



HM Government

Framework for the UK-EU partnership Financial Services

25 July 2018

PART I

CONTEXT

PART II

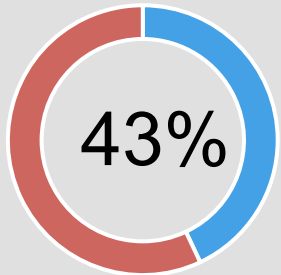
PROPOSED MODEL

PART III

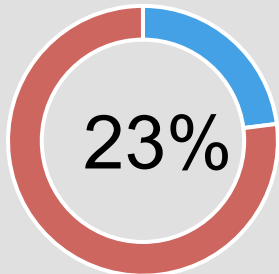
CONCLUSION

The UK is a global financial centre, with a broad service provision to the EU and internationally

UK FS international and wholesale business related to the EU represents



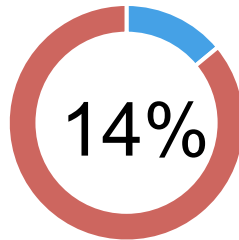
43% of total UK FS international and wholesale revenues²



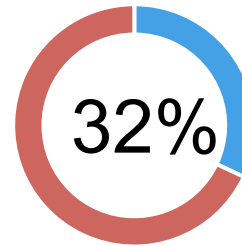
but 23% of total revenues in financial services²

Insurance

European business represents 14% of the London Market¹

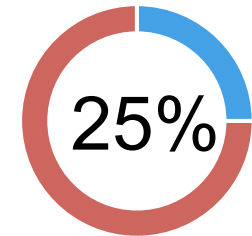


32% revenues for UK based insurers in international and wholesale activity comes from activity with EU clients, with activity from UK and RoW clients making up 68%²



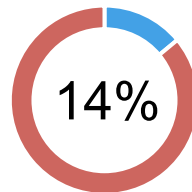
Asset management

25% revenues of UK based asset managers comes from managing funds for EU clients, with managing funds for UK and RoW clients making up 75%²

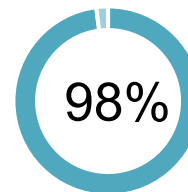


Central Counterparties

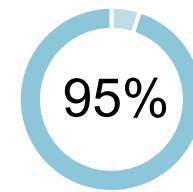
14% of LCH's clearing is from EU participants³



LCH clears 98% of all euro-denominated interest rate swaps³



LCH has 95% global market share in interest rate swaps³



(1) HMT analysis of Lloyd's of London annual report 2016, p.1 and Companies Market statistical report 2016, p.12 (2) HMT analysis of TCUK/Oliver Wyman's 'The impact of the UK's exit from the EU on the UK-based financial services sector' (3) company accounts and public disclosures

The interconnected market has benefits for consumers and businesses across Europe



UK-located banks underwrite around **half** of the debt and equity issued by EU companies⁴



Over 95% of euro-denominated derivatives are cleared on UK infrastructure. UK central counterparties, which clear derivatives, are the largest in Europe³



UK-located banks are counterparty to **over half** of the over-the-counter interest rate derivatives traded by EU companies and banks⁴



On average across the largest 5 EU27 MSs, **40%** of companies' shares trade in the UK⁵



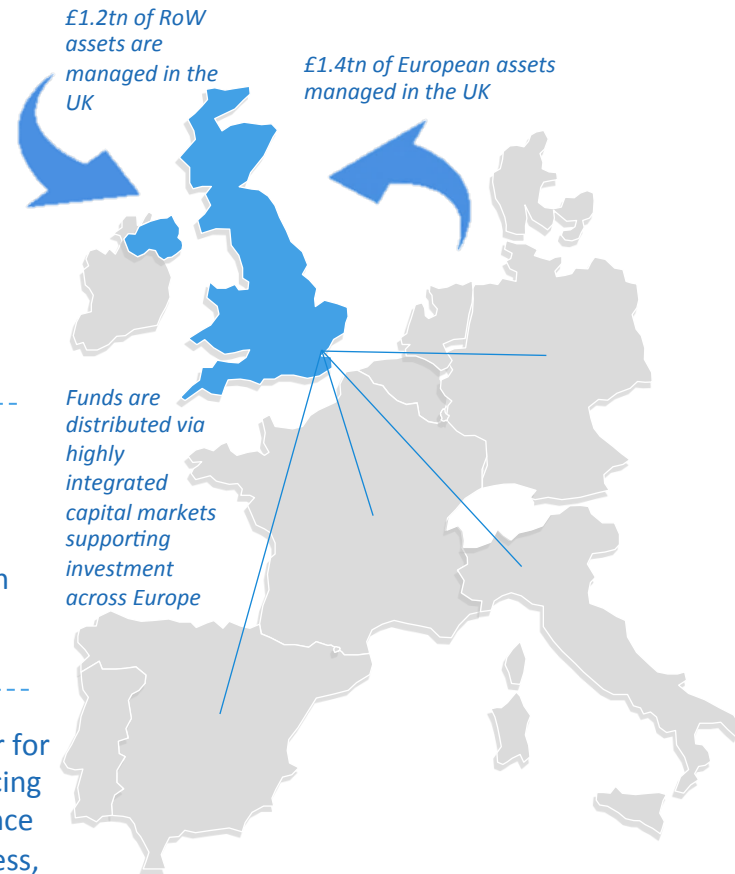
The UK has the largest share (**37%**) of global foreign exchange trading in the world. By comparison, France and Germany have **3%** and **2%** respectively⁶



