

Written evidence submitted by TheCityUK (FRE0108)

The financial and related professional services (FRPS) industry contributes nearly 10% of the UK's total economic output and employs over 2.3 million people, with two-thirds of these jobs outside London. It is the UK's largest tax payer and biggest exporting industry and underpins both national and individual prosperity.

In the limited time before the end of the transition period it is essential to progress the following FRPS industry priorities to ensure the best possible outcome for all users of financial and related professional services across the UK and EU:

- **Maximum certainty and stability in regulatory relations.** This includes equivalence determinations across all the c.40 equivalence regimes which currently exist in EU legislation.
- **A commitment to developing deep constructive relationships between UK and EU regulators** – including formal UK-EU regulatory dialogue processes to enhance supervision and coordination.
- **Establishing a framework for strengthening the processes for granting and withdrawing access to and rights within both markets,** ensuring greater legal and regulatory certainty, while protecting regulatory autonomy.

Understandably, progress on the negotiations has been impacted by COVID-19. However, the ongoing uncertainty caused by the lack of progress in the negotiations, including relating to equivalence determinations, is driving firms across the industry to accelerate and finalise their contingency planning, including for a no-deal outcome.

Regardless of the outcome of the negotiations, the industry is clear that the UK must remain open to global business, be competitive and consistent, and demonstrate its ongoing, strong commitment to open and free markets. I hope our response will be useful in supporting this inquiry. We stand ready to support your Committee and I would be delighted to discuss any points further.

Introduction

Following the result of the EU membership referendum in 2016, the UK-based FRPS industry has prepared for all possible scenarios. The priority for the industry is to be able to continue serving customers and clients through the transition period and beyond, and to grow new markets and develop fresh client relationships globally.

The COVID-19 crisis has understandably had implications for the negotiations, for example, both parties have confirmed that negotiating virtually, with dispersed resources and a loss of negotiating momentum has impacted progress.

The industry supports the UK and EU including commitments in the Free Trade Agreement on both regulatory and supervisory cooperation and the framework for strengthening the processes for granting and withdrawing access to and rights within both markets.

However, the final shape of the UK-EU relationship remains uncertain. The industry is aware of the increasing likelihood of an outcome that does not meet the needs of the FRPS ecosystem, even if the EU were to make equivalence determinations under all current EU legislation providing for them (as we discuss on page 4 below). It should be noted the granting of equivalence is currently uncertain given both the overall lack of progress in the negotiations and the recent European Commission statement¹.

This, taken together with other remarks and signals, including a recent note of caution by the European Central Bank² that for banks equivalence “does not constitute a sustainable basis for their business models”, indicates that the EU approach may be influenced by incentivising firms to move business from the UK to the EU.

The industry is concerned and disappointed that a politicised approach to equivalence is also being mirrored in the approach to data adequacy and the Lugano convention. We have been encouraged by support for the UK’s accession to the latter from the EFTA states and urge the EU to approve the UK application. This would ensure that those involved in cross-border trade and transactions are protected and have access to justice regardless of their financial resources.

Given the uncertain environment set out above, businesses across the industry are relying on their own preparedness as well as any unilateral UK, EU or Member State measures and Member State national regulatory regimes when considering how best to serve their customers and clients.

As we outline several times in answering the Committee’s questions the UK government must work in partnership with industry and regulators to simultaneously focus on key future UK-EU relationship issues and on policy proposals to ensure the UK’s openness to global business and overall competitiveness as a globally-leading location to do business in and from.

Our response to the questions posed in your letter is set out below:

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?

The UK financial services sector is one of the most differentiated in the world, offering deep diversity of sub-sector specialisms that attract clients to the UK as a global financial centre. Its regulation reflects this diversity. It generates gross value added (GVA) of £135.1bn, accounting for 7.1% of UK’s total.

¹ European Commission, ‘Communication on readiness at the end of the transition period between the European Union and the United Kingdom’, (July 2020), available at: https://ec.europa.eu/info/sites/info/files/brexit_files/info_site/com_2020_324_2_communication_from_com_mission_to_inst_en_0.pdf

² Yves Mersch, Member of the Executive Board of the ECB, ‘Brexit: banks must prepare for the end of the transition period’, (July 2020), available at: <https://www.bankingsupervision.europa.eu/press/blog/2020/html/ssm.blog200709~0568e283b2.en.html>.

According to data from the Office for National Statistics (ONS), gross value added (GVA) in Financial and insurance activities was £135.1bn in 2018 (latest available data). The sector is comprised of:

- financial service activities (including banking), accounting for £80.9bn, or 59.9% of total UK financial services
- insurance and pension funding, accounting for £28.6bn, or 21.2% of the total
- activities auxiliary to finance and insurance (including fund management), accounting for £25.6bn, or 19% of the total.

UK goods and services exports totalled £642.2bn in 2018 (latest available data). 45.3% of these exports went to the EU, and 54.7% to the rest of the world. The proportion of UK exports to the EU has remained relatively stable in recent years, at 42.4% in 2015, 43.7% in 2016 and 44.7% in 2017.

Financial services exports from the UK were £82.2bn in 2018, 39.7% of which was exports to the EU and 60.3% of which was to the rest of the world. The proportion of UK financial services exports to the EU has remained relatively stable in recent years, at 41.2% in 2015, 38.5% in 2016 and 38.7% in 2017.

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 EU passporting regime is comprehensive, covering virtually all financial services business between Member States. By contrast, the EU equivalence regime covers only certain areas of business (for further detail see below on page 4 in response to the next question).

In the areas they cover, equivalence determinations will define the rights and regulatory and prudential treatment, including in some cases market access to regulated markets, and whether there will be cost-effective access to market infrastructure.

