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BRIEFING PAPER

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Brexit & financial services

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Contents:

1. Introduction
2. Immediate reactions
3. Subsequent reaction and emerging issues.
4. Legislative and Regulatory work
5. Brexit Reports

Contents

Summary **3**

1. Introduction **4**

2. Immediate reactions **5**
2.1 Official bodies 5
2.2 UK financial institutions 6
2.3 Other organisations 7

3. Subsequent reaction and emerging issues. **10**
3.1 Introduction 10
3.2 Issues 10
Will they stay or will they go? 10
Timing 11
Access to markets: staff 12
Access to markets: Passporting/equivalence 12

4. Legislative and Regulatory work **17**
4.1 Regulatory work 17
4.2 The UK Government's approach to legislative implementation 20
4.3 Brexit White Paper 22

5. Brexit Reports **25**

Summary

Financial Services are of especial importance to the UK economy. The vote to leave the EU has significant implications for the financial services sector. The degree of inter-linkage between the 'City' and the EU economies is substantial, economically speaking, and intricate in terms of the legislative interface.

There is little certainty over what will happen next although the Government has published its broad aims in The Future Relationship Between the United Kingdom and the European Union – the Brexit White Paper.

With respect to the regulatory framework, the new chief Executive of the FCA, Andrew Bailey, confirmed that whilst the FCA had set up an internal Brexit unit to deal with Brexit specific activity, its main work remained unchanged. Many of the FCA rules were derived from the EU and the FCA would continue to enforce existing rules and work to implement ones that had been agreed, but which were not yet in place. For the Regulator therefore, it was 'business as usual' although its 2018/19 Business Plan confirmed that significant resources would have to be diverted away from normal activity to deal with Brexit in the forthcoming period.

Like many other industrial and commercial sectors, the more considered reaction of the industry to any Brexit question is "it all depends".

In the absence of any clear guidance on where the EU negotiations will lead to in terms of the treatment of services, commentators have largely been reduced to guessing what large institutions intend to do from their pre- vote statements and matching these to the permutations of different possible negotiation outcomes.

In a sector with different interests and priorities and with a wide range of possible outcomes, the possible permutations of outcomes are very high.

The debate and commentary has been largely framed around whether banks and other institutions would stay (in London) or go. Informing this choice have been two issues: timing and the likelihood of continued 'passporting' or equivalence.

Despite one banking commentator saying that most banks' "hands are quivering over the relocate button" currently, the experience of actual and likely 'leavers' is at the lower end of estimates. In the words of one fund manager "London is not so much being dethroned as being diluted".

The Treasury published its plans for managing the legislative and regulatory frameworks consequent on the UK leaving the EU as it applies to financial services in July 2018. The proposals, yet to be discussed with the EU negotiators, abandon the principle of 'passporting rights' and propose a system of enhanced equivalence' instead.

1. Introduction

Financial services are of especial importance to the UK economy. A 'Key Facts' report by TheCityUK (a representative body of the industry) states that:

> London and the wider UK is the leading global international financial and related professional services centre. Britain's trade surplus in financial services of £63bn in 2015, was more than the combined surpluses of the next three leading countries (US, Switzerland and Luxembourg).
>
> The UK has the leading share of trading in many international financial markets such as cross border bank lending (16%), international insurance premium income (29%) and foreign exchange trading (37%). It is also a global leader in providing professional services.
>
> Britain is the heart of Europe's financial system with London being its pre-eminent financial capital. London's major competitors include New York, Hong Kong, Tokyo and Singapore, with Asian centres gaining advantage in recent years from the shifting global trade patterns. At the next level Shanghai and Toronto are being joined by the likes of Istanbul and Dubai as they seek to develop their offerings. This is not a zero-sum game. And greater competition is a challenge to companies to innovate and improve services – areas of traditional strength for the UK.[1]

The Government's Brexit White Paper in February 2017 stated:

> 8.22 The financial services sector is an important part of our economy. It is not just a London-based sector; for example, two thirds of financial and related professional services jobs are based outside the capital, including 156,700 in Scotland, 54,300 in Wales and 32,000 in Northern Ireland. The UK is a global leader in a range of activities, including complex insurance, wholesale markets and investment banking, the provision of market infrastructure, asset management and FinTech.[2]

The vote to leave the EU has immense implications for the financial services sector, an economic sector which is critical to the UK economy. The degree of inter-linkage between the 'City' and the EU economies is substantial, economically speaking, and intricate in terms of the legislative interface. Some groups see getting rid of EU regulation as an opportunity and point to the previous concerns about the UK not adopting the Euro as a precedent. Most of the industry, however, have concerns about how best to respond to the new conditions.