TheCityUK estimates that **more than twice as many euros** are traded in the UK than in all the euro-area countries combined⁶



London is the world leader for speciality insurance, servicing special and unique insurance needs for European business, such as insuring satellites, offshore energy products, and complex projects such as metro systems



Source: (3) company accounts and public disclosures (4) Bank of England Financial Stability Report: June 2017 Issue No. 41, Investment Association, EFSCAC data; (5) Fridessa Fragulator, 2017 (6) TCUK, Key facts about the UK as an international financial centre 2017 (p18) (7) PWC, Impact of a loss of mutual market access in financial services across the EU27 and UK (2018)

If mutual market access is lost, independent analysis indicates economic benefits from UK FS activity relocating to the EU27 will be more than offset by negative fragmentation and lost efficiency impacts⁷

Financial stability is a shared interest

The UK is host to all 30 global systemically important banks and is the home regulator for four of them. The International Monetary Fund (IMF) has described financial stability in the UK as a “global public good”⁸ and the risks of disruption to continued UK-EU co-operation have been recognised by the EU authorities.

Chancellor Phillip Hammond

The government is strongly supportive of continued engagement and cooperation between UK and EU regulators to protect financial stability.

It is vitally important that we work with our European partners to put the technical arrangements in place to avoid financial market disruption.

Financial Services Update: Written statement, 20 December 2017

International Monetary Fund

Close cross-border regulatory and supervisory cooperation remains essential to assess risks and vulnerabilities, especially with a potentially more complex and fragmented European financial system.

Regulation and oversight arrangements related to euro-denominated derivatives clearing on UK-based central counterparties, and especially permissions for EU banks, will require careful design

Staff Concluding Statement of the 2017 Article IV Mission, 20 December 2017

European Banking Authority

Risks may, in the short term, endanger the continuity of cross-border financial flows and services between financial services providers in the EU27 and the UK.

A disruption of financial flows and financial services, coupled with diminishing confidence of market participants, could lead to the drying up of market liquidity and rising risk premia, with further potential adverse feedback loops for market confidence affecting financial stability in the EU banking system.

Risk assessment of the European Banking System, November 2017

(8) ‘United Kingdom financial sector assessment program’, International Monetary Fund, June 2016

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The UK proposal respects the autonomy of both Parties whilst providing certainty and protecting financial stability