As outlined in the IRSG 'The EU's Third Country Regimes and alternatives to passporting' report³, if no equivalence determinations for financial services are made UK-based financial services firms would have limited access options available to them as set out below:

Carry on such cross-border activities as are permitted under local laws

- For each Member State where it wished to conduct regulated business, a UK firm would have to consider whether national laws permitted it to carry on such business without a licence (or whether, for example, there might be an exemption available). Our analysis shows that the position differs between the different Member States, and different sectors, resulting in a complex patchwork of rules. There are no general exemptions across the EU.

Establish a subsidiary in the EU

³ IRSG, 'The EU's Third Country Regimes and alternatives to passporting', (January 2017), available at: <https://www.irsg.co.uk/assets/the-eus-third-country-regimes-and-alternatives-to-passporting-executive-summary.pdf>

- A UK firm could establish a subsidiary/subsidiaries (as some have done, or have extended the authorisations for existing subsidiaries) in the EU and apply for it to be authorised by the local regulator. The subsidiary can use passporting rights around the rest of the EU. Our analysis shows that the subsidiary could outsource certain activities back to the UK, but it would have to satisfy ‘substance’ requirements in the EU Member State where it is authorised. This route to market is, in some cases, inefficient (e.g. it may create new operating risks in the business). It will also be important to ensure that any requirements relating to outsourcing do not become so onerous that it becomes impractical or inefficient to continue to do so.

Apply to individual EU Member States for direct authorisation of a branch

- A UK firm could apply directly to a local regulator for authorisation in that Member State (i.e. instead of establishing a local subsidiary and applying for that entity to be authorised). The UK firm would typically have to establish a branch office in the Member State to obtain authorisation in this way. Some Member States allow this, but others impose limitations or rarely use the approach, so again it is not a universal solution.

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 EU equivalence regime was not designed or intended to operate as a comprehensive framework for cross-border access. There are around 40 third country (equivalence) provisions in the EU legislative framework. These provisions differ in each piece of legislation, and not all of them provide for market access. It is estimated that only around one-third of the provisions provide market access comparable to passporting and even in areas where market access is provided for it has not been granted in one-third of these areas to any third country suppliers⁴.

There are other concerns about equivalence, in particular, that the regime does not provide sufficient stability and clarity on the process for granting and/or withdrawing equivalence. For example, the fact that equivalence can be withdrawn with little or no notice means that end-users and market participants may not have sufficient time to make necessary adjustments to their business in response to withdrawal. There are also concerns that the process can become politicised and as such equivalence may be withdrawn in response or retaliation in instances not related to financial services (for example, the EU decision to withdraw equivalence for Swiss stock exchanges).

Equivalence will be the mechanism used to grant access and other rights between the UK and EU. It will therefore be important for there to be robust UK-EU regulatory dialogue processes. These will enhance regulatory and supervisory coordination and provide a framework for strengthening the processes for granting and withdrawing access to and rights within both markets, ensuring greater legal and regulatory certainty, while protecting each side’s regulatory autonomy.

⁴ New Financial, ‘A Reality Check on Equivalence’, (February 2020), available at: <https://newfinancial.org/report-a-reality-check-on-equivalence>

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?

Both the UK and EU draft FTA texts are limited in their provisions for financial services. However, the industry supports the UK and EU including commitments in the Free Trade Agreement, on both regulatory and supervisory cooperation and the framework for strengthening the processes for granting and withdrawing access to and rights within both markets.

The EU is offering the UK a limited set of FTA provisions on market access and equivalence. These follow the EU's recent model for financial services content in FTAs, including those with South Korea, Canada and Japan.

The UK's proposals for financial services as set out in the UK's draft FTA are more ambitious and include additional elements going beyond those set out by the EU. These include, for example, the UK proposal for a Financial Services Committee (to oversee the implementation of the financial services chapter to meet every three months) and provisions on regulatory cooperation, the detail of which is set out in the unpublished annex 17-F.

We welcome these UK proposals and are encouraged that the UK government is seeking close regulatory and supervisory cooperation on financial services with the EU. However, further detail on the proposed nature of this cooperation would be helpful and we would urge the UK government to publish the annex referenced above. Further detail on industry's thinking on regulatory and supervisory cooperation and dialogue can be found on page 11 below. We believe this is important as among other benefits it would limit the potential for accidental or unintentional divergence between the UK and EU (also discussed on page 10 below).

As for other aspects of the UK-EU relationship that are relevant to the financial services ecosystem, we set out below views on (a) related professional and business services, including the Lugano Convention (b) data adequacy, and (c) labour mobility.

(a) Related professional and business services

TheCityUK believes that any UK-EU agreement must work for all parts of the FRPS ecosystem and its customers and that provisions covering related professional services (RPS) – comprising legal services, accounting services and management consultancy – must form an integral part of the future relationship agreement between the EU and UK.

We welcome, for example, the fact that the UK draft legal text seeks to grant UK lawyers rights to advise EU clients on UK laws (England and Wales, Scotland, Northern Ireland) and public and private international law via all four GATS modes (including the ability to fly-in-fly-out to facilitate the provision of advice across the EU and UK).

In addition to market access, there are a number of significant cross-cutting issues that are important to each of the RPS sub-sectors including the mutual recognition of professional

qualifications (MRPQ), access to skills and talent and the continued ability to transfer data between the EU and the UK.

The future relationship agreement needs to include a robust framework for MRPQ which includes a clear path for admission into host-state regulated professions. We note the MRPQ framework proposed in the UK's proposed draft future relationship text with the EU and welcome the government's stated level of ambition on this issue.

