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1. **What is the difference between the UK's ability to sell financial services into the EU under the current passporting regime and (a) the equivalence arrangements for financial services and (b) no EU equivalence decisions for financial services for the UK?**

The differences are related to the degree of market access and to the procedures that are necessary for such market access to be secured. Before delving into more specific differences between the UK's ability to sell financial services in each of these scenarios, there are two broader considerations that seem relevant. First, losing access to the passporting regime will lead to a loss of clarity and more complexity: as the EU passporting regime is very broad and comprehensive, whereas equivalence and the other means of access to the EU market are a patchwork with different sets of rules for different market segments, there is more variation as to what will need to be done to secure market access. Second, the impacts of losing access to passporting will also vary: some financial services that were covered under the passport do not have equivalence frameworks that provide market access.

<u>Passporting</u>

Under the EU passport, authorisation from a single national competent authority allows firms to provide financial services and open branches across Member States with either very few or no additional authorisations and without being subject to duplicate supervision. Because of that, the passport depends on the adoption of the common corpus of EU financial regulation, as it implies in the mutual recognition of licences and supervisory capacity.

The passporting regime is quite comprehensive, as it includes: (i) retail and investment banks; (ii) asset managers; (iii) trading and market infrastructure such as exchanges, central counterparties and trading platforms; (iv) private equity and venture capital; (v) hedge funds; and (vi) insurance companies.

As mentioned, the impacts of losing access to the passport will vary, both across these different segments and across a single market segment. For instance, there are no equivalence frameworks for retail banking, which would therefore create a need to incorporate capitalised subsidiaries inside the EU to retain access to the Single Market. In the insurance segment, the Solvency II equivalence regime only allows market access for reinsurance, so a portion of the industry would not benefit from equivalence.

There are some instances where third countries can theoretically benefit from passporting rights. For example, in the asset management industry, AIFMD allows for third-country market access to the Single Market but limited to wholesale clients and subject to an assessment by ESMA, for which there is no clear timeframe. The equivalence regime under MiFIR (Articles 46 and 47) also allows access for a passport (although at the cost of some conditionalities, as we will discuss later on). However, the AIFMD regime has not even been activated and at least so far the Commission has not provided any equivalence decision to enable the MiFIR regime to be used to allow market access for third country financial services. There have also been discussions about killing off the AIFMD regime altogether. The actual availability of these solutions, therefore, should be a point of concern. Moreover, this goes again to the point that even in areas where there are mechanisms that provide for market access, there will be more complexity in obtaining and retaining such access. Finally, these *ad hoc* passports based on equivalence bring less clarity with regards to supervisory responsibilities, and clashes between home and host authorities would need to be settled based on non-legally binding MoUs.

Equivalence Arrangements

With regards to equivalence, two or more countries agree to recognize the adequacy of each other's regulation and supervision as a substitute for their own. However, the issue is that a unified Union approach to the treatment of third countries around the concept of equivalence and with a fixed role for the various actors is not yet in place. Equivalence solutions are not universally available, as further explored in our answer to Question 2.

Important areas not covered by equivalence include payment systems and settlement finality; legal uncertainty in these areas could threaten systemic stability. In some situations, the access that is available to a third country actor is limited to a Member State's national market and there is no single point of entry to the entirety of the EU single market. There is also variation in the extent to which the powers that remain vested in Member States to allow third country actors access to their national market only are subject to specific harmonized conditions. Furthermore, procedures for obtaining and retaining an EU-level equivalence decision will vary due to the mentioned lack of a single homogenous framework. Different equivalence frameworks allocate different roles to the Commission, ESAs, and the national competent authorities in ways that are not always readily understandable as being driven by differences in the contextual setting. There is also a lack of uniformity with respect to whether reciprocity of treatment for EU actors under the third country regime is required as a condition of equivalence.

The breadth and procedure for obtaining an equivalence determination can also depend on the characteristics of the business providing the financial services. For example, EMIR 2.2 utilises a two-tier model, differentiating between systemically important and non-systemically important CCPs – with the former being subject to more requirements, including compliance with all CCP requirements under EMIR and ESMA direct supervision. In a similar way, the changes introduced to the MiFIR regime by Regulation (EU) 2019/2033 increase the powers that the Commission has to attach conditionalities to an equivalence determination and apply a more granular assessment than before. Again, if the services provided by a third country firm "*are likely to be of systemic importance for the Union*", said conditionalities might be resorted to "*ensure that ESMA and national competent authorities have the necessary tools to prevent regulatory arbitrage and monitor the activities of third-country investment firms*". Therefore, as both of these examples illustrate, some equivalence frameworks have very limited levels of deference that impose relevant constraints for the home country regulator and can also come at a cost for firms in terms of at least additional reporting requirements to EU authorities.

Lack of Equivalence Arrangements

Although the impacts of Brexit in the areas that lack any sort of equivalence will still be dependent on the particular market segment in question, the use of branches and subsidiaries is one particular issue that merits some discussion.

For branches – which do not have a separate legal personality, but rather constitute only a place of business – conditions will usually vary on a country-by-country basis, with many jurisdictions restricting the use of branches in the financial sector on public interest grounds. Decentralised state-by-state authorisation tends to increase the cost and complexity of doing business.

For subsidiaries – which are separate legal entities controlled by a parent company based in the home jurisdiction – there are also important considerations. First, a subsidiary will have to obtain a licence from the authorities of the host country in which it plans to operate. Second, there are more costs associated with subsidiaries, especially given that they will need to be separately capitalised, often to comply with ring-fencing regulations of the host country.