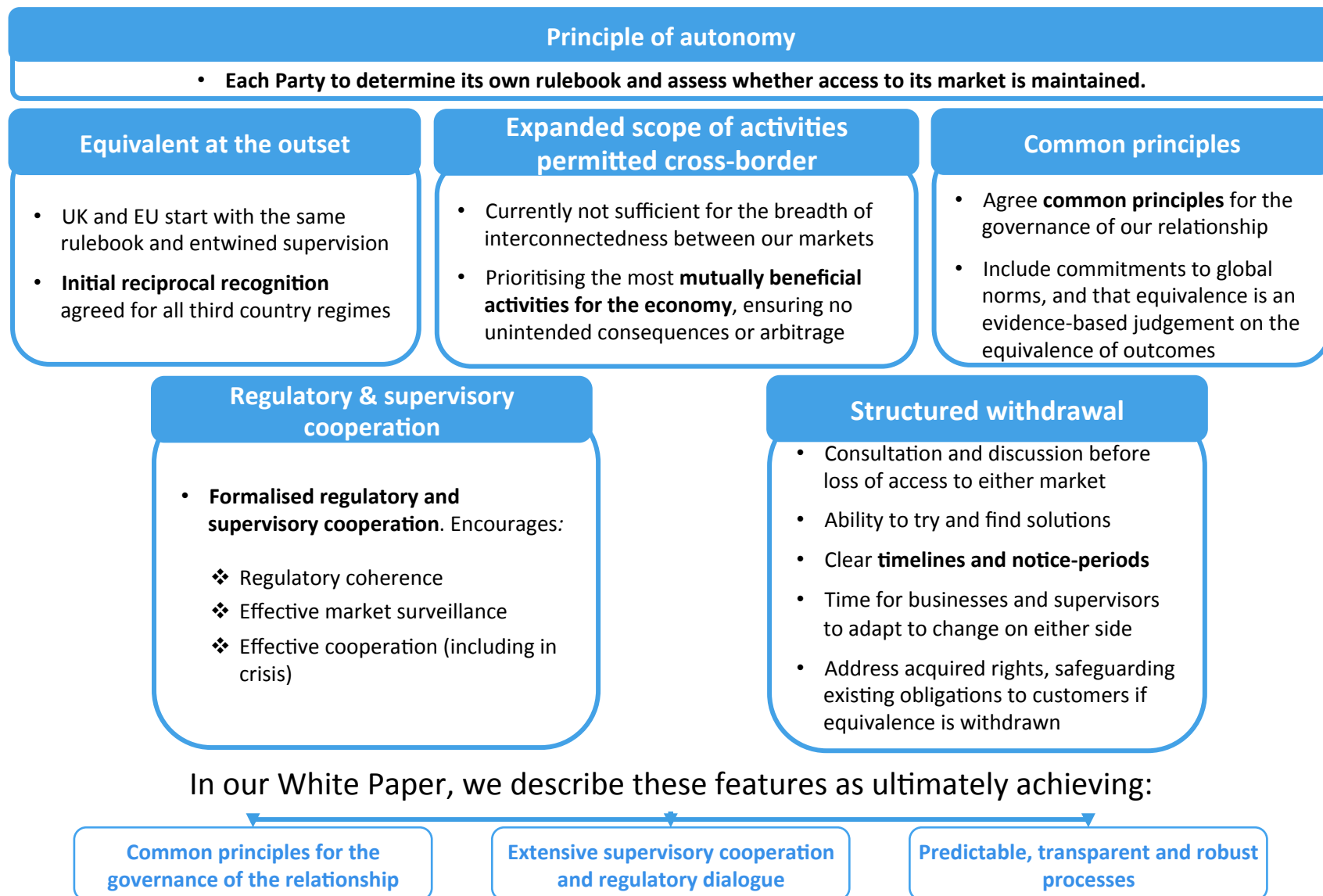
Once the UK leaves the EU, we will maintain **strong and appropriate regulation** of our sector, given the exposure of our economy to the fiscal risk it represents.

The UK hosts the **world's most significant financial centre**, with markets and products that are often **very different from what is found elsewhere in the EU**.

These differences mean that **ruletaking** – in the sense of an open ended commitment to adopt rules without having influenced their formation – **will simply not work for this sector**

It is important to find a **mutually acceptable solution** that encourages us to work together constructively, protecting financial stability, and respecting the **principle of autonomous decision-making**

Overview: key features of the UK position



The UK has proposed in its White Paper a two-fold relationship for financial services:



Parties retain autonomous judgement about access to their market and over legislation.



Bilateral agreement would include commitments and processes – ensuring transparency, stability and promoting cooperation.

The UK proposal would not undermine the autonomy of each Party, whilst encouraging regulatory compatibility



Each side's **legislative process and rulemaking** would be autonomous, where each of us are answerable to our respective political and judicial frameworks



The **criteria for determining if a foreign jurisdiction has equivalent standards and supervision** for a given sector would be autonomous



The decision to **grant or withdraw equivalence** would be an autonomous judgement



There would be no recourse to the **EU/UK Dispute Resolution Mechanism for autonomous matters** – only for commitments included in the bilateral, Treaty-based agreement

...with bilateral Treaty-based commitments to provide certainty and stability, not provided for under existing EU equivalence regimes

