency II.
- Reform the rules that regulate the UK's capital markets to deliver a rulebook that is fair, outcomes-based and supports competitiveness, while ensuring the UK maintains the highest regulatory standards;
- Harness opportunities of innovative technologies, including the use of stablecoins as a means of payment;
- Ensure people across the UK continue to be able to access their own cash with ease; and
- Introduce additional protections for those investing or using financial products and support the victims of scams.

The Chancellor also set out how the Government is delivering on its vision through a number of other workstreams, making sure the UK remains the most open, competitive, safe, and transparent place to do financial services business in the world. These include:

- making capital raising by listed companies more efficient by accepting all recommendations made to Government in Mark Austin's Secondary Capital Raising Review;
- taking forward work to understand the different ways Distributed Ledger Technology (DLT) could be applied to a UK sovereign debt instrument;
- working with the City of London to deliver the *State of the Sector: Annual review of UK financial services 2022* report. The report outlines key performance indicators, comparing the performance of the UK's financial services sector with those of other major economies. It also summarises the steps Government and regulators are taking to improve the overall environment for the sector and the wider ecosystem, and identifies potential areas for further reform.

8. **Despite our broad support for the Government's policy aims, it is important that the Government ensures financial services policy is not focused too heavily on the City of London alone. We therefore ask the Government to provide a full explanation of how it intends to support those parts of the sector operating throughout the rest of the UK with respect to the UK's evolving relationship with the EU. (Paragraph 61)**

The Government has set our strategy for financial services cognisant of the pan-UK nature of the sector. The financial services sector plays an important role across all four nations of the UK, each of which add to the £261 billion that the sector and related professional services contributes to the UK's gross value added.

Over 2.3 million people in the UK work in financial and related professional services, with two thirds of this employment based outside of London, including over 52,000 in Birmingham, over 50,000 in Manchester and over 48,000 in Edinburgh.

We are using our new freedoms to build on our historic strengths as a global financial centre and develop our relationships with jurisdictions all around the world, attracting investment and increasing opportunities for cross-border trade throughout the sector and throughout the country.

9. **We welcome the UK's open approach to granting its own equivalence decisions. We view this openness as one of the UK's great strengths in navigating its global relationships in the post-Brexit era. (Paragraph 72).**

10. **We regret that the EU has opted not to grant equivalence to the UK in a number of areas where it would be beneficial to market actors in the UK and the EU. We note that the Government does not consider the lack of equivalence in these areas to pose a significant problem, despite the effort originally expended in submitting information to the EU as part of the latter's consideration of the UK's regime. (Paragraph 100).**

11. **However, we recognise that further equivalence decisions are ultimately a matter for the EU. We therefore agree that it would be misguided to base the UK's future strategy for the sector on something that is not in the Government's gift and that currently seems unlikely to be forthcoming. (Paragraph 101)**

12. **Contrary to the Committee's expectations at the outset of this inquiry, we recognise now that the low number of equivalence decisions is not seen within the sector as a matter of fundamental concern. The sector has successfully adapted to operating without equivalence and sees limited benefit now in making further adaptions to accommodate it. We also recognise that the EU currently seems unlikely to grant further equivalence decisions without the UK constraining its regulatory flexibility and ability to diverge. (Paragraph 102)**

13. **Although the imbalance between the number of decisions the EU has granted to the UK compared to other jurisdictions is striking, the evidence we received suggested that the impact of this on UK competitiveness has been limited. We also recognise that not all equivalence decisions are equal and that most granted to other jurisdictions are unconnected to the crucial issue (as far as the UK is concerned) of market access. (Paragraph 103).**

14. **We ask the Government, in its response to this report, to set out the extent to which it believes there to be a competitive disadvantage as a result of the imbalance in equivalence decisions, and how it intends to address any such competitive disadvantage. (Paragraph 104)**

As the Committee set out in its report, other jurisdictions receiving more equivalence decisions from the EU will not in itself create a competitive disadvantage for the UK, as only certain equivalence decisions within the EU's overall framework directly grant market access to overseas jurisdictions. Equivalence decisions do not just encompass market access, as the Committee highlighted; some equivalence decisions remove regulatory barriers for domestic firms engaging in overseas markets, or provide exemptions from certain requirements for central banks and other public bodies.