There are also *sui generis* options available under some regulations. For instance, in the asset management sector, AIFMD and UCITS US-based fund managers have often relied on *delegation*, whereas a company is incorporated in one of the Member States and management is delegated to the UK. There is uncertainty attached to these solutions as well: during its review of the ESAs, the European Commission has asked for a focus on "*market participants that intend to make an extensive use of outsourcing, delegation and risk transfer in third countries with the intention of benefitting from the passport*". Other *ad hoc* arrangements are discussed in our answer to Question 2.

2. **Which aspects of UK financial services are covered, or not covered, by the equivalence proposals? How is the UK seeking to establish new arrangements with the EU for those areas not covered?**

The existing equivalence regime is full of gaps, which could have potentially adverse effects for the EU as well as for the UK. Andrew Bailey has referred to it as a "patchwork", which is an effective metaphor to indicate the significant variations in depth and procedure that equivalence has. Overall, equivalence is more extensive for wholesale and investment services and least extensive for commercial banking, with retail markets and insurance failing in the middle. The table below tries to summarise existing equivalence frameworks:

<table>
<tr><th rowspan="2">Sector</th><th rowspan="2" colspan="2">Legislation</th><th rowspan="2">Equivalence</th><th colspan="2">Market Access</th><th rowspan="2">Reciprocity</th></tr>
<tr><th>Retail</th><th>Professional</th></tr>
<tr><td>Banking | Payment Services</td><td colspan="2">N/A</td><td>No</td><td>N/A</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Banking | Retail</td><td colspan="2">CRD IV/CRR</td><td>Yes (*)</td><td>No</td><td>No</td><td>N/A</td></tr>
<tr><td>Banking | Investment</td><td colspan="2">MiFID II/MiFIR</td><td>Yes</td><td>No</td><td>Yes</td><td>Partial</td></tr>
<tr><td>Asset Management | UCITS</td><td colspan="2">UCITS</td><td>No</td><td>N/A</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Asset Management | AIFMD</td><td colspan="2">AIFMD</td><td>Yes</td><td>No</td><td>Yes</td><td>No</td></tr>
<tr><td>Insurance</td><td colspan="2">N/A</td><td>No</td><td colspan="2">N/A</td><td>N/A</td></tr>
<tr><td>Reinsurance</td><td colspan="2">Solvency II</td><td>Yes</td><td colspan="2">Yes</td><td>No</td></tr>
<tr><td>Market Infrastructure | CCPs</td><td rowspan="4">EMIR</td><td>-</td><td>Yes</td><td colspan="2">Yes</td><td>Yes</td></tr>
<tr><td>Market Infrastructure | Trading Venues</td><td>-</td><td>Yes</td><td colspan="2">Yes</td><td>Partial</td></tr>
<tr><td>Market Infrastructure | Trade Repository Services</td><td>SFTR</td><td>Yes</td><td colspan="2">Yes</td><td>No</td></tr>
<tr><td>Market Infrastructure | Settlement Systems</td><td>CSDR</td><td>Yes</td><td colspan="2">Yes</td><td>No</td></tr>
<tr><td>Credit Rating Agencies</td><td colspan="2">Regulation (EC) 1060/2009</td><td>Yes</td><td colspan="2">Yes</td><td>No</td></tr>
</table>

Securities Prospectus	Regulation (EU) 2017/1129	**Yes**	**Yes**	**No**
Financial Benchmarks	Regulation (EU) 2016/1011	**Yes**	**Yes**	**Yes**
(*) Equivalence under CRD IV/CRR only covers the prudential treatment of exposures to foreign institutions and does **not** provide for market access.				

From that overview, we can roughly group equivalence frameworks based on the degree of market access that they provide.

The best example of a segment with **broad coverage** are derivatives, alongside all of the market infrastructure that they require. EMIR also has one of the equivalence frameworks with the highest number of equivalence decisions, so the broad coverage has actually been used by countries (including some that have different approaches to the regulation of the sector, such as the US). MiFID II/MiFIR are equally an interesting example, as the coverage is quite high for transactions with professional clients, including services such as brokerage, underwriting, market making, and proprietary trading. Finally, it is worth mentioning that some frameworks that are broad (and complicated) on paper – such as AIFMD and MiFIR – still do not have equivalence determinations, which makes their value post-Brexit unclear. Moreover, the AIFMD regime for third countries comes at a heavy price for firms: having to comply with EU law in that respect.

Solvency II is a good example of **intermediary coverage**, as the provisions allowing for market access are limited to the reinsurance industry and do have equivalence decisions for a number of countries. Although narrow in terms of the financial service it covers, the Prospectus regime also facilitates market access and eases continuing obligations for non-EEA issuers.

Areas with **limited coverage** are related to equivalence frameworks that are usually facilitating supervisory coordination and comparison of prudential rules, as to avoid duplicative regulation that ends up being more costly for both the EU and for the third country involved. CRD IV/CRR illustrate that, as they do not allow for market access and their equivalence provisions mostly facilitate the calculation of risks.

With regards to arrangements for areas not covered, we refer to our answer to Question 1 above. In addition, on the regulatory level, some of the preparations for "no-deal" did also accomplish a similar role, at least temporarily. One example are the temporary permissions and supporting MoUs agreed between ESMA and UK authorities for the recognition of UK CCPs and CSDs. However, it is still difficult to assess the medium and long-term effects of these exceptional measures.