This note brings together some immediate responses from relevant organisations; outlines some of the issues which have emerged as important since the referendum; and more recent indications of preparation for Brexit.

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1 CityUK *Key Facts about the UK as an international financial centre 2016*; 1 November 2016

2 The United Kingdom's exit from, and new partnership with, the European Union

2. Immediate reactions

This section brings together responses made immediately after the Referendum result from relevant organisations. There is no intention to analyse the comments, merely to present what is available as it is published. The choice of material reflects what there was. Other material and commentaries can be found. All entries are dated 24 June 2016 unless otherwise stated.

2.1 Official bodies

The Bank of England

The Bank of England (through the Prudential Regulation Authority) is responsible for financial stability in the United Kingdom.

> The people of the United Kingdom have voted to leave the European Union.
>
> Inevitably, there will be a period of uncertainty and adjustment following this result. […]
>
> Some market and economic volatility can be expected as this process unfolds.
>
> But we are well prepared for this. The Treasury and the Bank of England have engaged in extensive contingency planning and the Chancellor and I have been in close contact, including through the night and this morning.
>
> The Bank will not hesitate to take additional measures as required as those markets adjust and the UK economy moves forward.
>
> These adjustments will be supported by a resilient UK financial system – one that the Bank of England has consistently strengthened over the last seven years.
>
> The capital requirements of our largest banks are now ten times higher than before the crisis. The Bank of England has stress tested them against scenarios more severe than the country currently faces. As a result of these actions, UK banks have raised over £130bn of capital, and now have more than £600bn of high quality liquid assets.
>
> Why does this matter?
>
> This substantial capital and huge liquidity gives banks the flexibility they need to continue to lend to UK businesses and households, even during challenging times.
>
> Moreover, as a backstop, and to support the functioning of markets, the Bank of England stands ready to provide more than £250bn of additional funds through its normal facilities.
>
> The Bank of England is also able to provide substantial liquidity in foreign currency, if required.
>
> We expect institutions to draw on this funding if and when appropriate, just as we expect them to draw on their own resources as needed in order to provide credit, to support markets and to supply other financial services to the real economy.
>
> In the coming weeks, the Bank will assess economic conditions and will consider any additional policy responses.

Bank of England website

Financial Conduct Authority (FCA)

The FCA is the main regulator of financial conduct in the United Kingdom.

> The FCA is in very close contact with the firms we supervise as well as the Treasury, the Bank of England and other UK authorities, and we are monitoring developments in the financial markets.
>
> […]
>
> Firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect.
>
> Consumers' rights and protections, including any derived from EU legislation, are unaffected by the result of the referendum and will remain unchanged unless and until the Government changes the applicable legislation.
>
> The longer-term impacts of the decision to leave the EU on the overall regulatory framework for the UK will depend, in part, on the relationship that the UK seeks with the EU in the future. We will work closely with the Government as it confirms the arrangements for the UK's future relationship with the EU.

FCA website

2.2 UK financial institutions

Barclays

> Barclays Group Chief Executive Officer Jes Staley said: 'The United Kingdom has voted to leave the European Union. This is a significant decision and there will be many questions asked in the coming days and weeks about what happens next. The answers are complex but our position is not: we will not break our stride in delivering the Barclays of the future.
>
> 'Barclays has stood in service of our customers and clients for over 325 years. We have been here for them through equally profound changes before. And no matter what has been laid before us, we have been here to help them achieve their ambitions.
>
> 'That does not change today. And through the uncertainty of the months ahead, be in no doubt that we are ready to do whatever it takes to uphold that promise.
>
> 'The strategy we announced on 1 March was not conditional on the UK remaining in the EU. We are a transatlantic consumer, corporate and investment bank, anchored in the UK and the US. That remains the core of our strength and the Barclays of the future.'

RBS

> The result of the referendum has been announced. The UK has voted to leave the European Union.
>
> We would like to reassure our customers that the outcome of this referendum should have no immediate impact on their everyday banking services.

> We are operating business as usual, please find further information on our FAQs [here].

Santander

> Nothing has changed for Santander UK. There are no changes to the way we serve you and we won't make any changes to our products and services as a result of the referendum without notifying you first.
>
> Your eligible deposits are still protected by the Financial Services Compensation Scheme (FSCS) up to a limit of £75,000.[3] This won't change now that the UK has voted to leave the EU.

Lloyds of London

> Commenting on the vote, Chairman John Nelson, said:
>
> "I am confident that Lloyd's will stay at the centre of the global specialist insurance and reinsurance sector, and I look forward to continuing our valuable relationship with our European partners.
>
> "For the next two years our business is unchanged. Lloyd's has a well-prepared contingency plan in place and Lloyd's will be fully equipped to operate in the new environment."