The Lugano Convention governs jurisdiction and the enforcement of judgments in civil and commercial matters between EU member states and EFTA members Iceland, Norway and Switzerland. It predates the Single Market and is part of the international infrastructure that underpins the rule of law and respect for obligations across our region with common rules on jurisdiction and enforcing court judgments.

As things stand, the UK's involvement in the Lugano Convention will cease at the end of the transition period. On 8 April 2020 the UK submitted its application to accede to the Lugano Convention. Accession would result in little change to the current arrangements. English court judgments would continue to be enforceable throughout EU and EFTA countries and English jurisdiction clauses respected, and vice versa. Without accession to Lugano, enforcement of judgments will no longer happen automatically, and this may lead to judgments being challenged.

The UK's application to accede will only succeed if it has the unanimous agreement of all contracting parties. Whilst Iceland, Norway and Switzerland have indicated their support for the UK's access the EU has been less positive in its response. There is no clear basis for the EU's stance, which leads to concern that this approach has been adopted for reasons of negotiating and/or political expediency, regardless of the detrimental consequences of politicising this international agreement.

(b) Data

The ongoing free flow of data is vital both for day-to-day cross-border business and for longer-term economic development, jobs and growth. International trade requires data-flows not to be disrupted. The FRPS industry is among many which critically depend on the free flow of data, which is also essential to business stability and to the detection and prevention of financial crime and related offences.

The most legally sound and stable option for ensuring the continued ability to transfer personal data between the UK and the EU/EEA and international destinations is to secure mutual adequacy decisions between the EU and UK. These decisions are unilateral and not part of the FTA negotiations and should be taken in a technical, depoliticised manner and free of undue influence from the wider trade negotiations.

We welcome the government's updated guidance and published draft legislation which will transitionally recognise all EEA countries as 'adequate' to allow data flows from the UK to the EU and EEA to continue. However, we note the publication of the updated

Communication from the European Commission⁵. This reconfirms the approach that the Commission adopted in November 2018, and will require firms to rely on the provisions under the EU GDPR as applicable to all transfers to non-equivalent third countries, such as Consent, Binding Corporate Rules, Model Contracts and Legitimate Interests derogations. We view this as significantly inferior to adequacy, for the following reasons:

- **Consent**
This can be withdrawn or withheld at any time making it unreliable for important activities like financial crime prevention.
- **Binding Corporate Rules**
These are valid for intercompany personal data transfers only. The approval process can be slow and if there is a significant increase in applications it could have resourcing implications for the ICO. They are also only available to companies with a presence in an EU Member State. Further, this process is time-consuming and complex to design and secure, and requires continuous updating. They are not a feasible solution for smaller firms that do not have a group level presence.
- **Model Contracts**
These are more readily useable but do not provide legal certainty, as they are currently subject to a legal challenge. In addition, the identification and renegotiation of relevant contracts can be time consuming and complex, and they are not well suited to transfers in a group using a branch structure, for multi-party or complex transfers and do not address the realities of processor to processor and processor to controller transfers.
- **Legitimate interests derogation**
There are limitations on the size and frequency of transfers, coupled with a requirement to notify the Data Protection Authority and the data subject, which makes this unworkable for most arrangements or transfers.

UK-based firms have prepared for a no-deal outcome by putting alternative data transfer arrangements in place, with Standard Contractual Clauses (SCC) as one of the most widely used mechanisms. However, while SCC remain valid following the recent CJEU judgment in the Schrems 2 case on the EU-US Privacy Shield there will be an increased burden on data exporters that wish to use SCC, such as the requirement to consider the law and practice of the country to which data will be transferred.

However, we are concerned that similar preparations have not been made by businesses across the EU that will continue to need to transfer personal data to the UK. Firms based in the UK have indicated low levels of requests from EU-based firms to agree to, for example, Model Contracts. This would imply that EU firms are unaware of the regulatory risk, or believe that there will be some form of regulatory forbearance. We believe the failure of EU firms to act now could have a significant impact on vendor, customer and other relationships going forward, where EU-based firms are sharing personal data with their UK counterparts.

⁵ European Commission, 'Addressing the impact of a withdrawal of the United Kingdom from the Union without an agreement: the Union's coordinated approach', (April 2019), available at: <https://ec.europa.eu/transparency/regdoc/rep/1/2019/EN/COM-2019-195-F1-EN-MAIN-PART-1.PDF>

In the event of no adequacy determination being made by the end of December 2020 we would urge a period of non-enforcement (as per the Safe Harbour precedent) to safeguard personal data transfers from the EU to the UK, to avoid unprecedented disruption to firms and individuals.

(c) Labour mobility

The UK's legal text is ambitious in its provisions for mobility allowing firms to move key personnel for extended periods and providing for business visitors. The UK has also asked for contractual service suppliers to move between the markets. The EU's legal text is more restrictive and less ambitious but includes visa-free travel for short stays. This aligns with the EU's approach in previous trade agreements.

The draft negotiating texts include several definitions of business visitors. The draft EU text (unlike that of the UK) also does not include the term 'investor' as part of the business visitor activities; the UK's inclusion of the term is a welcome addition.

Neither the UK nor the EU has provided a draft list of covered activities, which is important for understanding the full scope of what is being proposed by each side. EU precedent suggests their list will be limited and will not include paid work. However, for these arrangements to work for the FRPS industry, the UK government must seek to negotiate broad provisions with regards to short-term business visitors, including a wide scope of covered activities.

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?

It is very disappointing that the EU has taken this approach. It is not immediately clear why equivalence determinations are not possible. While the EU is undertaking reviews, it is not certain whether these will impact on the aims or outcomes of the EU's regime. In any case, the UK and EU regimes will be identical at the end of the transitional period. Against this background, some commentators have suggested that the Commission's announcement is part of an overall political approach to equivalence.