3. **What are your views on the proposals put forward on financial services by both the UK and the EU in their draft legal texts? What other aspects of the UK-EU relationship are relevant to the financial services 'ecosystem' and yet to be clarified, in particular (a) related professional and business services, (b) data adequacy, and (c) labour mobility?**

The comparison of both draft legal texts illustrates how the UK is pushing towards more flexibility and an outcomes-oriented system, whilst the EU is keen on securing alignment with its legislation to some extent. Interestingly, the EU draft agreement has a provision discussing the role of international standards – as we discuss in our answer to Question 5, these standards can be helpful in mediating differences between the UK and the EU in the future, although this also has important limitations that should be kept in mind.

For financial services, the UK draft agreement text is fundamentally a modified version of CETA, with some changes that aim to enhance the degree of market access while adopting an outcomes-based approach regarding regulatory alignment.

As is the case with CETA, the UK draft agreement does not match passporting. Instead, it relies on EU equivalence to allow for some degree of market access – that is, it only provides for deference where deference is already coded into EU legislation, with authorisation being potentially required in other areas. As we have discussed in our answer to Questions 1 and 2 above, equivalence frameworks are non-existent or quite limited in specific market segments. However, there are some interesting differences between CETA and the UK draft agreement that are worth discussing.

First, the UK draft agreement mentions the need for more "*transparency and appropriate consultation in the process of adoption, suspension, and withdrawal of equivalence decisions*". In fact, Article 17.15 – which deals with "recognition of prudential measures" – reflects the take on equivalence that the UK has historically echoed in the Economic and Financial Affairs Council ("ECOFIN") meetings and also the risks with the possibility of unilateral withdrawal of equivalence decisions by the EU. These issues are further discussed in our answers to Questions 4 and 5 below.

Second, Article 17.6 tries to facilitate the supplying of new financial products and reduce regulatory burdens in situations where the host country "*would permit its own financial service suppliers, in like circumstances, to supply without adopting a law or modifying an existing law*". While it does not impede the Parties to require authorisations, it is aligned with the UK's push in the articles regarding equivalence, which try to combine flexibility with a higher degree of clarity. Such changes are related to UK FinTech: as it is a significant and growing market in an area where there is significant regulatory uncertainty and no substantive rules on the EU level, the UK draft agreement tries to include novel services that might still fall in regulatory grey areas. This is a positive development, as FinTech is another area in which the UK might be able to benefit from a first-mover advantage.

Third, the UK draft agreement provides for the establishment of a "*Financial Services Committee*", which would responsible for overseeing the implementation of the agreement. Although CETA has a similar structure, the Financial Services Committee under the UK draft agreement provides for more recurring meetings and seems to be more structured. Considering the importance of bilateral and other "structured" regulatory dialogues in financial regulation – as further discussed in our answers to Questions 7 and 9 below and illustrated by initiatives such as the EU-Japan Joint Financial Regulatory Forum – the use of such committee would be positive, as it could help to ease some frictions and facilitate cooperation in areas such as supervision or consumer protection.

Fourth, the UK draft agreement contains a distinctive dispute settlement mechanism for the disputes arising with relation to financial services, in which the Financial Services Committee plays a relevant role in selecting individuals that could act as panellists. This could be related to concerns about the potential role that the Court of Justice of the European Union ("CJEU") could play in equivalence decisions, further discussed in our answer to Question 5.

In terms of **professional and business services**, the UK draft agreement is much broader than the trade agreements that the EU has in place, as it would enable more types of UK-based professionals to offer services in the EU. Although this could be helpful to facilitate the offering of services that are closely related to financial services – such as legal services – there are no precedents in current EU trade agreements. With regards to professional qualifications, what is worrying is that while the UK has favoured a framework that facilitates mutual recognition, the EU has stated that "*recognition of professional qualifications of United Kingdom nationals in an EU27 member state will be governed by the national policies and rules*".

With regards to **data adequacy**, the UK will require an "*adequacy decision*" under the EU's General Data Protection Regulations ("GDPR") through which the EU would deem the UK's data protection rules equivalent to those in the GDPR. Although the UK Data Protection Act 2018 implemented the GDPR in the UK, the procedures for adequacy decisions have been quite slow and detailed. Therefore, there is a possibility that delays in such a decision will cause additional costs for data transfer in financial services between the UK and the EU, as there will be more complexity to be dealt with.

Finally, **labour mobility** is also relevant to financial services in terms of the professional infrastructure that the segment relies on to properly function. Whilst the absolute detail of the UK post-Brexit immigration system remains elusive, recent policy statements outline the broad principles, many of which will assist with attracting and retaining highly-qualified professionals from outside the UK.

4. **What is your view of the Commission's announcement that it is not even considering UK equivalence for a number of sectors, including investment services under MiFIR?**

Equivalence decisions concerning UK financial services regulation and supervision at the time of exit from the EU *should* be a relatively straightforward exercise provided the UK's financial services regulatory and supervisory framework remains largely unchanged at that point. In other words, the UK will be substantively and materially equivalent on day-one, both in terms of rules and supervision, if no material changes are introduced.

However, we should note that the EU has established that equivalence is a ***unilateral, conditional, and discretionary act*** during ***adoption and withdrawal,*** and which needs to be *reviewed periodically*.[1] As a result, there is no right – either for a third-country or for its firms – to compel the European Commission to conduct the assessment and render a decision, even when the criteria is very clearly met. Furthermore, while third countries may express an interest in being assessed, there is also not a fixed timeframe for how long it should take for a decision to be reached. For example, it took more than three years for the EU to consider the US regime on central counterparties equivalent under EMIR and some frameworks have still not been used (such as AIFMD and MiFIR Articles 46 and 47).