2.3 Other organisations

TheCityUK

TheCityUK is a trade body representing the interests of the City of London. It said:

> The people of the UK have decided that the future of the UK is a new one outside of the European Union. There will be challenges ahead and it will be important for Government and business to work together to address them. Our immediate focus is on stability – in the markets, for investors, and for our industry's customers.
>
> Clear agreement is now needed on the way forward for the forthcoming negotiations as Government shapes a new relationship for the UK with the EU and retains the jobs and investment that the UK has seen to date. For financial and related professional services, the focus is on securing continuing access to the Single Market.
>
> It is vital that action is taken to reinforce the global competitiveness of the UK as a place in which and from which to do business. This will help to mitigate the risk of prolonged uncertainty while a new relationship with the EU is negotiated. We look forward to working with Government on forward-looking policies to help achieve this and to advancing the attractiveness of UK-based financial and related professional services.

Prior to the referendum it had produced *A practitioner's guide to Brexit* which:

> considers the UK's post-Brexit trading arrangements with other countries and three alternatives to our current EU membership

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[3] Note this is now £85,000

> from the perspective of the financial and related professional services industry.

Travers Smith

Travers Smith is a London law firm with significant experience in the development of European financial services law. It has produced a summary – *Brexit: What is the short term legal impact on UK financial services?* . Having looked at the immediate impacts it concluded:

> Will there be a significant impact in the future?
>
> This will depend in part on the terms of exit which are unlikely to be known for some time. If the UK remained part of the European Economic Area, it would retain access to the single market for financial services and operate within broadly the same regulatory framework. That outcome seems unlikely because the UK would also be subject to EU obligations on the free movement of persons, which was a key theme in the leave campaign. If the UK does not negotiate a trade deal with remaining EU members requiring it to comply with all EU financial services law and regulation, there will be an intense debate about how much of that law and regulation is retained and for how long.

It has produced a longer Brexit document written pre- referendum.

New Capital

A pro-market think tank, New Capital, set out the implications (from its pessimistic viewpoint) that City firms will generally be considering in the aftermath in a report - *Beyond Brexit: what happens next for European capital markets?* In summary they include:

1) Pulling the trigger: The decision by David Cameron not to pull the trigger on Article 50 means that capital markets will be in limbo for at least the next few months until a new government or Parliament start the clock on the formal two-year process of leaving the EU.

2) First mover advantage: Banks and asset management firms cannot afford to wait. They have to assume the worst-case scenario of complete separation with no access to the single market and start the process of relocating legal entities, operations and staff immediately.

3) Relocation, relocation, relocation: In order to future proof their business, banks, asset managers and other market participants will need to have a separately authorised subsidiary with a sufficient management presence inside the EU. Dublin, Frankfurt, Paris and other cities will be vying for that business.

4) An acrimonious divorce (and a protracted custody battle): Most firms seem to be planning for an acrimonious divorce. While the divorce process itself may be reasonably swift, the separate negotiations to establish the terms of the future relationship between the UK and the EU will be slowed down by the competing domestic political imperatives in all 28 member states and could take years.

[…]

6) A regulatory backlash?: Brexit could trigger a concerted regulatory backlash in the rest of the EU against elements of the single market and capital markets union that are seen to play to the UK's advantage, such as the location of euro-denominated clearing.

7) A loss of influence: Whatever the outcome, the UK will lose influence over the future direction and nature of EU regulation that it may have to implement. The departure of Lord Hill will significantly change the tone of the future regulatory dialogue.

8) Equivalence vs divergence: In order to retain access to the single market from outside the EU, the UK would have to retain an 'equivalent' regulatory framework. While it would be equivalent on day one, over time changes to EU legislation may lead to costly regulatory divergence.

9) The future of EU citizens: In some sectors of the capital markets EU27 citizens account for as much as a quarter of all staff in the UK. Assurances over their future legal status have so far been too vague to instil confidence [Note there have been several statements subsequent to this publication which have addressed this question].

3. Subsequent reaction and emerging issues.

3.1 Introduction

Even two years after the referendum there is precious little certainty in the debate.

Like many other industrial and commercial sectors, the more considered reaction of the industry to most Brexit questions is "it all depends".

In the absence of any clear guidance on where the EU negotiations will lead to in terms of the treatment of services, commentators have largely been reduced to guessing what large institutions intend to do from their pre- vote statements and matching these to the permutations of different possible negotiation outcomes.

In a sector with different interests and priorities and with a wide range of possible outcomes, the number of possible outcomes is very high. However, several key issues are emerging which may determine whether the City sees many banks, insurance companies and investment funds leave or downgrade their London operations or whether, the natural advantages of London prevail and it simply adapts to new conditions. The first is timing and the second is the 'passporting/equivalence' debate. It is worth looking first though, at who is saying what, and who has done what in regard to the 'will they stay or will they go' question.