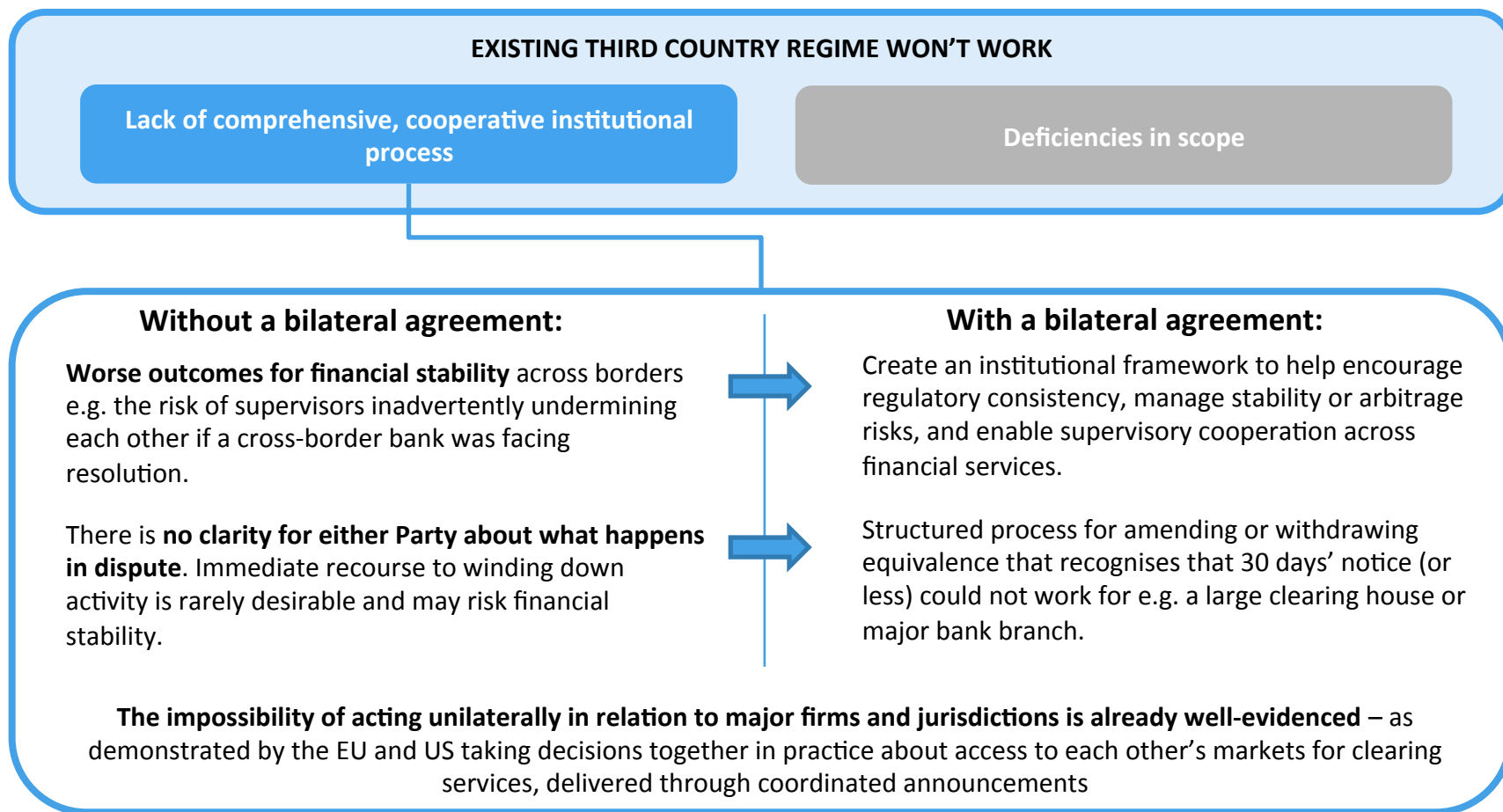
Why this is important?

- ➔ Managing the scale of financial services activity occurring in both directions as part of a productive and efficient European market will inevitably demand bilateral engagement. A structure is needed to **provide greater clarity** about how we will work together.
- ➔ There are **gaps in coverage of the existing third country regimes**. For example, there is no third country equivalence regime to support the rights of around 7,000 EEA domiciled funds to market to UK retail customers, who operate under the passport today.
- ➔ Supervisory cooperation should reflect the level of integration between the UK and EU and provide a clear legal framework which covers micro- and macro- prudential supervision and crisis management. Reliance on informal MoUs would inevitably leave **gaps in the oversight of micro and macroprudential risk**, while uncoordinated decision-making could lead to conflicting or unenforceable decisions.
- ➔ **Cross-sectoral structured consultation and dialogue** on the evolution of rules is essential if we are to maintain compatible regulation across the very broad spectrum of activity taking place. This is not provided for under existing equivalence frameworks.



It is therefore critical that we have a bilateral aspect to our relationship. The EU has already pursued such an approach, first in the offer to the US on TTIP, and now as agreed with Japan.

There are deficiencies in institutional process, which a bilateral agreement would overcome...



Clarifying and formalising the process of managing cross-border regulation and market access will not limit either Party's judgement or flexibility, but rather will create greater confidence in and predictability of the process for affected firms and supervisors.

...and further deficiencies in scope under the EU's existing third country regime

EXISTING THIRD COUNTRY REGIME WON'T WORK

Lack of comprehensive, cooperative institutional process

Deficiencies in scope

The scope of what cross-border activity is permitted into the EU has evolved **dossier-by-dossier** following the crisis, rather than in a conscious way.