The European Commission did not clarify what it meant when it outlined it would not adopt equivalence determinations in the 'short- or medium-term' in certain areas. The industry remain hopeful that the European Commission will consider making a determination on equivalence under MiFIR at some point after the new EU legal framework for the Investment Firm Review is in place, in June 2021. The industry is also hopeful that the Commission will make equivalence determinations before the end of 2020 in at least some of the other areas not specifically singled out in its communication, in particular in the important area of recognition of trading venues for the purposes of the share and derivative trading obligations.

The industry is concerned at the lack of clarity as to the ability of firms in the UK or EU undertaking certain cross-border business in each other's territory, which is compounded by a lack of clarity on the timing. This means that firms will, as noted in the European Commission's communication, be considering their existing preparedness plans to ensure that they can best mitigate risks and continue to service customers and clients.

Looking to the future, and if equivalence is to be granted, it is critical that processes are put in place to ensure greater legal and regulatory certainty.

To optimise British national and global financial markets' interests, the UK should not retaliate against any EU attempts to restrict market access. Britain should remain open to global business and show its ongoing, strong commitment to open and free markets.

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?

It is difficult to give an estimate on the economic impact as this is dependent on many factors including any mitigation measures taken by relevant parties. The impact will be greater in some parts of financial services than others. A lack of equivalence could lead to a loss of access to certain clients, an increase in costs where firms have had to set up subsidiaries in EU Member States, and liquidity splitting in certain instances.

At a headline level, UK financial services exports to the EU account for 27.6% of total services exports and any possible decline in financial services exports caused by not obtaining equivalence would (all other things being equal) reduce GVA generated by the financial services sector and therefore wider economic output in the UK.

In recent years, FRPS firms have undertaken a significant amount of planning under regulatory oversight to prepare for a no-deal (including a lack of equivalence) outcome, and given the lack of progress in the negotiations this will accelerate from now to the end of 2020. This preparation includes applying for licences to operate in EU Member States, moving activity and staff, and engaging with clients to manage various scenarios and ensure a continuation of services.

Nonetheless, there are some areas where individual firms cannot plan or make arrangements in response to the no-deal/no equivalence scenario and so disruption may occur despite this work. For example, in the absence of both the UK and EU granting equivalence in relation to derivatives trading rules, firms' transactions between EU and UK counterparties operating under their respective trading obligations may be subject to conflicting requirements, and global liquidity would be fragmented across multiple venues.

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?

We have consistently heard that, as part of its assessment of the prospects for equivalence, the EU will need to take account of future regulatory alignment and the extent to which the UK diverges from the EU regime. As the UK has onshored the EU's equivalence regime both

the UK and EU equivalence regime would allow either party to withdraw equivalence – if granted – in the case where the other is no longer aligned in an acceptable way.

It is clear that both the UK's and the EU's approach to future legislation will be guided by what is right for their markets, and both have announced their intention to undertake legislative reviews, for example, on Solvency II. This may have implications for any equivalence determinations granted by either party. It underscores the need for outcomes-based assessment of the equivalence of the respective regulatory regimes as we discuss in more detail below.

There is no uniform definition as to the meaning, in practice, of equivalence. The meaning can vary between the EU's different third country regimes (TCRs) and their precise legislative provisions, and between different industry sectors.

The assessment of equivalence is meant to be outcome-based, so potentially it allows some scope for divergence between the respective regimes of the EU and the third country. In the absence of more detailed guidance from the EU authorities, however, it will be difficult for the UK policymakers and regulators to know how far they can diverge from the EU standards without ceasing to be regarded as equivalent.

We believe that where the UK and EU autonomously decide to grant access to their markets on an assessment of the equivalence of their respective regulatory regimes, this should be as determined on a regulatory outcomes basis. These outcomes should be determined, free of political considerations, by reference to the following shared regulatory objectives:

- financial stability
- investor and consumer protection
- fair competition
- market integrity
- the prevention of regulatory arbitrage.

Assessments should be determined by reference not only to the content of law and regulation, but also taking into account the approaches of the respective parties to supervision and enforcement, and the resources devoted to them. The focus on regulatory outcomes, rather than line by line comparison, is an important feature of this approach.

There is also a need to avoid accidental or unintentional divergence, both between the UK and EU and globally. We would encourage the UK and EU to continue to work through international fora, for example, the Financial Stability Board, Basel Committee, International Monetary Fund and International Organization of Securities Commissions, to promote global regulatory coherence.

We are pleased that the UK has completed its assessment of the EU and call for the UK to announce its final determinations, sending a strong signal to the EU and other jurisdictions. We also welcome the UK making clear its intentions with regards to international and EU regulatory reforms that it needs to address before the end of the transition period.

In regards to areas such as clearing, it is important to note that clearing is a global business and it is key for financial stability for markets around the world. Regulators should be encouraged to work closely together in their supervision of clearing houses, sharing

information and helping ensure a smooth system. As in other areas, equivalence on clearing should not be used as a political tool.

More broadly, the UK needs to consider its position towards overseas firms, including EU firms. The UK should identify how to enhance its regime to ensure it is as open as possible, and in particular to cross-border wholesale financial services. This openness, underpinned by a predictable, evidence-based approach to decision-making would be a clear sign of a regulatory mindset that supports cross-border trade in the way that the UK is keen to champion.

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?

It is clear the European Commission will be making a number of legislative changes in financial services in the coming years, not least as it looks to support the EU's recovery from the COVID-19 economic crisis.

We will engage constructively with this process, commenting where appropriate, especially given that many UK-based FRPS businesses will maintain significant activity within the EU.