3.2 Issues

Will they stay or will they go?

Generally, post-vote comments were a shade more positive than those made before but this may be because companies (especially publicly listed ones) have to be careful about giving out market sensitive data, so their public statements have been guarded.

Comments on the banking industry made by the Chief Executive of the British Banking Association reflect the hesitancy and uncertainty that banks have faced. Writing in the Observer, Anthony Browne wrote:

> "Most international banks now have project teams working out which operations they need to move to ensure they can continue serving customers, the date by which this must happen, and how best to do it," he says.
>
> "Their hands are quivering over the relocate button. Many smaller banks plan to start relocations before Christmas; bigger banks are expected to start in the first quarter of next year."[4]

[4] Reported [Guardian 22 October 2016]

Currently, the only bank that has indicated that it will leave completely is the Russian investment bank VTB which announced that it will move HQ from London. According to Herbert Moos, deputy Chair VTB "We did have bigger plans for the London office but, after Brexit, we are scaling them down and building them up elsewhere".[5]

In a separate announcement the European Banking Authority which is the regulator for the euro-zone area, announced that it will move from its current London headquarters within the next two years.[6]

What there has been is a lot of talk about what the intentions might be.

A BBC article 30 June 2016 quotes Barclays as saying that it "has no plans to move jobs out of the UK". On the other hand, the same article quotes HSBC as saying that 1,000 jobs may go to Paris and JP Morgan saying 4,000 might be relocated.

18 months on from the vote, it has become clearer that the more apocalyptic warnings of the impact of the decision to leave have not been realised. Relocations have been at the lower end (i.e. fewer job losses and moves) of some scenarios put forward. The most assiduous source of moves is the EY Brexit Tracker. In December 2017 it noted:

> **LONDON, 11 MONDAY DECEMBER 2017:** According to the latest EY Financial Services Brexit Tracker, a total of 10,500 UK financial services jobs, including many front office roles, could be relocated to the continent in time for Day One of Brexit, with Dublin and Frankfurt emerging as the most popular relocation destinations. To date, 68 of the largest financial services companies in the UK have said they are considering or have confirmed they will move some of their operations and/or staff out of the UK as a consequence of Brexit.
>
> In 2016, 12 financial services firms publicly estimated that 12,500 jobs would move out of the UK as a consequence of any type of Brexit, but a year on, while the number of firms has risen to 26, the total has dropped to 10,500 jobs. In many cases, details of the types of roles that will be relocated is yet to be provided, but the Tracker data confirms they are not primarily back office or support functions; 18 companies have specified the types of work that might move to Europe and, of these, 14 are client facing 'front office' roles.

The agreement between the EU and UK on a lengthy transition (implementation) period may have contributed to the muted scale of departures so far. However, the FT reported that "Hiring tumbles at asset managers" due to the contingency plans of companies.[7] Even then though, one asset manager said that "London is not so much being dethroned as being diluted". The same article quotes the Chancellor as saying that "we have dammed the flow [of job losses]".

Timing

[5] Financial Times 12 October 2016.
[6] Financial Times 30 June 2016
[7] Financial Times 23 April 2018

A thing which overhangs a lot of current decision-making discussions is the timing issue. The best time for a bank or insurer to decide whether London still held comparative advantages over other locations would be when the outcome of the negotiations is known.

But. The time it takes to move a bank or other institutions to an alternative location – assessing where to go, arranging premises, gaining regulatory permissions and staffing etc cannot be much less than about two years. So, if any bank wants to be certain that it is not, after Brexit, left in a London that does not have what it wants mainly the ability to offer services freely across Europe, the time to start thinking about moving is now – or very soon. The agreed implementation period, may have removed some of the immediate pressures on financial institutions.

Access to markets: staff

For many years, continued access to overseas staff has been a key concern of many financial institutions in the City. Brexit has sharpened this concern. It is reported that UK asset managers have begun plans to secure visas for their EU staff, and pay the associated costs, if they become necessary.[8] For some companies, about half their staff are non-UK residents, and even if visas were free or easy to acquire, recent examples of hostility to racial abuse have made some staff reconsider their UK futures.

Access to markets: Passporting/equivalence

Along with staffing, the main pre-occupation of financial firms has been the potential (now confirmed see section on White Paper below) loss of 'passporting' rights. This part of this Paper describes the differences between the two approaches and the views expressed about them in the period up to the publication of the White Paper.