The nature and objective of EU third country rules vary considerably (e.g. MiFID2, EMIR, Solvency 2, CRR).

Some services that **provide clear economic benefits are not covered**, leaving a patchwork of EU national regimes instead, which risks regulatory arbitrage and fragmentation of markets.



For example, wholesale lending and deposit-taking in CRD; some areas of investment firm activity in MiFID; wholesale insurance within Solvency II.

Live file discussions are amplifying **uncertainty for firms** through a politically-charged debate in the EU on revisions to equivalence regimes which have only recently come into force.



For example, most evident in the Investment Firm Review. Unpredictability makes it an impossible basis for the UK to rely on and negotiate Brexit, as the goalposts are constantly shifting.

We are not proposing an expansion of the third country equivalence regime to all the areas covered by the passport. Instead, we propose that the scope of the relationship should be defined appropriately in relation to mutually economically beneficial global market activity.

There are many international and EU precedents to build on

Model component International precedents

Common principles for the governance of the relationship

- **G20** agreed that deference of regulatory and enforcement regimes should be possible for high quality regimes based on similar outcomes
- **EU TTIP proposal** offered outcome based regulatory and supervisory tests which may lead to ‘mutual reliance on the rules of the other Party’
- **EU-CH GI agreement** permitted mutual market access on the basis of an objective set of agreed regulatory standards
- Basel accords and **international standards** bodies such as FSB, IAIA, FAFT, IOSCO provide a framework for similar outcomes-based rules

Extensive supervisory cooperation and regulatory dialogue

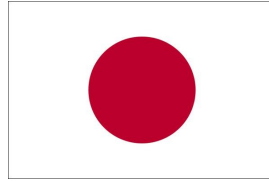
- **EU-US covered agreement on insurance** provides for worldwide group prudential oversight in the home jurisdiction only
- **FSB’s global college framework** is the standard third country baseline and the FSB has also set out the requirements for resolution scenarios
- Information sharing within EU FTAs (**CETA, EU-Ukraine, EU-Japan, EU-Singapore, EU-Vietnam, EU Korea**)
- MoUs like the **BoE/ECB** bespoke arrangement for UK CCPs

Predictable, transparent and robust processes

- **EU TTIP proposal** included governance arrangements for regulatory co-operation, equivalence assessments, data sharing and dispute resolution
 - **EU-Japan** establishes a financial regulatory dialogue between the Parties, commitments to consultation prior to either Party rescinding regulatory reliance on the other’s rules, and technical mediation, to be available where disputes arise (*further detail overleaf*)
 - **CETA** includes an FS commitment for annual dialogue to supervise implementation, develop international standards and resolve disputes
 - **WTO/GATS** supports the inclusion of specialist FS experts for disputes
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Precedent: focusing in on EU-Japan

A similar two-fold approach has recently been agreed in the EU's deal with Japan.



While the criteria and decision-making for equivalence is outside the agreement, the two Parties have agreed:

- ✓ That wherever possible the **Parties shall be able to rely on each other's rules and supervision**;
- ✓ A financial **regulatory dialogue** is established between the Parties;
- ✓ Commitments that in assessing regulation of the other Party, the Parties will not require identical rules but will take an **outcomes-based approach**, give consideration to impacts on the other, and take into account different business models;
- ✓ Commitments to **consultation prior to either Party rescinding decisions** regarding regulatory reliance on the others' rules and reverting to the application and enforcement of its own rules;
- ✓ **Technical mediation**, to be available where disputes arise;
- ✓ **Development of a framework of guidelines** and procedures to implement the commitments, which could increase cooperation, certainty, and the closeness of the relationship.

The new, bilateral economic and regulatory arrangement would have 3 pillars

ECONOMIC AND REGULATORY ARRANGEMENT

1. Common principles for the governance of the relationship

The UK-EU arrangement should include common objectives to manage shared interests such as financial stability, investor protection, market integrity, and the prevention of regulatory arbitrage