Overall, our industry supports the development of a deep, open, interconnected and internationally aligned Capital Markets Union (CMU) in Europe. This can be used to bring to fruition shared policy objectives including supporting the green transition, the furtherance of other ESG issues and the recapitalisation of the economy post-COVID-19.

The International Regulatory Strategy Group (IRSG) – a joint venture between TheCityUK and City of London Corporation – responded to the European Commission's consultation on the roadmap to the CMU Action Plan. This stressed the need for an open, internationally-aligned CMU with a legislative and regulatory framework which allows EU businesses and citizens to benefit from capital and expertise from outside the EU, within a fully competitive environment. In this way, EU investors will be able to access liquidity pools and have a broader range of investment opportunities. This point underscores the benefits of being open and attractive to investors, maintaining high regulatory standards and not engaging in regulatory retaliation.

It is worth noting that while some of the challenges that the EU is trying to resolve through the CMU are EU-specific, objectives such as improving retail participation in capital markets are as relevant for the UK as for the EU. It will be important for the UK to monitor the progress of the initiative to understand how any rules or requirements may interact with those set in the UK, and to identify any ways in which future legislative changes relating to UK capital markets can help enhance capital markets in both jurisdictions, and help benefit businesses and individuals.

The proposed UK and EU reviews on Solvency II are welcome as the regime remains relatively new. The UK will review certain features of Solvency II to ensure that it is properly tailored to take account of the structural features of the UK insurance sector.

More broadly, and in particular on global challenges including Anti-Money Laundering we would encourage the UK to continue to work at the global level to promote global regulatory coherence, and this will include working with the EU in these fora.

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?

Industry is reassured that the UK regulators continue to engage in dialogue with the EU and their counterparts in Member States. A number of MoUs exist, or have been agreed, between UK and EU regulators (both European bodies and national regulators) which help facilitate relationships. We would welcome the continued recognition of these post-2020 and welcome the announcement from ESMA which indicates this should be the case and that the agreements between ESMA, FCA and national regulators will come into effect at the end of the transition period.

However, we believe that it is important that regulatory and supervisory cooperation is also covered by the UK-EU FTA to help strengthen and formalise the process. The establishment of a UK-EU Regulatory Forum in the FTA would support this and should be built upon existing examples such as the EU-US and the EU-Japan fora and provide for appropriate consultation and dialogue. The aims of the forum should include⁶:

- taking a consistent approach to changes in regulation or the development of new regulation with a view to avoiding opportunities for regulatory arbitrage or financial instability
- cooperating in relation to international standards, both in terms of their development and of their consistent implementation
- considering the impacts of new initiatives on market operators in each other's markets
- structured engagement with industry representatives.

In which aspects of UK financial services is the UK looking 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?

TheCityUK's membership includes representative firms from all FRPS industry sectors, including commercial banking, investment banking, equity trading, fixed income, currencies and commodities trading, life insurance, commercial insurance, reinsurance, asset management, wealth management, legal services, accounting and auditing and consulting. While the potential gains to be made by each of these sectors will vary from market to market, we approach our work on international trade and investment from a pan-industry perspective.

TheCityUK submitted a number of in-depth submissions to HM Treasury in 2019 in which we explained how the industry could add strength to the government's Global Financial Partnership (GFP) initiative, which sought to increase trade in financial services with key

⁶ IRSG 'An economic partnership based on close and structured cooperation: Key principles for the management of the future UK-EU relationship in financial services', (February 2020), available at: <https://www.irsg.co.uk/assets/Uploads/IRSG-An-economic-partnership-based-on-close-and-structured-cooperation.pdf>

financial centres. The GFP priority markets initially identified by HM Treasury (Hong Kong, Japan, Singapore, Switzerland and the US), which contained the five largest financial services centres outside of the EU, offered a helpful starting point for considering which markets are priorities for the industry.

However, decisions about the immediate and ongoing prioritisation of markets are complex. Factors in any assessment may well shift over time, so the process involved must be dynamic and flexible as well as sustainable. The UK is one of the world's leading trading nations and its businesses are deeply embedded in global value chains that cut across several regions and markets.

For all these reasons it is difficult, if not impossible, to categorise a ranking of priority markets that will be shared across all sectors of our industry. Any ranking will be influenced by a mix of factors, from the stability of relatively mature markets to the need to grow trade with countries and regions where the potential for economic expansion is greatest, such as China, India, Turkey and Malaysia.

Across all markets, the main barriers to trade in financial and professional services are often behind-the-border regulatory barriers, and the UK's international strategy should seek to find ways of promoting more regulatory cooperation with key trading partners.

Regulatory cooperation can be highly valuable, but it also takes time: before embarking on new initiatives, it is important to undertake political and technical assessments of the strength of government-to-government and regulator-to-regulator cooperation between the UK and its potential partner.

Agreements on regulatory cooperation require trust on both sides and are far likelier to be reached between countries with strong bilateral ties. Regulatory cooperation is also best advanced through a joined-up approach from government, regulators and industry. A recent example of bilateral co-operation is the US-UK Financial Regulatory Working Group, a regulatory dialogue convened by the US Treasury and HM Treasury to further financial regulatory cooperation and increase compatibility between the countries' regulatory frameworks. TheCityUK is supportive of this dialogue and has together with leading US trade association SIFMA co-founded the UK-US FRPS Industry Coalition⁷ to provide advice on commercial opportunities and regulatory barriers that governments can consider and address in the context of the bilateral relationship.

The UK's Economic and Financial Dialogues (EFDs) and Financial Dialogues (FDs) with trade partners provide another good example of how to structure and take forward bilateral cooperation on macroeconomic and financial issues.