Box 1: Passports and Equivalence: the quick read

Equivalence allows the UK to set its own rules and, where appropriate, make them equivalent to the rules of the EU. That is an uncertain future as the rules may be equivalent one day and not the next, which means that passporting is not allowed as the regulations may differ. A mutual recognition system ensures the rules are kept the same, which means that passporting may be achieved because the regulations are known to be the same.
Chris Skinner (financial commentator)

In the EU, financial authorisation in one Member State means that in many markets and activities, the firm can operate and sell in all EU countries because it now has an (authorisation) passport. In the UK context, financial firms like to set up in London – which is seen to have advantages over other European cities – get authorisation from the UK authorities and then they can operate across the EU freely. The Bank of

8 FTfm 1 August 2016, p1.

England described passporting in its booklet about EU membership: EU Membership and the Bank of England

Alongside the passport, it has been suggested that if the UK does not secure this, it would at least be able to show that it was compliant with EU requirements and hence could operate across several markets under the *equivalence rules* which gives the same level of access.

Although 'it all depends' applies here with full force, there are some things we do know and can say:

- that the UK financial sector is compliant with all EU financial directives – it has written lots of them and has been instrumental in setting all of them
- the directives will continue to be enforced and applied until the point of departure
- some directives have equivalence built in, others do not
- at the point of departure, the UK will be fully compliant with EU regulations
- with respect to UK law now set by an EU directive, the most likely starting point is everything continues as was and then the UK can alter the law in all areas as and when we want.

From the City's point of view, now that passports are agreed to be going, is equivalence just as good?

An interesting Bloomberg article on the issue of equivalence and the comments on negotiating it from (ex) Commissioner Hill are revealing:

> **What's involved in an equivalence decision?**
>
> Equivalence refers to the European Commission's recognition that a country's rules and oversight of specific business lines are as tough as its own. This allows the EU to rely on firms' compliance with those frameworks, reducing overlaps on both sides as well as reducing capital costs for EU companies exposed to equivalent third countries.
>
> Most EU financial-services acts contain provisions for equivalence, including the updated markets rules known as MiFID II, which come into effect in 2018. Equivalence is also possible for some purposes in the EU's bank capital rules and in Solvency II, which governs the insurance industry.
>
> **How does it work?**
>
> To see how equivalence works, take the recent agreement the commission struck with the U.S. Commodity Futures Trading Commission on central counterparties.
>
> EU law, in this case the European Market Infrastructure Regulation, allows companies based outside the bloc to "provide clearing services to clearing members or trading venues" set up in the EU on two main conditions. First, the commission has to determine that the country's legal and supervisory systems are an "effective equivalent" to those in the EU; second, the company must be recognized by the bloc's markets regulator.
>
> The deal with the CFTC, announced in February, enabled companies such as Chicago-based CME Group Inc. to continue

> providing services to EU firms. Without it, traders would have faced higher EU capital requirements to clear swaps, futures and other derivatives in the U.S.
>
> **How long can equivalence talks take?**
>
> While the EU's equivalence talks with the CFTC were successful, they dragged on for nearly four years even though at issue was "one tiny subset of the whole financial services sector landscape," as Jonathan Hill, the EU's former financial-services chief, said in June. What's more, this was a case in which both sides "wanted to conclude it quickly," he said.
>
> "The bureaucratic process of gaining equivalence is complex," said Edward Chan, banking partner at Linklaters LLP in London. The process is "likely to take a minimum of six months upon exit," he said. The European Commission is under "no obligation" to grant equivalence, and "the decision can be time-bound and reversed, so, although it is not meant to be a political process, it is likely that political considerations will influence this decision."[9]

Another report on this from Open Europe puts more detail on the political process underlying the granting of equivalence:

> In theory, having been a member of the EU, the UK would have no problem obtaining equivalence on day one after Brexit. However, if EU regulations change over time the UK would have to adapt its own legislation to maintain continued market access for its financial services sector. This could become increasingly challenging if in future, with the UK no longer involved in the law-making process, the EU takes a more protectionist approach to financial regulation. Although in that scenario being able to diverge from onerous regulations may in fact prove a competitive advantage for the UK, even if access is lost.
>
> That said, it is worth noting that the European Commission has never actually withdrawn an equivalence decision due to divergence of regulation. While it is a relatively new concept, this is still important. It has, however, withheld the granting of equivalence for both technical and political reasons. Overall, equivalence is therefore a far more piecemeal approach than the passport:
>
> - Equivalence does not currently cover the whole range of EU financial regulation, particularly when it comes to retail financial services;
> - The level of market access third-country firms can obtain via equivalence varies depending on the relevant piece of EU legislation. While equivalence under MiFIR essentially offers passport-like rights to third country firms providing investment services to professional clients, equivalence under Solvency II does so only for re-insurance services;
> - Equivalence is granted at the behest of the Commission, and is therefore part of a political process.