The equivalence process has been very opaque and there have been instances where politics intruded into equivalence decisions, as even the European Parliament acknowledged.[2] The most obvious example is Switzerland, which received a conditional, one-year equivalence determination with respect to its trading venues that was abruptly revoked[3]. As for the future, it is tricky to ascertain what will happen: on the one hand, the UK was one of the vocal supporters of an open and comprehensive equivalence regime in the ECOFIN; on the other hand, the more the process become overtly political, the more

[1] See: European Parliament, 'Resolution of 11 September 2018 on Relationships Between the EU and Third Countries Concerning Financial Services Regulation and Supervision' (2018); European Parliament, 'Third-Country Equivalence in EU Banking and Financial Regulation' [2019] 20.

[2] European Parliament, 'Third-Country Equivalence in EU Banking and Financial Regulation', 21.

[3] European Commission, 'Implementing Decision (EU) 2017/2441'.

other third countries will be wary of relying on it. This is at odds with the development of the equivalence framework in the last five years, as the growing focus on substantive outcomes in practice as well as on paper was instrumental to allay fears that blockages would be causes by undue attention to differences in line-by-line detail, or that technical discussion would be derailed by politics.

There is no "silver bullet" to solve this issue: while some have discussed that the arbitrary denial or discretionary use of equivalence could violate the General Agreement on Trade in Services ("GATS") standards, there are significant limitations to what can be achieved under the World Trade Organization ("WTO") frameworks, as discussed in more detail in our answer to Question 8.

With regards to MiFIR in particular, it is once again worth mentioning the changes introduced by Regulation (EU) 2019/2033. Considering the (i) greater involvement of ESMA, which will "*monitor the regulatory and supervisory developments, the enforcement practices and other relevant market developments in third countries*"; (ii) conditions for the assessment of equivalence include elements ranging from capital requirements, corporate governance and organisational requirements, as well market transparency and abuse regulation, it is worthwhile to analyse *whether* and *how* much the UK might want to diverge, so as to understand the impact of not pursuing an equivalence decision in the area.

Finally, we should also flag that the UK is entertaining changes in its financial regulation as to – in the words of the Chancellor – take "*an approach that better suits our markets*". For the moment, areas that have been pointed out include bank resolution, insurance, benchmarks, market abuse, and changes to the prudential regime for UK investment firms. We will discuss some of these changes in our answer to Question 6 below.

5. **To what extent would you expect the EU to make equivalence dependent on commitments by the UK on continued regulatory alignment in financial services, and how should the Government address those demands? How should the Government approach equivalence in areas, such as derivatives clearing, in a way that protects the**

UK's financial ecosystem while maximising the ability of UK financial services to continue to operate in the EU?

In the short-term, regulatory alignment should not be a concern. Over the longer-term, equivalence should not be about being identical: it should be about getting to the same outcome and retaining dynamic alignment *vis-à-vis* these outcomes. Although the longer-term prospects are inevitably more speculative and divergence will involve a balancing act, insights drawn from our current understanding of law and politics of EU and international financial regulation can help to give an informed view on whether the UK is destined to be forever bound to being in lockstep with the EU.

First, we can be sure that financial regulation and financial markets will continue to co-evolve. Notwithstanding the massive post-crisis reform efforts, new vulnerabilities will emerge in the financial system, and there will be new opportunities to exert influence as well. Another example are nascent markets such as FinTech. Historically, the UK has a very good record of being an effective first-mover, due to its technical regulatory expertise and comparatively less cumbersome legislative and regulatory processes: it was ahead of the EU on bank resolution, for instance. In that sense, if the UK manages to take the lead in solving new problems, that first-mover advantage could allow it to set the agenda in equivalence negotiations.

Second, it is reasonable to discount the likelihood of fundamental disagreement between the UK and the EU on the broad, high-level parameters of financial regulatory policy. Brexit comes after a period of high-political saliency around the capacity of interconnected financial markets to contaminate each other, which has propelled a significant degree of international regulatory convergence through standard-setting bodies such as the Basel Committee and the International Organization of Securities Commissions ("IOSCO").

Although international standards are helpful and can be integrated into equivalence assessments – as the Australian Corporations Act 2001 or ESMA's use of peer reviews and IMF FSAP findings illustrate – it is worth noting that (i) international standards come in different flavours and with variations in granularity; (ii) standards are usually not enough to be used as the sole basis of an equivalence assessment.

Third, we should not disregard the role of a UK equivalence-like regime. EU equivalence has been shown to diffuse EU regulatory preferences to third countries. In that sense, given the dominance that the UK has in the wholesale market sector and areas such as FinTech or the developing climate change markets, an equivalence-like regime could help the UK to export its preferences in these areas and constrain the regulatory options available internationally. This is further discussed in our answer to Question 9, especially with reference to the draft Overseas Fund Regime published by HM Treasury.

That being said, some concerns should be equally noted.

Equivalence is a moving target: financial regulation evolves quickly and the way through which equivalence is assessed is also constantly changing. Furthermore, different equivalence frameworks will often require different levels of alignment. These differences should be acknowledged as to inform *if, how, and when* divergence should happen.