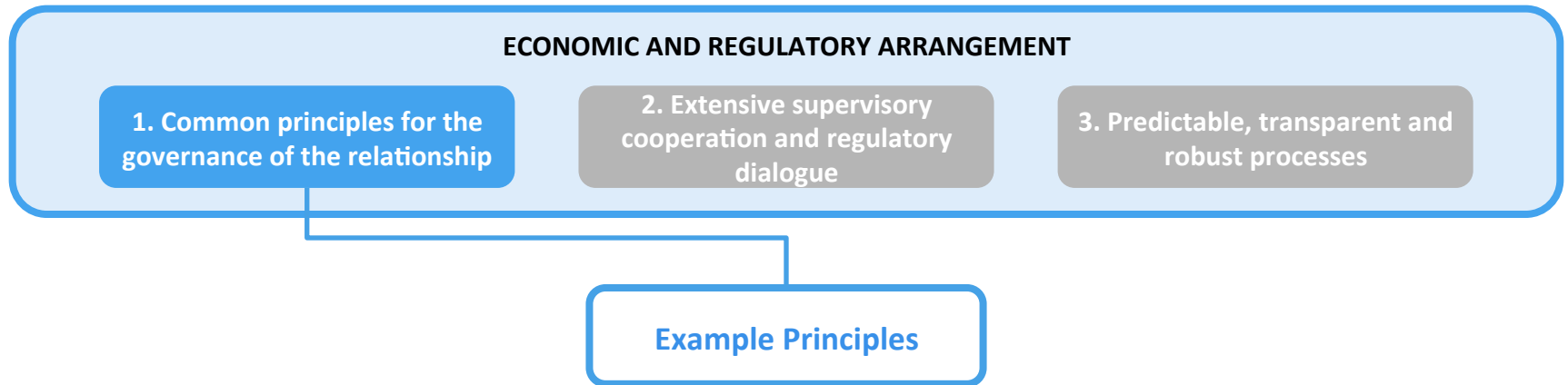
2. Extensive supervisory cooperation and regulatory dialogue

The UK proposes that the UK and the EU would commit to an overall framework that supports extensive collaboration and dialogue

3. Predictable, transparent and robust processes

To give business the certainty necessary to plan and invest, transparent processes would be needed to ensure the relationship is stable, reliable and enduring

Pillar 1: Common principles for the governance of the relationship



Non-discriminatory, evidenced, and outcomes based approach to determining equivalence

Support cross-border financial services between the EU and UK; and take into account the impact on the other Party of legislative change

Maintain economic relations of broad scope

Set out in the agreement where cross-border service provision would be permitted and assessed under respective regimes

Acknowledging existing levels of co-operation and initial reciprocal recognition

Reflecting the unique starting point of the UK-EU relationship, while still respecting autonomy to assess equivalence as the relationship develops

Commitments to respect global norms for financial services

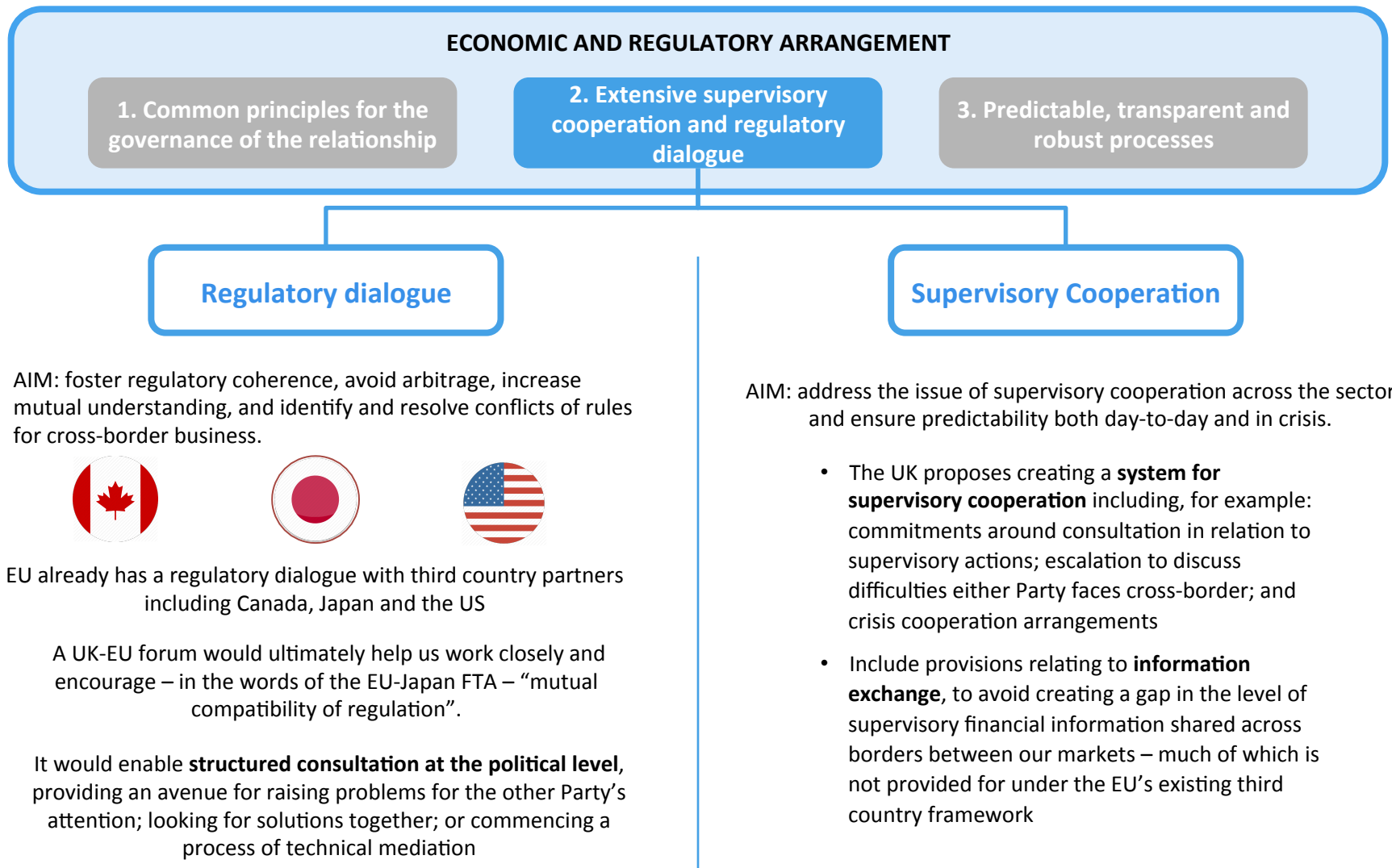
For example, commitment to international standards; fair and non-discriminatory supervision