Bearing in mind the timing issue the Report continues:

> The case for 'pre-emptive' equivalence

1. [9] Bloomberg's; Banks in U.K. Eyeing EU Market May Find Equivalence Cold Comfort

> One option the UK should consider is to seek 'pre-emptive' equivalence on financial services regulation as part of the upcoming exit talks with the EU. This means the EU would treat the UK's regulatory and supervisory framework as equivalent from the moment the withdrawal agreement concluded under Article 50 TEU enters into force – that is, from day one of Brexit. This would help minimise uncertainty, at least with regard to those pieces of EU law that make provisions for third-country access.
>
> Admittedly, such an arrangement would likely involve a liberal interpretation of the existing equivalence process. The UK will not become a 'third country' until the entry into force of its withdrawal agreement with the EU – or until the two-year deadline set out by Article 50 TEU expires. Therefore, in principle the UK should not be able to apply for equivalence until then.
>
> However, there is a precedent for this kind of 'pre-emptive' equivalence – albeit in slightly different circumstances. The European Commission adopted a first package of positive equivalence decisions under Solvency II in June 2015, with the new rules due to come into effect six months later.69 There will remain a question around whether ESMA can begin assessing a state before it is fully a third country and the UK will likely have to lay out its regulatory regime in detail so that it can be assessed (or just promise to keep things as they are). However, if the decision is forward-looking and does not come into force until after the UK leaves, this is less of an issue.
>
> Alternatively, the UK could seek interim equivalence – broadly mirroring what happens in some cases with the provisional application of free trade deals between the EU and third countries. Essentially, the EU would grant the UK provisional equivalence on day one of Brexit – pending confirmation from the European Commission and the relevant pan-EU financial watchdog (ESMA, EIOPA or EBA). By logic, such an arrangement should be fully possible given that the UK has so far been applying EU financial services regulation as a member of the bloc.[10]

Sentiment appears to be moving away from the view that an unadjusted 'equivalence' will work as a stand-alone alternative to passporting. The clearest indication of this was in evidence given by. Asked whether 'equivalence' mitigated the risks of Brexit the Bank Governor, Mark Carney, said to the Treasury Committee in January 2017 that it would need to be further augmented by other bodies:

> We do not want to be a rule-taker as an authority. Right now, we are not a rule-taker; we come to a consensus within the EU, and we might not always like the end result, but in general we feel that the regulatory construct in the EU is broadly as we would have it with respect to safety and soundness.
>
> […]
>
> In general, we like it, but the rules in the EU are influenced by international standards and by the presence of UK officials in their development. Once we are not there, one would expect increasingly rules with which we do not agree and which may cause risks to financial stability. That goes to the equivalence point, which is: on what grounds is equivalence granted, and is equivalence granted in a way such that we are a rule-taker? In

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10 Open Europe; *How the UK's financial services sector can continue thriving after Brexit*, October 2016

other words, we have to basically cut, copy and paste any change that is made in Europe, in order to maintain equivalence.

Alternatively, if I can wear my chair of the FSB hat for a moment, is equivalence viewed as it should be cross-border, with rules that achieve equivalent outcomes in terms of safety, soundness, consumer protection etc.? You can have slightly different approaches but achieve roughly the same outcome that recognises different institutional structures and other aspects. We should very much want the latter, because that allows us to tailor our system to the fact that we have the world's leading global financial system and to the nature of UK law and other peculiarities. We should want that.

If we were going to have equivalence, we would want that recognised up front. That then requires some way for the two sides to make continuous judgments about whether or not they are equivalent. As you will have heard and as you know, you do not want equivalence that is there on day 1 and is taken away the next year. Again, we want stable access. There are various ways to determine how you would maintain equivalence, if that is the route that the Government and the country go down.

One of them is with reference to international standards. You are equivalent if you broadly meet international standards. They are high, and, whether it is the IMF or the FSB itself through peer review, countries are judged on whether or not they meet international standards. If you meet international standards in slightly different ways—sometimes you are super-equivalent—then you are still equivalent. If that is what is agreed, that is very sensible and, as a financial stability authority, we would look at that and say it is broadly okay.

The second thing, though, that is likely to be necessary, if we were in a trade deal-type arrangement, and I am not going to prejudge that—otherwise, we would be relying directly on the MiFID II equivalence as written, I would suggest—is some form of dispute resolution authority, which is not a UK one or an EU one but, as in a trade deal, is a separate panel of experts and is able to make judgments only in those cases where it is a matter of dispute, as opposed to generally meeting equivalence.