The Government is taking advantage of opportunities to strengthen ties to financial markets outside the EU. A key example of this is the Mutual Recognition Agreement currently being negotiated with Switzerland; this will facilitate trade across a broad range of financial services, based on high regulatory standards and cooperation. We also undertake regular financial dialogues with the world's leading financial centres; for example, we established the UK-Japan Financial Regulatory Forum in June and committed to use it to explore options to increase interconnectedness between our markets.

15. **We also note that there is continued medium-term uncertainty. While the lack of equivalence has been less detrimental than anticipated prior to the end of the transition period, this has partly been as a result of specific business model adaptations. (Paragraph 105)**

16. **The Committee regrets the fact that the UK-EU Memorandum of Understanding on regulatory cooperation is still not in place, despite technical negotiations having concluded more than a year ago. The Committee notes the widespread view that the MoU has become a casualty of wider tensions between the Parties, particularly regarding the implementation of the Protocol on Ireland/Northern Ireland. (Paragraph 113)**

17. **We consider the lack of a structured mechanism for regulatory cooperation on financial services between the UK and the EU to be particularly striking given that both the UK and the EU have established structured dialogues with other partners, notably with the United States. (Paragraph 114)**

18. **We consider that the Government's overall objective should remain the earliest possible entry into force of the Memorandum of Understanding and that, as and when it enters into force, the Government should make the fullest use of the dialogue established to work for effective cooperation with the EU in this important sector. (Paragraph 115)**

19. **The Committee acknowledges that the non-implementation of the Memorandum of Understanding does not appear to have posed major practical problems to date, particularly as it is a tool for political cooperation rather than something that, in itself, facilitates market access. However, the Memorandum of Understanding would provide a useful mechanism and structure for future strategic dialogue and cooperation between the UK and the EU, and the Committee considers that its implementation would benefit both sides. (Paragraph 124)**

20. **We caution the Government against complacency in this area. Despite the limited impact of the non-finalisation of the Memorandum of Understanding to date, its real value is likely to be found in the future as the UK and the EU diverge, particularly in the event of cross border financial services developments and potential future crises that may require transnational solutions. (Paragraph 125)**

    The Government notes the Committee's conclusions regarding the Memorandum of Understanding on Financial Services Regulatory Cooperation (MoU).

    The Government is ready to sign the MoU, but further steps are required on the EU side before the MoU will come into effect and the UK-EU Forum can be convened.

    The UK and EU's financial markets are deeply interconnected, and building a constructive relationship is of mutual benefit to both of our financial markets.

We stand ready to operationalise the forum and continue to engage with EU authorities in the meantime bilaterally and through multilateral fora.

Regarding conclusion 20, the Government agrees with the Committee that the MoU will be a valuable tool as the UK and EU's regulatory regimes evolve to adapt to the needs of their respective markets, as well as in the event of cross border financial services developments and potential future crises that may require transnational solutions.

21. **The Committee welcomes the series of bilateral Memoranda of Understanding that have been agreed between UK and European regulators and supervisors at both EU-wide level and Member State level. These appear to be working well and have meant that day-to-day regulatory and supervisory cooperation has continued despite the lack of a higher-level UK-EU Memorandum of Understanding. (Paragraph 130)**

22. **Alongside formal regulatory cooperation, the Committee urges the Government to increase its political and diplomatic engagement on financial services both with the European Commission and with key Member State capitals. (Paragraph 133)**

Over the last twelve months, the Government has pursued an ambitious programme of engagement with the EU institutions and member states, and the European Economic Area and Switzerland.

The former Economic Secretary travelled to Madrid, Luxembourg, Brussels and Berlin, to engage with his counterparts, financial services industry, and in some cases, regulatory and supervisory authorities.

The former Minister also travelled to Lichtenstein and to Switzerland to discuss the Government's ambitious agenda in financial services.

HM Treasury officials have relationships with their counterparts across the EU and its member states and are in regular contact to discuss matters of policy.

The Foreign, Commonwealth and Development Office as well as the Department for International Trade have teams across their European network of posts engaged in promoting the country's financial services priorities.

The Government has been clear that it has an abiding interest in a prosperous and productive Europe, and on financial services, our engagement
with the EU clearly demonstrates this.

23. **While welcoming news of the Economic Secretary's recent meeting with the European Commissioner for Financial Services, we are concerned that such meetings are not taking place with the structure or regularity needed for close UK-EU cooperation. Notwithstanding the importance of establishing a more comprehensive structure for regulatory cooperation with the EU, we therefore recommend that these meetings take place at least once a year and are used as a forum for discussing regulatory cooperation and raising any issues of concern. (Paragraph 134)**

The Government notes the Committee's conclusion 23 (Paragraph 134) regarding UK-EU regulatory cooperation.