Commitments to avoid erecting unnecessary barriers in the areas agreed

Agreement that additional requirements would focus on cooperative solutions unless and until equivalence is no longer maintained by either Party

The relationship should follow commonly accepted principles for co-operative relationships in financial services, and reflect the unique UK-EU starting point and the ambition of the Parties

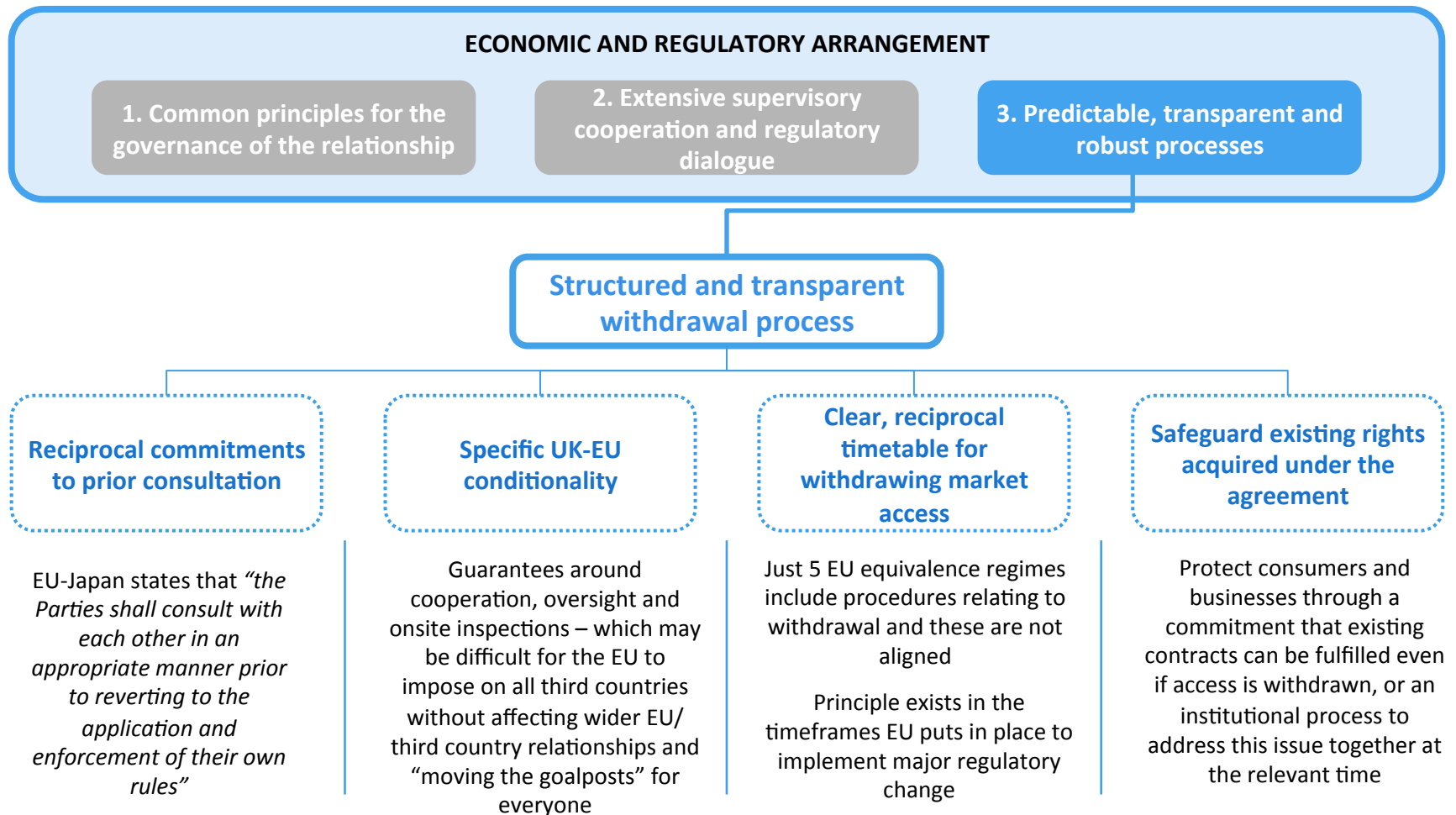
Pillar 2: Extensive supervisory cooperation and regulatory dialogue