Globally, the UK should seek to ensure it is seen as the prime location to raise finance, facilitate investment and manage risk. The development and expansion of regulatory cooperation and an outcomes-based approach to recognition of other jurisdictions will help underpin this.

⁷ TheCityUK, 'TheCityUK joins new industry coalition' (September 2018), available at: <https://www.thecityuk.com/news/thecityuk-joins-new-uk-us-financial-and-related-professional-services-industry-coalition>

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?

The government has taken steps to ensure that the benefits of existing EU trade agreements to which the UK is a party will continue to be enjoyed by the UK until fresh agreements between the UK and those countries have been negotiated. TheCityUK welcomes this and urges the government to continue to make rapid progress in securing these agreements and building upon them.

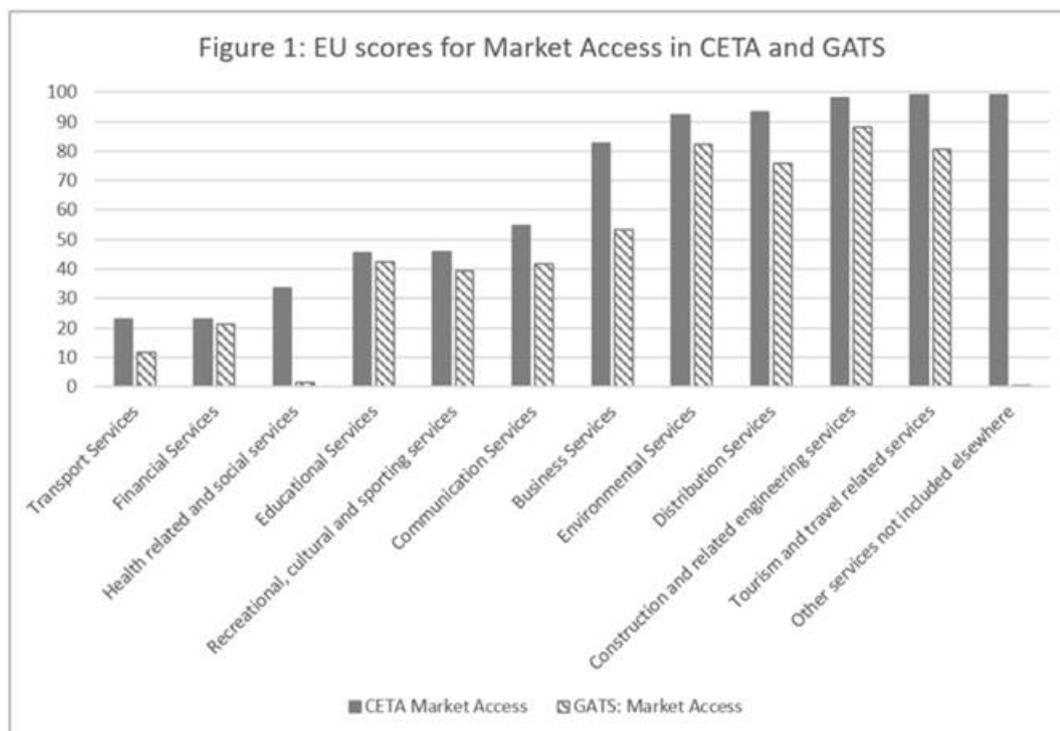
Recent news suggests that the UK -Japan negotiations are on the point of completion, and that they will build on the EU-Japan Economic Partnership Agreement (EPA). The EU-Japan EPA contained important provisions for FRPS providers, including a forward-looking annex covering regulatory cooperation on financial regulation and a framework for establishing mutual recognition of professional qualifications. It is welcome that the UK and Japan are ready to build upon these, especially with regards to liberalising digital trade, which is a priority for both UK and Japanese FRPS providers.

It is important for the UK to add further ambition to existing EU agreements with third countries such as the EU-Canada Comprehensive and Economic Trade Agreement (CETA). Some of these have tended to provide only limited additional benefits for FRPS. For example, CETA is often cited as the most advanced agreement the EU has reached with respect to services trade. It takes a “negative list” approach (meaning all aspects of trade are liberalised unless specifically excluded) and includes features to prevent any future moves to reduce market access, through “standstill” and “ratchet” clauses. It covers all four GATS modes of supply and prohibits any quantitative restrictions or discriminatory treatment of services providers and investors from either party. However, for FRPS suppliers, CETA has achieved only very limited market opening beyond the level of access already accorded to suppliers from all WTO members (see figure 1 on page 14 below).

While most FTAs include encouraging provisions on services trade in the body of the text, the real scale of market opening can only be judged from the detailed schedules of services commitments. In practice, such schedules, while setting out terms for market access and national treatment, tend also to include lists of reservations on non-conforming measures that the parties intend to keep in being.

CETA is considered substandard as a model for many of the key requirements for UK FRPS providers in the future UK-EU relationship such as the mutual recognition of professional qualifications (MRPQ) and limiting reservations on corporate forms. It also allows member states to impose reservations on short-term business visitors. Despite advancing market liberalisation for FRPS, CETA still falls well short of what these sectors need to operate smoothly.

Figure 1: Chart comparing relative market access for services sub-sectors CETA and GATS⁸



The Committee will be aware of HM Government’s update⁹ on EU trade agreements continuity, which outlines how many such relationships have been replicated, and which of these need 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?

The delay in granting equivalence is disappointing, especially given the commitments made in the Political Declaration. The delay to equivalence determinations by the EU has meant that many firms have had to continue to plan for a range of outcomes which is both time-consuming and resource-intensive. Given the uncertainty, those firms have had to take an approach based on a worst-case scenario outcome.