As mentioned above, equivalence determinations can be unilaterally withdrawn. That has happened for the first time in 2019 under Regulation (EC) 1060/2009 on credit rating agencies, as the European Commission rendered a decision that affected Argentina, Australia, Brazil, and Singapore. Although there are practical considerations that the EU will have to observe before a sudden withdrawal – such as market and third country expectations, as well as financial stability –, the UK should push for a more streamlined equivalence process and a higher degree of certainty over what types of changes will trigger a review. The Swiss example referred to in our answer to Question 4 above could also be mentioned.

Finally, the European Parliament has hinted that the CJEU theoretically has competence to decide over the legality of an equivalence determination taken by the European Commission.[4] However, there is no precedent to date in that sense.

6. What are your views on the areas of financial services where the EU is considering introducing legislative changes in the near future, such as for Capital Markets Union, Solvency II, and Anti-Money Laundering, and how the UK might respond?

The changes that the UK is entertaining as per HM Treasury documents published in June 2020 could be helpful both for identifying areas in which divergence with the EU might happen sooner rather than later, as well as for providing some clues as to how the UK can retain its status as an influential actor in international financial regulation. Overall, the statements made by the Chancellor reaffirm the UK's commitment to international standards, stress the role that UK regulators had in designing these standards and the financial architecture that supports them, whilst also mention potential adaptations to local specificities and fine-tuning. Changes that introduce more granularity to implementation – such as adaptations to REFIT aimed at smaller firms – might be interesting examples of reforms that improve domestic regulation while maintaining alignment with international standards.

The proposed changes to the rules on bank recovery and resolution are worth mentioning in a little bit more detail. Historically, this is one area in which the UK contributed significantly in the past, both at the EU and international levels, in large part due to the technical expertise of UK regulators and the size of the UK market. Judging from the consultation, the UK seems to be willing to continue to build its own track record and implement domestic variations of, at least, some aspects BRRDII during the transposition process. When discussing what some of the variations might be – e.g. MREL requirements – reference is usually made to international standards. As we have mentioned in our previous

[4] European Parliament, 'Third-Country Equivalence in EU Banking Legislation', 16.

answer, international standards often leave some space for adaptation during implementation.

Moving on, it is relevant to stress that EU financial regulation is also dynamic. The drivers of change take different forms: some changes will be incremental and about adding nuance to the existing rules; other pieces of legislation will be periodically reviewed, as is the case with CRRII; sudden regulatory failures and financial crashes will upset the system and often lead to broader reforms. All of these might – at different paces – lead to divergence from whatever the UK regulation might be. Arguably, divergence might come quicker in areas where there are historical differences between the UK and the other Member States, such as in takeovers and regulation of foreign ownership of companies. This goes back to our statements about dynamic alignment.

Regarding the **Capital Markets Union**, it is important to remember that its main purpose is opening up new sources of finance and new investment opportunities, as to reduce the EU's excessive reliance on banks. This has important consequences in light of Brexit. First, it would be unwise for the EU to cut out the UK as a market, both because of the services that the UK provides to the EU, but also because of the services that EU firms might provide into the UK. Second, the EU has been increasing its influence in international regulatory fora, especially after the 2008 financial crisis. Implementing excessively protectionist measures would cut across that. Third, the Capital Markets Union is another area where ESAs will play an important role. As a result, it can benefit from their strong technical expertise (and lessen political interference). Therefore, even if Brexit makes the preferences among the remaining Member States more homogenous and opens-up more space for the "market-shaping" countries such as Germany and France, it is unlikely that an excessively protectionist version of the project comes into fruition.

Overall, it is worth noting that keeping track of the changes that are happening at the EU level will consume additional resources, especially considering the pace of the reforms in some areas. This also opens up the option of developing parallel regimes – EU compliant and non-EU compliant – to cater to different groups of market participants. This is further discussed in our answer to Question 9.

Changes to the equivalence regime itself should also be a point of focus. The European Parliament has called for evolution towards "*a consistent and coherent system of sensible recognition of each other's qual or similar standards*".[5] While introducing the aforementioned changes to MiFIR, Article 60 (which deals with the review scheduled for 2024) mentions that the equivalence regime should be assessed in relation to, among other things, its "*alignment with a consistent framework for equivalence in financial services*". The EBA has been vocal in pointing out that some areas of banking regulation require more clarity in the equivalence assessment process.[6]

Brexit could smooth the progression towards a more unified system for the treatment of third countries, as there may be less pressure on the Commission to broker difficult internal compromises on the treatment of third countries that satisfy both the more 'closed' economies, such as Germany and France, and the more 'open' economies once the UK, the lead member of the 'open' camp, is out of the picture. However, three considerations reduce the chance of a definite shift towards a more protectionist version of the equivalence regime. First, the prospect of negative macroeconomic effects resulting from protectionism should discourage extremism, especially considering that there might be some degree of regulatory competition between the UK and the EU. Second, a post-Brexit inward turn would cross directly across the EU's established financial services political agenda at the international level, where the EU has been gaining more ground since the 2008 financial crisis. Third, the growing capacity of the technocratic ESAs in the equivalence sphere should help to curb extremism.

7. **What structures are in place to facilitate cooperation between the respective regulatory bodies? What is outstanding that needs to be put in place to facilitate regulatory dialogue?**

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[5] European Parliament, 'Report on Stocktaking and Challenges of the EU Financial Services Regulation: Impact and the Way Forward Towards a More Efficient and Effective EU Framework for Financial Regulation and a Capital Markets Union' A8-0360/2015.