The Government remains committed to a position of openness and cooperation with the European Union and continues to engage with EU counterparts to strengthen relations and promote the Government's overall aims of openness and cooperation.

As noted elsewhere, the Government is ready to sign the MoU on financial services regulatory cooperation, that will establish a structured dialogue, when the EU side is ready to.

24. **Although the retention in primary legislation of key aspects of EU financial services law at the point of the UK's departure from the EU was the right decision for regulatory stability, it now means that the UK regulatory framework for financial services is complicated, unwieldy, and difficult to amend. Accordingly, the Committee welcomes the Government's Future Regulatory Framework Review. (Paragraph 144).**

25. **The Committee notes that, as a result of the Future Regulatory Framework Review, the Government is considering introducing an additional, secondary**

'competitiveness' objective for the Financial Conduct Authority and the Prudential Regulation Authority. However, it is equally important for the UK's overall economic competitiveness for the Government and regulators to work together to develop a broader regulatory culture that is responsive, consistent, and proportionate. (Paragraph 151)

26. **We ask the Government, in its response to this report, to explain in further detail how a secondary 'competitiveness' objective would be applied by the regulators in practice and how success will be measured. (Paragraph 152)**

The Financial Services and Market Bill was introduced into Parliament on 20 July. This Bill implements the outcomes of the Future Regulatory Framework (FRF) Review, repealing retained EU law in financial services, and replacing it with an approach to regulation that is designed for the UK. Further detail can be found in the Bill's explanatory notes.

The Bill introduces new secondary growth and competitiveness objectives for the PRA and the FCA, which will ensure that for the first time the regulators can act to facilitate medium to long-term growth and international competitiveness. Now we have left the EU, and as the regulators take on responsibility for setting rules following the repeal retained EU law, it is right that the regulators' objectives reflect financial services' critical role in supporting the economy.

This approach strikes the right balance as it introduces a new focus on these important issues while maintaining the regulators' focus on their existing objectives of ensuring that UK firms remain safe and sound, that the UK's markets function well, that there is effective competition in the interests of consumers, and that consumers and users of financial services receive an appropriate degree of protection.

The regulators will be responsible for operationalising their new objectives. The Government expects that there will be a step—change in the regulators approach, similar to the introduction of the PRA's secondary competition objective in 2014. The introduction of this secondary competition objective led to a number of policies to facilitate effective competition including to make the calculation of regulatory capital requirements fairer in retail banking, levelling the playing field and reducing barriers to entry. This had led to the authorisation of 30 new UK banks over 9 years. The PRA has also indicated its ambition to go further to ensure a proportionate regime and promote competition now that the UK has left the EU via their ‘Strong & Simple’ initiative for smaller banks and building societies.

The Financial Services and Markets Bill places a requirement on both regulators to report on their performance against their growth and competitiveness objective on an annual basis. This is similar to the PRA’s current reporting requirement for its secondary competition objective. The same requirement will apply to Bank of England in its exercise of its new secondary objective to facilitate innovation in the provision of FMI services.

27. **The Committee agrees with the Government that, in the interests of flexibility, agility and proportionality, many of the regulations currently contained within primary legislation would be more appropriately managed by the regulators themselves. However, it is essential that this transfer of powers is accompanied by appropriate mechanisms for Parliament to scrutinise the regulators and hold them to account, and that the regulators are given sufficient resources to allow them to accommodate the increase in their workloads resulting from such a change. (Paragraph 160)**

28. **The details of parliamentary scrutiny and accountability of the regulators are a matter for Parliament, but we ask the Government to commit to facilitating the establishment of appropriate mechanisms as necessary. (Paragraph 161)**

The Government notes the Committee’s view regarding appropriate mechanisms for Parliamentary scrutiny and accountability of regulators and shares the observation regarding the importance of these matters for financial regulators. The Government also notes that determining the best structure for Parliamentary scrutiny and accountability of financial regulators of these matters is for Parliament.

The Government however also notes the Committee’s request.

The Financial Services and Markets Bill includes two measures that build on the existing arrangements for Parliamentary scrutiny of the regulators, and seek to ensure that Parliament has the appropriate tools to conduct scrutiny of regulators’ rulemaking and other functions in the manner that it sees fit.

These measures in clause 36 of the Bill require the regulators to notify the Treasury Select Committee of any consultations they publish, and to respond in writing to representations to their public consultations made by Parliamentary committees.