The final date when clarity is needed will differ depending on the firm, the service in question and overall business model. In practice, many businesses will need time to notify clients in case of business changes as a result of a lack of equivalence determination. Where firms need to engage with a large number of clients or deal with complex financial relationships, the time needed to transfer contracts, unwind contracts, or make operational systems changes, may mean that the final date has already passed, or is fast approaching. Other firms have had the necessary arrangement in place for some months now.

⁸ UK Trade Policy Observatory, ‘Can CETA-Plus solve the UK’s services problem?’, (March 2018), available at: <https://blogs.sussex.ac.uk/uktpo/files/2018/03/BP18-10.209199781912044559.pdf>

⁹ HM Government, ‘Existing UK trade agreements with non-EU countries’, (June 2020) available at: <https://www.gov.uk/guidance/uk-trade-agreements-with-non-eu-countries>

We welcome the confirmation that the European Commission is considering the adoption of a time-limited equivalence decision for UK CCPs. This is essential to address a very important financial stability risk. It is important that the equivalence and recognition is in place before the end of September to ensure that UK CCPs do not have to start the process of off-boarding clients.

On CCP equivalence, the Bank of England recently stated¹⁰ that EMIR 2.2 adds complexity to the process and additional steps are required to grant recognition of UK CPPs, including the Bank of England and ESMA having to negotiate a new cooperation agreement. Furthermore, if the new rules on tiering are in place by the end of September, UK CCPs must be tiered before recognition can be granted.

In the absence of recognition, UK CCPs would need to start the process of off-boarding EU members by the end of September in order to provide up to 3 months' notice to their clearing members. This would result in EU and UK counterparties facing the need to seek to migrate thousands of contracts and the related collateral to alternative CCPs. In practical terms, three months may not be sufficient time for the larger clearing members to close out their positions and make alternative arrangements. Even if feasible, this would involve significant risks to market and financial stability.

Finally, we have urged the UK to take its own unilateral equivalence decisions as soon as possible. This is an important move to signal the UK's continued commitment to being an open and international financial centre.

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 UK is a world-leading international financial centre because of the strength of its FRPS ecosystem. In TheCityUK Vision report¹¹, produced with PwC, TheCityUK demonstrated the strength and breadth of the industry's expertise. The UK holds a top-five position in almost all industry sectors, including banking, investment banking, equity trading, fixed income, currencies and commodities trading, life insurance, commercial insurance, reinsurance, asset management, wealth management, legal services, accounting and auditing and consulting. It has particular strength in fixed income, currencies and commodities trading, commercial insurance, asset management and international listings. The UK's predominance in FRPS is reinforced by its world-leading financial and capital markets infrastructure.

The importance of the FRPS ecosystem cannot be emphasised enough. The UK, and London in particular, benefits from a cluster effect: firms across the industry learn from each other, strengthen each other's offerings and form new partnerships.

Ecosystem economics keeps London at the forefront of financial innovation. London is a global hub for FinTech because it co-locates capital, financial and technology talent, and

¹⁰ Bank of England, 'Monetary Policy Report and Financial Stability Report', (August 2020) available at: <https://www.bankofengland.co.uk/report/2020/monetary-policy-report-financial-stability-report-august-2020>

¹¹ TheCityUK 'A vision for a transformed, world-leading industry', (July 2017), available at: <https://www.thecityuk.com/research/a-vision-for-a-transformed-world-leading-industry/>

effective regulation. A similar dynamic has propelled London to the forefront of LawTech and RegTech developments.

But these dynamics are not a given and the factors that deliver them must be recognised, encouraged and supported. Other relevant factors behind London's status include:

- access to UK, European and international markets
- the UK provides deep pools of capital and liquidity and strong risk management
- UK firms have access to highly skilled talent pools
- the UK offers an attractive lifestyle
- international use of English law and the English language are key strengths
- the UK has high-quality regulators, with a strong regulatory regime
- time zone.

None of these factors alone are responsible for the UK's success; however, taken together they help to explain it.

The most immediate challenge faced by the industry is the economic crisis caused by the COVID-19 pandemic. The rapid response by government and industry has helped companies survive the initial economic impact of the crisis but, looking ahead, it is clear that many businesses will need help to tackle a debt burden that could hold them back or drag them under.

In the report¹² 'Supporting UK Economic Recovery' recently published by TheCityUK, supported by EY, the UK-based FRPS industry has set out a far-reaching set of options for converting, restructuring and repaying this debt to help hundreds of thousands of SMEs get back on their feet, save millions of jobs, protect billions of pounds of taxpayer money, and help power Britain's economic recovery and future growth.

The options presented are the collective work of our industry, which has come together and worked at speed to find solutions to this imminent debt challenge that will ultimately impact us all. Our analysis suggests that some sectors may enter into difficulty as early as autumn 2020. That is why taking action now is vital to help businesses get back onto a stable footing as the UK emerges from the pandemic, and will ultimately support the UK's economic recovery and fuel its future return to growth.

The industry can also play a broader role in the country's recovery, for example, taking forward work on digital skills, levelling-up and sustainability; all key policy areas which have accelerated due to COVID-19.

There are a number of long-term socio-economic and geo-political challenges that the industry faces, from continuing to support the UK's economic recovery to digitalisation and unmet customer need, including adequate funding for pensions and infrastructure.

Increasing life expectancy, low levels of lifetime saving and a low interest rate environment are key factors in deficits between pension fund assets and liabilities – reflecting a wider

¹² TheCityUK, 'Supporting UK economic recovery', (July 2020), available at: <https://www.thecityuk.com/assets/2020/Reports/2d5179dbfb/Supporting-UK-economic-recovery-recapitalising-businesses-post-Covid-19-v2.pdf>

challenge in supporting an ageing population. An urgency in tackling climate change will also increase the demand for funding green projects. This is an area where the industry has made significant strides in recent years, for example as it helps businesses across the economy in the transition to a low carbon economy.