[6] EBA, Opinion on Cooperation with Third Countries (EBA/Op/2015/19) para 13.

First of all, it is worth stressing the highly technocratic nature of international financial regulation and of the structures that compose its architecture. This is relevant to understand that the significant influence that the UK has gathered on these regulatory bodies will not go away overnight, especially due to its market size and the technical expertise that UK regulators have. Having said that, the UK will lose connections with important channels of influence, such as the European Commission, the European Central Bank, and the ESAs, which have increasing participation at the international networks. Therefore, active participation in the regulatory bodies discussed below is relevant for the UK to retain influence in the future.

A first relevant structure for cooperation in financial services is **bilateral agreements**. Apart from facilitating cooperation between supervisory authorities and creating ties between them, there have long been suggestions that combining enough bilateral agreements could help to create and disseminate *de facto* global standards. Countries such as the US have sometimes side-stepped multilateral organisations in the past in favour of bilateral understandings. Both the Financial Stability Board ("FSB") and IOSCO have reported an increase in the number of bilateral agreements in the last couple of years.

In the context of Brexit (and during the preparations for a potential no-deal): (i) the ESAs and British authorities adopted multiple MoUs providing the basis for information sharing and supervisory cooperation; and (ii) some of the UK's authorities (such as the FCA) entered into cooperation agreements that do provide for some degree of market access, such as the Mutual Recognition of Funds agreement with the Hong Kong Securities and Future Commission.

There are also **regulatory dialogues and supervisory colleges**. The basic purpose of these structures is to enhance information exchange and cooperation between supervisors to support effective international supervision, but they do facilitate the fostering of mutual trust and the formation of alliances at the international level. The use of these colleges is particularly advanced in the insurance sector. The UK already has more structured dialogues with countries such as Japan and the US, but there is also the possibility of creating structures around certain areas, such as FinTech. Furthermore, structures such as the aforementioned CETA Financial Services Committee and the EU-Japan Joint Financial Regulatory Forum could serve in a sort of complementary role: whereas colleges are operational and ease the frictions in supervision, committees can be more policy focused and facilitate the transition of the technocratic input to a more policy/strategic level.

Moving on, there are **international networks** which are usually sector-specific: the Basel Committee provides the standards for banking, IOSCO produces standards for securities, and the IAIS deals with standards for insurance, with the FSB facilitating the coordination between these networks and dealing with the implementation of the standards. The UK has played a very prominent role in designing the networks and has been very influential within their structures. While they do have limitations – which will be discussed in our answer to Question 9 – the UK should nevertheless be well-positioned to use these networks after Brexit.

Finally, there have been some examples of structures that replicate multilateral networks, but which are more closely spearheaded by a particular country. As we will also discuss in our answer to Question 9, the FCA has been very effective at diffusing UK's preferences on how to regulate FinTech through the Global Financial Innovation Network ("GFIN").

In terms of what is outstanding, the litmus test for all of the aforementioned structures is determining how well does all this work when there is stress and failure. In the event of a crisis, the UK would require formal international agreements that make it clear who is in charge, and arrangements under which you formally commit to recognising the other countries' resolution procedures and to enforcing in your laws any steps that need to be taken in the other countries' laws, so that you have a legal underpinning. Otherwise, the obvious problem is that all countries will retreat to their own interests in a crisis.

There is also some fine-tuning that will be required on a sector-by-sector basis. Looking at derivatives, for example, there have been discussions about OTC contract continuity after Brexit, especially considering that requirements related to certain contractual events – such as the exercise of options and transfers of collateral – might vary from country to country.

8. How does the UK financial services industry benefit from trade arrangements between the EU and third countries? How many such relationships have been replicated? And what needs to be negotiated still?

Generally, the existing international trade framework and trade agreements have quite a limited effect for financial services and its regulation.

First, the level of liberalisation under the GATS is narrow, especially when compared to EU Treaty freedoms. Moreover, the GATS is not prescriptive regarding the substance and scope of domestic financial regulation and allows for a high degree of regulatory diversity among its members. It is worth noticing that the GATS has a list of potential recognition models that might be used to ease frictions between members but, once again, it is not prescriptive while doing so.

Second, GATS' members can continue to impose licensing requirements and to take measures on prudential grounds that may impact cross-border supply or have other restricting trade effects. This is what is called the "*prudential carve-out*". Historically, the WTO Appellate Body – which is responsible for deciding the appeals from reports issued by panels in disputes brought on within the WTO framework – has shown a high degree of deference with respect to the prudential carve-out.

Moving on to trade agreements, they tend to impose weak, transparent, and cooperation-based constraints. As a result, they are very limited for facilitating regulatory coherence and for providing market access with respect to financial services. Even though the UK draft agreement is distinctive in some ways, it is worth noticing that it does have a prudential carve-out (Article 17.13).

Considering the precedents that the EU has with regards to free trade agreements, the situation does not look promising. Furthermore, the EU rules also create significant constraints to bilateral agreements with specific Member States, as they are designed to prevent backdoors into the Single Market.

9. What are the longer-term challenges and opportunities for UK financial services? What is the sector doing to make sure UK financial services are competitive globally?

London still is the home for systemically important banks and has a breadth of services that cannot be straightforwardly replicated by another European hub. Having said that, one of the main challenges for the UK is retaining its influence and expertise over time.