The regulators, as operationally independent non-governmental bodies, are responsible for ensuring that they are resourced appropriately to discharge their responsibilities. They publicly consult on their annual budgets, which are funded by levies on financial services firms.

29. **The Committee recognises the need for continued scrutiny of ongoing and future developments that might affect the sector. In this regard, we welcome the Chancellor of the Exchequer's commitment to make an annual 'State of the City' report to Parliament, as proposed by Lord Hill in the UK Listings Review. (Paragraph 167)**

30. **The Chancellor has committed to presenting the first of these 'State of the City' reports this year, but it is unclear when this will be; the Government should provide clarity on this. We recommend that this report includes for at least the next five years a section dealing expressly with the UK-EU relationship in financial services. (Paragraph 168)**

The first 'State of the Sector' report was jointly published by HM Treasury and the City of London Corporation on 20 July.

The report outlines key performance indicators, comparing the performance of the UK's financial services sector with those of other major economies. It also summarises the steps Government and regulators are taking to improve the overall environment for the sector and the wider ecosystem, and identifies potential areas for further reform.

The report shows that there is strong agreement that the Government's vision for the sector is focussed on tackling the right challenges to retain the UK's place as a world-leading financial services hub. But there are clear challenges from industry to do more, for example on regulator authorisations, and ensuring we continue to push to be at the forefront of international standards on emerging areas such as green finance and fintech. These are issues that Government and regulators will be focussed on going forward.

The Government is committed to working with industry and consumers to ensure that the UK's financial service sector remains world-leading and continues to deliver the services needed by everyone across all four nations of the UK. And as set out in this report, there is a wide range of work underway already. Further announcements on specific next steps will follow, but we are already looking forward to the next report.

31. **The Committee welcomes the launch of a series of reviews into the regulatory framework governing financial services that the UK inherited from the EU. The Committee is concerned, however, that progress on some of these reviews appears to have stalled. (Paragraph 174).**

32. **The Committee asks for an update on the progress of the various reviews into the regulation of financial services in the Government's response to this report. (Paragraph 175)**

In addition to the FRF Review, which is being implemented through the Financial Services and Markets Bill, the Government has undertaken a number of reviews into specific parts of retained EU law, as identified by the Committee in its report.

The Financial Services and Markets Bill implements the most urgently needed reforms from the Wholesale Markets Review, to boost UK markets' competitiveness while maintaining high standards.

The Bill repeals retained EU law relating to financial services, and provides the Treasury with the necessary powers to deliver a number of reforms, including the outcomes of Lord Hill's UK Listing Review and the reforms to Solvency II. This will all be subject to the normal process of consultation by Government and regulators.

The Government is prioritising those areas that offer the greatest potential benefits of reform. The Government will set out further detail on the rest of its reform programme in due course.

33. **Diverging from EU law may present opportunities for the UK's financial services sector, and the Committee notes the sector's positivity about**

pursuing these opportunities. Much of the inherited acquis was designed to cater to 28 countries, and Brexit provides an opportunity for the UK to innovate and to tailor the regulation of its financial services sector to reflect the UK's own interests. (Paragraph 187)

34. **It is nonetheless vital that the Government balances the benefits of reform against the cost of implementing new rules, and that the sector is not now subject to a constant process of piecemeal change. Some pieces of EU regulation were unpopular with businesses when they were implemented but are now regarded by the sector as a sunk cost, further reform of which would impose an additional, unnecessary cost burden on the sector. (Paragraph 188)**

The Government notes the Committee's recommendation. In order to implement the outcomes of the FRF Review, the Financial Services and Markets Bill will repeal retained EU law in financial services, so that it can be replaced with an approach to regulation that is designed for the UK.

The Government and the regulators recognise the importance of providing stability and continuity for firms and their customers by avoiding unnecessary changes. The Government does not intend to pursue change for its own sake, but in order to pursue better outcomes, and to ensure that rules are appropriately tailored to the UK.

In terms of the process for doing so, the repeal is subject to commencement, and each individual piece of legislation listed in the Bill will only cease to have effect once the Treasury lays an Order commencing the repeal. The Treasury will only commence a repeal when the necessary secondary legislation and rules are in place to replace it in domestic legislation. This will be a coordinated process between Treasury and the regulators, and the Government and the regulators will ensure that there is sufficient time for HM Treasury and the regulators to consult where necessary, and that there is a sufficient time for firms to adapt to any rule changes before they are applied.