Sufficient oversight for cross-border business will require cooperation between Parties to effectively implement

Pillar 3: Predictable, transparent and robust processes

It is important that the new economic and regulatory arrangement provides **sufficient stability and transparency for our market actors and supervisors to rely on**. A structured and transparent withdrawal process is needed to support this



The judgement of either Party to amend or withdraw equivalence would be sovereign, but the Parties will agree bilateral processes to enable the effective implementation of these changes while protecting consumers and financial stability

The UK's proposal does not undermine either side's autonomy

We are not suggesting that this type of framework would set out the detailed criteria for equivalence for a given sector

Nor would it prevent either Party from making its own judgement about whether equivalence continues to be maintained

Nor could our proposal for a binding dispute resolution system be used as a means to challenge whether the EU's or UK's judgement, against its criteria, was correct

The judgement of either Party would be autonomous, both in making a determination of the equivalence of rules to access its market and deciding whether or not this is sustained over time

Instead, our thinking is grounded in:



“By informing each other and cooperating early on in the process, regulatory and competent authorities can come up with solutions to similar problems, while keeping up their respective policy objectives and standards. This reduces the cost of doing business and creates more and fairer competition across borders”

- Commission Better Regulation materials

Autonomy does not prevent either of us entering into commitments today about how we will approach our respective judgements, or agreeing clear processes around mediation, problem-solving and sensible timetables for winding down activity and avoiding retaliation

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Key takeaways

Three key takeaways:

Autonomy of decision making

This is a proposal that **fully respects each side's autonomy of decision-making**, addressing challenges and concerns around the sovereignty of decision making. The bilateral **commitments envisaged do not constrain each side's discretion**, but rather ensure that change can be managed effectively.

Bilateral component is critical

Should be **commensurate to our relationship and degree of market integration**; address **key gaps in scope**; set out **institutional cooperation**; and use consultation and mediation to **explore solutions** and agree **timescales** appropriate for the scale of changes before they take effect.

Cross-border cooperation matters

For EEA firms doing business in the UK and for supervisors, the **UK has no desire to water down existing cooperation**. There is no need to default to a world with less predictability about how the two sides will share information, and cooperate day-to-day and in crisis.



Together, this represents a deal that avoids needless fragmentation and divergence of our markets, of our shared regulatory rulebook, and of cross-border supervisory cooperation

The proposal respects EU concerns and has a number of important benefits for both the UK and EU

EU concerns

Safeguards within the economic and regulatory partnership

Ensure financial stability is safeguarded across Europe



- Ensures continuation of the post-crisis, deep and collaborative regulatory partnership to ensure financial stability

Unilateral decision making on granting/revoking equivalence



- Ensures that the UK and EU retain control of access to their markets and respects regulatory autonomy of both Parties
- Sets out clear, transparent and robust institutional processes based on cooperation and trust

Enhanced regulatory co-operation and **level playing field commitments**



- Provides a robust framework of treaty-based commitments to underpin the relationship, as well as ensuring transparency and stability and to promote cooperation

Avoid market fragmentation which will harm European citizens and businesses⁽⁹⁾



- Enables cross-border provision of the most important and mutually beneficial international financial service offerings between the UK and EU
- Provides certainty to consumers, business and governments

No UK cherry picking of rights and responsibilities



- Sets out a balance of rights and responsibilities for the UK and does not replicate current levels of market access

(9) PwC estimate an annual GVA cost of €33bn to EU27: Impact of a loss of mutual market access in financial services across the EU27 and UK (2018)