This might be trickier today, as international financial regulation has seen an increase in the variation of regulatory preferences and progressively fragmented markets. Developments such as the US aversion to multilateralism, the impacts of Brexit, and the more prominent role of countries such as China in international fora serve to illustrate the complexity of the processes for exerting influence.

However, there are some opportunities that are worth mentioning and that are enabled exactly because some degree of divergence and regulatory competition will be possible.

One alternative to carve a distinctive regulatory path within the bounds of international standards and equivalence is related to "**super-equivalence**" – that is going above and beyond what is required by standards and EU law. Super-equivalence (also known as gold plating) is not an issue so far as international standards are concerned, but EU financial regulation has increasingly taken the form of full or maximum harmonisation measures beyond which Member States are not permitted to go. Admittedly, aggressive super-equivalence might make it hard for the UK to satisfy itself that EU regulation meets its standards, which would have implications for two-way access based on reciprocity of treatment, but super-equivalence is any event bounded by international competitiveness considerations and within these bounds the reciprocity implications of super-equivalence should be manageable.

Another possibility for the UK to put its own stamp on financial regulation post-Brexit is through the development of **parallel regulatory requirements** that allow businesses to choose whether or not to be regulated by an EU-equivalent regime. Jurisdictions such as Jersey, Guernsey, Bermuda, and the Cayman Islands have introduced mechanisms in that sense. How attractive it would be to the UK Government to offer parallel regimes is an untested question. As long as the lessons of the financial crisis – that regulatory fragmentation can lead to gaps that result in systemic vulnerabilities – remain in the memory, there is likely to be wariness among policymakers about introducing differentiated requirements for fear that this could encourage harmful regulatory arbitrage or undermine safety. The UK would also be unlikely to want to put its credibility within international standard-setting bodies that aim at regulatory convergence at risk by an ill-judged venture into extensive optionality. In any case, parallel regulatory requirements could be helpful for adapting regulation for smaller companies that only plan to do business domestically or with countries that are not EU Member States.

The **Overseas Fund Regime**, as proposed by HM Treasury, is worth mentioning. Under the current draft, two regimes based on equivalence would be introduced, with one directed at retail investment funds and the other at MMFs. An equivalence determination rendered under these regimes would allow overseas funds to be marketed to all investors in the UK, as long as the home regulatory regime meets the equivalent "*required standard on an outcome basis*". In addition to being broader than the EU approach to equivalence in relation to investment funds, the Regime seems to outline UK's approach to equivalence. Alongside with a more streamlined process, the draft contains (i) a more structured procedure to the modification or withdrawal of equivalence determinations; (ii) details on what composes the "outcomes-based assessment", as well as how the parallel equivalence regimes (for retail and MMFs) will differ in terms of said assessment; (iii) a clearer division of supervisory responsibilities and timeframes for the determinations. As mentioned in our answer to Question 5, EU equivalence has been shown to be effective at diffusing regulatory preferences to third countries. In this sense, introducing an UK variant of equivalence could both work in a similar way for the export of substantive rules, while also create a competing model for how equivalence should function.

As we have also mentioned, there are potential **first-mover advantages** to be harnessed. These represent another point in support of the UK being able to break free of the detail of EU law in the longer term whilst remaining equivalent, and are interconnected with the deep skill and expertise in financial regulation that the UK enjoys and the opportunities afforded by a dynamic regulatory field that exists in a permanent state of adaptation to put that expertise to use in driving regulatory innovation. As a Member State, the UK might sometimes have held back from anticipating possible EU level intervention so as not to prolong disruption and add to adaptation and compliance costs. Since that consideration will no longer apply, Brexit may enhance the UK's "first-mover" capabilities.

UK FinTech regulation provides some examples of innovative approaches that helped to consolidate UK regulators – and especially the FCA – as influential actors in the segment.

First, early initiatives regarding themes such as crowdfunding and robo-advice, as well as novel regulatory structures such as the regulatory sandbox, have had first-mover advantages and influenced regulation abroad, including in some of the EU Member States.

Second, the creation of GFIN provides an interesting template of how the UK managed to export its regulatory *ethos* to other countries in a very quick and effective manner. From the launch of Project Innovate in 2014, the FCA's started entering into bilateral agreements with other authorities to facilitate cooperation. Following a consultation in 2018, the FCA advocated the benefits of establishing the structure for a global regulatory sandbox. This led to the creation of the GFIN in 2019, which was accompanied by a very quick expansion of its membership. What is worth noting is how that expansion of membership happened: while the first series of bilateral agreements were mostly entered into with Asian countries, the expansion was able to bring on board some of the regulatory authorities from the US (including the Consumer Financial Protection Bureau, the Commodity Futures Trading Commission, the Financial Industry Regulatory Authority, and the Federal Reserve Board) and even some EU Member States. In that sense, GFIN might serve to illustrate different pathways to building alliances around how to approach a specific sectoral regulation. UK's involvement in the Green Finance agenda, for instance, could be another venue worth exploring.

Third, it is also worth noting how GFIN differs from other multilateral initiatives and to some extent already reflects the UK's more flexible and outcomes-oriented approach. In the surface, it resembles an international standard-setting body such as IOSCO, but it has some interesting differences: (i) rather than producing standards, it serves as a forum to discuss more flexible outcomes and facilitate arrangements between its members; (ii) it is more closely linked to the authority that spearheaded its creation and reflects the UK approach to FinTech regulation; (iii) it does not mean to replace international networks, but rather to work alongside them. Effectively, GFIN seems to represent a model through which the UK was able to export and consolidate some of the first-mover advantage it developed in the regulation of FinTech – again, not in the sense of rules, but of exporting a regulatory *ethos*.