This approach will allow the regulators to ensure that the rules are properly tailored for the UK markets. When making new rules to replace retained EU law, regulators will doing so under an enhanced accountability framework, including the new secondary objectives on growth and international competitiveness and a new Cost-Benefit Analysis panel. It will also mean that the rules can be more efficiently updated in the future, for example in response to new global standards, or to take account of new business models.

35. **UK-EU divergence will also be driven by future regulatory changes on the part of the EU. The Committee notes the contrast between the UK's approach of an internationally open financial services sector and the EU's prioritisation of control and market location as part of its drive for 'open strategic autonomy' and is concerned that the latter could lead to increased barriers to cross-border trade in financial services. (Paragraph 195)**

36. **After the UK's exit from the EU, it was inevitable that the UK would lose the ability as a Member State to influence the EU's legislative processes directly. Nevertheless, the Committee is concerned by the Government's apparent unwillingness to use its wider influence and diplomatic resources in order to engage with the EU and its institutions to further the UK's interests, as other third countries do. (Paragraph 196)**

37. **The Committee asks the Government to clarify its approach to engaging politically and diplomatically with the EU and its institutions to support and advance the interests of the UK's financial services sector in the EU's legislative decision-making processes. (Paragraph 197).**

38. **Notwithstanding the inevitability of UK-EU divergence on the details of financial services regulation, and the opportunities this is likely to afford the UK's financial services sector, in the long-term, the Committee considers that there is a strong case for pursuing global convergence on the principles and outcomes of the regulation of financial services. (Paragraph 200)**

The Government notes the Committee's conclusions (35-38).

Following the UK's exit from the European Union, the UK and the EU are two separate, independent jurisdictions, and equal partners.

As noted in other elements of this response, the Government continues to engage with EU Institutions and Member States on issues of joint interest.

The Government continues to pursue a proactive strategy of engagement with the EU institutions and Member States. This includes through the UK network of embassies, including the UK Mission to the EU in Brussels, and through direct engagement between HM Treasury ministers and officials with their counterparts.

The Government has been clear that the UK already has one of the world's most robust regulatory regimes, and it remains committed to the highest standards of financial services regulation. The UK has a long history of membership of the various international financial services bodies, such as the Financial Stability Board and the Basel Committee, and we have been clear that we will continue to make the case for international cooperation and global standards in this sector.

39. **In terms of data flows between the UK and the EU, the Committee recognises the possibility that the Government's plans for reform of the UK's data protection rules could lead to the withdrawal or non-renewal of the EU's data adequacy decision for the UK. This could have consequences for a range of service providers engaged in cross-border personal data transfers, including for some financial services providers, primarily those handling retail business. (Paragraph 211)**

40. **The Economic Secretary told this inquiry that the decisions the Government will take on the UK's future data protection regime will "reflect what is right for the UK interest". In the Committee's view, it is in the UK's interest that it continues to benefit from the EU's positive data adequacy assessment. (Paragraph 212)**

41. **While the future of these adequacy decisions is ultimately a matter for the EU, the Committee urges the Government to ensure that it carefully considers the implications of losing data adequacy, including for the financial services sector, into its future changes to the UK's domestic data protection framework, particularly under the forthcoming Data Reform Bill. (Paragraph 213)**

The Committee rightly recognises the importance of data flows between the EU and UK for our financial services industry. Since the former Economic Secretary's appearance at the Committee, the Government has published its response to the consultation 'Data reform: a new direction' setting out its ambitious, pro-growth agenda that maintains high standards of data protection. The Data Protection and Digital Information Bill was introduced to parliament on the 18th July.

The UK benefits from a positive data adequacy decision from the EU. This decision does not require a country to have the same rules, but they must be essentially equivalent. The UK is firmly committed to maintaining high data protection standards - now and in the future. Our reforms are underpinned by this commitment and we view them as compatible with maintaining flows of personal data from the EU. Whilst this is ultimately a matter for the EU, it remains reasonable to expect to maintain EU adequacy whilst designing a future regime that reflects what is right for UK interests.

The Government will continue to engage with the EU as appropriate with a view to ensuring our reciprocal arrangements for free flow of personal data can remain in place.

As noted by the Committee, service providers can adopt alternative transfer mechanisms in the event that the EU were to make changes to its adequacy decisions. Any disruption to adequacy would take a period of time to come into effect and the Bank of England's Financial Policy Committee previously judged that large UK financial services firms were well advanced in mitigating against non-adequacy in the run-up to the end of the Transition Period.