On top of that, we should want domestic protection to have some sort of institutionalisation of regulatory co-operation between ourselves and Europeans, and they will want the converse, because if we are going to have free and seamless access in wholesale markets, we want some comfort that the rules are being applied and supervision is robust on the counterparties for your major financial institutions. One could start from equivalence, but I would suggest from a financial stability perspective that one would want to build on that equivalence with other institutional structures.[11]

[11] Evidence from Dr Mark Carney, Treasury Select Committee 11 January 2017; Q137

4. Legislative and Regulatory work

4.1 Regulatory work

With respect to the regulatory framework, and preparations and options pre- and post-Brexit, the chief Executive of the FCA, Andrew Bailey, confirmed at the 2016 Annual Public Meeting of the FCA, that whilst the FCA had set up an internal Brexit unit to deal with Brexit specific activity, its main work remained unchanged. Many of the FCA rules were derived from the EU and the FCA would continue to enforce existing rules and work to implement ones that had been agreed, but which were not yet in place. For the Regulator therefore, it was 'business as usual'.

In July 2017, Andrew Bailey outlined the work that the FCA had done and the key issues that they had identified. The speech can be found here: Why free trade and open markets in financial services matter. It ended with:

> My view is that if there is a commitment on all sides that the UK and the EU maintain substantially equivalent regulatory arrangements in future, that it will not be necessary to restrict open markets and free trade in financial services and therefore not necessary to limit the freedom of firms on location. And therefore, I see no reason why we should sacrifice open financial markets and free trade, as an inevitable response to Brexit.

There have been further speeches by Andrew Bailey, about the regulatory implications and possible 'steady state' solutions post Brexit, one speech from February 2018 and another speech from April 2018. The latest statement (July 2018) on Brexit preparations by the FCA can be found here. Edited extracts are shown below:

> **Preparing for a smooth transition**
>
> Our starting assumption is that a transition or implementation period, from March 2019 until the end of December 2020, will form part of the final agreement with the EU
>
> […]
>
> However, we know […] we must prepare for all scenarios, including the possibility of a 'no-deal' or 'hard' Brexit at March 2019. […]
>
> Let us just consider some examples of the challenges we face in doing this – there are 'cliff edge' risks that would be caused by abrupt loss of passporting.
>
> **'Cliff edge' risks**
>
> There are 'cliff edge' risks we face in relation to contract continuity.
>
> Our analysis suggests that these primarily relate to insurance contracts and derivatives. The FPC has estimated that 10 million UK policyholders and 38 million EEA policyholders could be affected; and that around a quarter of derivatives contracts – £26 trillion worth – could be affected.

[…] Our view is that where any of these contracts extend beyond March 2019, the UK and the EU must, together, create contractual certainty, either through an implementation period or by some other means.

If this is not achieved, there is a risk that some of these contracts could not be appropriately serviced – in concrete terms, insurers may not be permitted to pay out claims on policies, and derivatives users may not be able to manage the risks of their positions. This would not enhance the integrity of markets, nor serve the interests of consumers, either in the UK or in the EU.

Legal and Regulatory Framework

[…] we have undertaken significant work around the EU Withdrawal Act. […] In addition, the Withdrawal Act also gives Ministers the power to amend retained legislation via Statutory Instrument (SI), ensuring it functions effectively post-Brexit. HMT laid three SIs earlier this week.

Accordingly, we at the FCA have been working over the past months on identifying the various aspects that may need amending, and how these might be resolved. The most obvious examples are references to the Commission, or European Supervisory Authorities, which will have no jurisdiction here after Brexit; others include functions currently performed by EU bodies which will no longer be appropriate when UK leaves the EU (eg supervision of credit ratings agencies and trade repositories); or the broader impact of loss of passporting.

The changes in the legislation through Statutory Instruments will also mean changes to our rule book. We have been undertaking a line by line review of around 50 pieces of EU financial services legislation, and 185 Binding Technical Standards (the technical detail below the EU Directives and Regulations).

Temporary Permissions Regime

A further key safeguard we have been working on is the Temporary Permissions Regime (TPR), which will allow EEA firms and funds using a UK passport to continue to operate, without needing to apply for authorisation at this stage. At the end of last year, HMT announced that they would legislate to enable this if necessary.

The TPR will allow for business as usual for EEA firms and funds passporting into the UK. As at April this year, more than 8,500 financial services firms were registered as passporting into the UK, and nearly 6,000 out of the UK. Those that receive a temporary permission will be able to enter into new business and fulfil existing contracts with UK customers for a defined period after exit day, while seeking full authorisation.

[…]

Once they have temporary permission, firms will be given a period of time, or 'landing slot', within which they'll need to submit their authorisation application. We will confirm landing slots to firms in due course so they can prepare their applications. We expect the first of these slots to be later in 2019, with the last timed towards the end of the temporary permissions period.