Table of Abbreviations

AIFMD	Directive 2011/61/EU [Alternative Investment Fund Managers Directive]
Basel Committee	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BRRDII	Directive (EU) 2019/879 [Bank Recovery and Resolution Directive II]
CCP	Central Counterparty Clearing
CETA	EU-Canada Comprehensive Economic and Trade Agreement
CJEU	Court of Justice of the European Union
CRD IV	Directive 2013/36/EU [Capital Requirements Directives IV]
CRR	Regulation (EU) 575/2013 [Capital Requirements Regulation]
CRRII	Regulation (EU) 2019/876 [Capital Requirements Regulation II]
CSDR	Regulation (EU) 909/2014 [Central Securities Depositories Regulation]
CSDs	Central Securities Depositories

EBA	European Banking Authority
ECOFIN	Economic and Financial Affairs Council
EMIR	Regulation (EU) 648/2012 [European Market Infrastructure Regulation]
ESA	European Supervisory Authorities
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GATS	General Agreement on Trade in Services
GDPR	General Data Protection Regulation
GFIN	Global Financial Innovation Network
IAIS	International Association of Insurance Supervisors
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
MiFID II	Directive 2014/65/EU [Markets in Financial Instruments Directive II]
MiFIR	Regulation (EU) 600/2014 [Markets in Financial Instruments Regulation]
MMFs	Money Market Funds
MoU	Memorandum of Understanding
MREL	Minimum Requirement for own Funds and Eligible Liabilities
OTC	Over-the-Counter
REFIT	Regulatory Fitness and Performance Programme
SFTR	Regulation (EU) 2015/2365 [Securities Financing Transactions Regulation]
Solvency II	Directive 2009/138/EC [Solvency II Framework]
UCITS	Undertakings for the Collective Investment in Transferable Securities
WTO	World Trade Organization

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Committee on the Future Relationship with the European Union

House of Commons, London, SWlA OAA

Email: freucom@parliament.uk Website: https://committees.parliament.uk/committee/366/committee-on-the-future-relationship-with-the-european-union/

23 July 2020

Professor Eilis Ferran
Professor of Company and Securities Law
University of Cambridge

Dear Professor Ferran,

The House of Commons Committee on the Future Relationship with the European Union is inquiring into the progress of the negotiations between the UK and the EU. Under normal circumstances, the Committee holds regular oral evidence sessions in Westminster. However, measures to prevent the spread of the coronavirus make this difficult.

The Committee is keen to gather as much evidence as possible to inform its deliberations so I am writing to you to ask whether you would be willing to help us with our work by making a written submission. We welcome general responses to our call for evidence, which was published on 4 March. We also hope that you would be willing to answer some of the more specific questions set out below on issues that fall within your area of expertise. Submissions need not address every bullet point and can include other matters that you think are relevant to the negotiations and should be drawn to the attention of the Committee.

- What are the characteristics of the UK financial services sector, the relative sizes of the different services provided, and which parts of UK financial services exports rely on market access with (a) the EU and (b) the rest of the world?
- What is the difference between the UK's ability to sell financial services into the EU under the current passporting regime and (a) the equivalence arrangements for financial services and (b) no EU equivalence decisions for financial services for the UK?
- Which aspects of UK financial services are covered, or not covered, by the equivalence proposals? How is the UK seeking to establish new arrangements with the EU for those areas not covered?
- What are your views on the proposals put forward on financial services by both the UK and the EU in their draft legal texts? What other aspects of the UK-EU relationship are relevant to the financial services 'ecosystem' and yet to be clarified, in particular (a) related professional and business services, (b) data adequacy, and (c) labour mobility?
- What is your view of the Commission's announcement that it is not even considering UK equivalence for a number of sectors, including investment services under MiFIR?
- What would be the economic impact of the UK not obtaining equivalence from the start of 2021? What actions have UK financial services firms taken in anticipation of this possibility?
- To what extent would you expect the EU to make equivalence dependent on commitments by the UK on continued regulatory alignment in financial services, and how should the Government address those demands? How should the Government approach equivalence in areas, such as derivatives clearing, in a way that protects the UK's financial ecosystem while maximising the ability of UK financial services to continue to operate in the EU?
- What are your views on the areas of financial services where the EU is considering introducing legislative changes in the near future, such as for Capital Markets Union, Solvency II, and Anti-Money Laundering, and how the UK might respond?
- What structures are in place to facilitate cooperation between the respective regulatory bodies? What is outstanding that needs to be put in place to facilitate regulatory dialogue?

- In which aspects of UK financial services is the UK look to increase exports in financial services and to which specific markets? And what are the relevant regulatory structures that govern that trade with the rest of the world?
- How does the UK financial services industry benefit from trade arrangements between the EU and third countries? How many such relationships have been replicated? And what needs to be negotiated still?
- How does the delay in the EU's decision on equivalence, and the ongoing uncertainty in clarifying what the future EU-UK relationship will look like, impact upon the sector's ability to prepare for the 1 January 2021? What is the final date when clarity is needed if businesses are to get ready for new ways of working?
- What are the longer-term challenges and opportunities for UK financial services? What is the sector doing to make sure UK financial services are competitive globally?

The Committee staff will be happy to discuss the inquiry, any issues raised, or the process for submitting written evidence. You can contact them at freucom@parliament.uk.

Yours,

Hilary Benn
Chair of the Committee