The new International Data Transfer Agreement (IDTA) and Addendum came into force on 21 March 2022 as an alternative transfer mechanism, replacing the Standard Contractual Clauses (SCCs) inherited from the EU which are being phased out. IDTAs are clearer and easier to use than SCCs, and this should facilitate adoption of alternative transfer mechanisms where required.

42. **The Committee welcomes the Government's comprehensive and forensic approach to developing the regulatory and trading structures for innovative and novel products and technologies, including through high-profile Government-sponsored reviews such as those for green finance and FinTech. In particular, we welcome the UK's pioneering role in establishing 'regulatory**

sandboxes' for FinTech, which have since been imitated in other jurisdictions. (Paragraph 233).

43. **The Committee urges the Government to prioritise leadership and cooperation with its global partners in the establishment of global standards for novel and innovative products and technologies. In particular, we urge the Government to cooperate closely with the EU and other major jurisdictions on their respective approaches to Green Taxonomy, while ensuring that the UK's own approach is environmentally sound and grounded in science. (Paragraph 234)**

    One of the key principles guiding the implementation of the UK Green Taxonomy is for the Taxonomy to be built for the UK to support a global transition. This means the Government will take an approach that is suitable for the UK market and consistent with UK Government policy, but that there will also be a clear focus on the benefits of coherence and compatibility with other international frameworks. The UK has joined the International Platform on Sustainable Finance (IPSF), which allows us to work with our international colleagues to support the development of common international standards on Taxonomies.

    The UK Taxonomy also takes an objective and science-based approach to assessing sustainability. To support this, the Government created a Green Technical Advisory Group (GTAG) to provide independent advice on market, regulatory and scientific considerations, around developing and implementing the Taxonomy.

44. **The Committee welcomes the Government's innovative approach to securing market access for the UK's financial service sector and, in particular, hopes for the successful conclusion of a Mutual Recognition Agreement with Switzerland. (Paragraph 240)**

45. **We urge the Government to continue to innovate and learn from its successes as it pursues further Mutual Recognition Agreements. While we note the traditional limitations of Free Trade Agreements with respect to financial services, the Government should continue to seek to embed the**

interests of financial services in the Free Trade Agreements it pursues as much as possible. (Paragraph 241)

The Government notes this recommendation and remains committed to pursuing the UK's interests for financial services in all our free trade agreements. Free trade agreements offer the opportunity to seek closer cooperation in financial services between governments and regulators – an example would be the annexes for regulatory cooperation recently agreed by the UK with Japan and Australia.

46. **The Government is right not to adopt a 'Fortress UK' approach, and to prioritise openness. The Committee also welcomes the Government's non-reciprocal approach to maintaining the UK's openness to external participation in its financial markets and wider financial services sector. The Committee urges the Government to adopt a principle of openness in all aspects of its regulation and support of the UK's financial services industries. In this regard, the Committee urges the Government to continue to recognise the importance of immigration and access to talent to the openness of the sector. (Paragraph 248)**

The Government notes the Committee's conclusion.

The Government remains committed to a position of openness and cooperation with all our friends and partners across the globe, including the European Union.

The UK has an internationally respected and innovative ecosystem for financial services, and access to talent and skills is a key component which contributes to the competitiveness of our sector. The Government is committed to ensuring the UK remains the location of choice for top talent and innovative businesses from across the world. Our Points-Based Immigration System provides simple, effective and flexible arrangements for skilled workers from around the world to come to the UK. This includes attractive and competitive visa offers, such as the Skilled Worker and Graduate routes.

In Build Back Better: our plan for growth (March 2021) and the UK Innovation Strategy (July 2021) the Government announced targeted high-skilled visa reforms, which included a:

- New Global Business Mobility route which opened in April 2022, to streamline several existing offers and make it easier for overseas businesses to transfer staff to the UK.
- New High Potential Individual visa, available from May 2022, for those who have recently graduated from a non-UK university ranked in the global top 50.
- New offer for Scale-ups that launches in August, to help fast-growing businesses bring in the talent they need to grow and drive innovation.
- Reformed Innovator visa from the autumn, to make it easier for those with the skills and experience to found, and invest in, innovative businesses in the UK.
- New Global Talent Network from the end of the 2022, to attract talent from across the globe in Science and Technology, with an initial focus on the San Francisco Bay area, Boston, and Bengaluru.