In line with the global shift towards a digital economy and the growing importance of digital assets, the threat from cyber-crime and the need to protect digital assets and personal data will increase enormously.

These issues will need to be addressed if the UK is to maintain its world-leading position. In the face of these challenges, the industry will continue to innovate and adapt in order to continue to serve our customers, clients and contribute to the wider economy.

The industry is committed to working in partnership with government and regulators to ensure the UK's competitiveness is enhanced and we reinforce our position as a leading international FRPS centre.

It is vital that the UK maintains its high regulatory standards and its openness to international firms and capital. We welcome the opportunity to contribute to the various government reviews underway, including the next stage of HM Treasury's Future Regulatory Review.

We are also committed to undertaking industry-led work to help inform the UK's future regulatory framework to ensure the UK maintains high regulatory standards and its openness to international firms and capital. As part of this, the IRSG is undertaking work on the UK's regime for overseas firms, which will make recommendations on the overall operation of the UK's access mechanisms. It will deliver an interim report in early Autumn and a more detailed analysis of specific changes required to make the UK more attractive and globally competitive.

This work will analyse the current access mechanisms for overseas firms to the UK which currently include (but are not limited to) the OPE, the TPR and the onshored EU TCR as well as the overseas funds regime which is currently under review. It is expected that a more transparent, coherent and clearer access regime will provide an improved toolbox for the promotion of UK financial services internationally.

In addition to providing high-quality regulation and openness to foreign firms, other areas of domestic policy which we believe that government and regulators should focus on include:

- securing access to skills and talent in the UK through immigration policy and domestic skills development
- delivering a simplified, stable and internationally competitive tax regime
- recognising the UK's value proposition includes the significant talent, abilities and skills of professional and legal services, the UK jurisdiction and dispute settlement, and market infrastructure. These are key element of the attraction of the UK ecosystem to potential investors and partners
- ensuring that the UK continues to enjoy high quality digital and physical infrastructure
- ensuring that key domestic hubs and key financial centres outside of London enjoy first class transport links

- supporting regional and national financial centres so that they become more prominent within the UK industry.

Looking outward from the UK a key longer-term challenge for the UK FRPS industry includes gaining and improving market access and prudential treatment rights where this is currently restricted. The recent announcement of an agreement between the UK government and the Swiss government is welcome and such an outward and ambitious approach to financial services partnerships should be encouraged.

Achieving this will involve a mix of securing improved commitments on market access and national treatment (on a bilateral, plurilateral and multilateral basis) and achieving (particularly for financial services), at the intergovernmental level, greater depth of regulatory cooperation, institutional partnerships, dialogues and alliances, and other mechanisms that can further the interests of the UK industry and the wider economy that it supports. For example, EFDs and FDs have led to progress in some trade and investment fields and deepened cooperation on macroeconomic policies, finance and industrial strategies. These usually allow for industry-government dialogue and have proved useful opportunities to further discussion on cooperation across FRPS activities.

Moreover, TheCityUK and its members continue to work with HMG to advise on how best to craft a new range of FTAs and regulatory cooperation agreements that could allow the industry to benefit from greater access to new markets. We work with HMG on projects to promote greater financial inclusion in new and emerging markets so that more people can take part in the global financial system.

Despite these existing areas of collaboration, we would strongly urge the government to establish a comprehensive trade policy whereby it clearly defines its objectives and that trade in services is identified as a critical priority.

It is imperative that the UK plays a leading role at the global level, shaping global standards and their consistent implementation, in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage.

The industry is therefore focused on the global regulatory agenda to ensure that the global challenges that our economies and societies face are tackled by a global approach. The challenges of climate change, the economic recovery from COVID-19 and financial crime need to be addressed by global regulatory cooperation and the industry is committed to playing its part in this regard.

Conclusion

It is important that the government recognises the key role that regulatory regimes can play in informing and influencing investment decisions across the FRPS industry. This includes aspects such as predictability and an evidence-based approach to decision-making. Openness to foreign business is a key component of the UK's international competitiveness and the UK FRPS ecosystem.

UK-based financial institutions are often European or global businesses that carry out vitally important activities that make a significant contribution to the UK economy. The ability of international firms to conduct activities in the UK is an important part of ensuring that

customers are able to access the best financial services in the world and realise the full benefits of innovation.

The UK needs to consider its position towards overseas firms, including EU firms. The UK should identify how to enhance its regime and overall business environment to ensure it is as open and attractive as possible, and in particular to cross-border wholesale financial services. This would be a clear sign of a regulatory mindset that supports cross-border trade in the way that the UK is keen to champion.

By remaining open and developing clear policy proposals for the competitiveness and growth of the UK's market inward investment from across the world, job creation and economic growth post-Brexit will be supported.

August 2020



Committee on the Future Relationship with the European Union

House of Commons, London, SW1A 0AA

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

23 July 2020

Miles Celic
Chief Executive Officer
TheCityUK

Dear Mr Celic,

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.

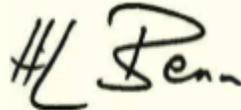
The Committee is keen to gather as much evidence as possible to inform its deliberations so I am writing to you to ask whether you would be willing to help us with our work by making a written submission. We welcome general responses to our [call for evidence](#), which was published on 4 March. We also 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,

A handwritten signature in black ink, appearing to read 'H/ Benn'.

Hilary Benn
Chair of the Committee