[..]

However, we are aware that this work does not necessarily resolve the challenge for all firms, particularly those that need to continue to access the EU – 'outgoing business' – as currently there is no

> reciprocal 'TPR' arrangement from the EU. And the challenges this presents, in terms of lack of commercial certainty, and business disruption, is clear from my speaking to senior leaders in regulated firms.[12]

The FCA has acknowledged the fact that Brexit work was going to force it to raise specific levies to meet the extra work and that some of its planned or ongoing projects would need to be curtailed to provide specific Brexit resources.[13]

Following the decision between the EU and the UK in December 2017 that there would be an extended transition period post Brexit day, the Bank of England made the following announcement about its regulatory approach in the year leading up to March 2019. It recognised especially the time pressures that all institutions were under and conceded that full readiness for separate authorisation would only be needed at the end of the transition:

> The foundation of the Bank of England's approach to preparations for EU withdrawal remains the presumption that there will continue to be a high degree of supervisory cooperation between the UK and the EU. This reflects the UK's financial system's role as both a national asset and a global public good, bringing shared risks as well as wide benefits.
>
> The Bank has made clear that it would be difficult, ahead of March 2019, for all financial institutions to have completed all of the necessary steps required to mitigate the risks to the provision of financial services in the EU and the UK.
>
> In light of the agreement at the EU Council, the Bank considers it reasonable for firms currently carrying on regulated activities in the UK by means of passporting rights, or the EU framework for central counterparties, to plan that they will be able to continue undertaking these activities during the implementation period in much the same way as now. In letters published today, the Bank has made clear to relevant firms that they may plan on the assumption that UK authorisation or recognition will only be needed by the end of the implementation period.
>
> The Government has committed to bring forward legislation, if necessary, to create temporary permission regimes to allow relevant firms to continue their activities in the UK for a limited period after withdrawal. In the unlikely event that the Withdrawal Agreement is not ratified, this provides confidence that a back-stop will be available.
>
> The Financial Policy Committee (FPC) continues to track a wider checklist of actions that authorities and firms must take in order to mitigate risks of disruption to financial services. The FPC published its most recent quarterly assessment of these actions on 16 March.
>
> Today the Bank also confirms its approach to the authorisation and supervision of international banks, insurers and central counterparties (CCPs). In the context of their future preparations for the UK's withdrawal from the EU, EEA banks and insurers may

12 Speech by Nausicaa Delfas, Executive Director of International at the FCA; 19 July 2018

13 FCA Press Release; 16 April 2018

> (if they are not conducting material retail business) apply for authorisation to operate as a branch in the UK. Non-UK CCPs should continue engaging with the Bank on the UK recognition process.
>
> In light of the responses to the public consultation which started on 20 December, the PRA has increased the level of the threshold of FSCS-protected liabilities indicating an insurer should potentially operate as a subsidiary from £200 million to £500 million.[14]

More information is available on the FCA's website.

4.2 The UK Government's approach to legislative implementation

The Treasury has published outline guidance on how it seeks to manage the exit from the EU in the sphere of financial services: HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act. Extracts from this are shown below:

- The UK will continue to implement new EU law that comes into effect and the UK will continue to be treated as part of the EU's single market in financial services. This will mean that access to each other's markets will continue on current terms and businesses, including financial services firms, will be able to trade on the same terms as now until 31 December 2020.
- Given the highly regulated nature of financial services, the volume of trade between our markets, and our shared desire to manage financial stability risks, we would need a stable process for maintaining equivalent regulatory outcomes as legislation evolves – including a system to resolve disagreements at regulatory and supervisory levels – alongside an open, collaborative relationship between supervisors that protects our respective financial systems and our taxpayers from financial stability risks.

As well as the issuance of SI's to translate current EU law into UK law – an issue common to all areas of legislative activity:

- HM Treasury also plans to delegate powers to the UK's financial services regulators to address deficiencies in the regulators' rulebooks arising as a result of exit, and to the EU Binding Technical Standards (BTS) that will become part of UK law. Such sub-delegated powers will be subject to broadly the same constraints as HM Treasury's use of the Act's powers, as well as additional mechanisms to ensure robust HM Treasury oversight. An SI to achieve this will be laid before Parliament now that the EUWA has received Royal Assent. Further information on regulatory changes to BTS and regulators' rules for EU exit will be provided by the financial services regulators in due course.
- The government is continuing this work to ensure that the UK will have a functioning legislative and regulatory framework in all scenarios. As part of this, HM Treasury intends to legislate to provide the financial services

[14] Bank of England Press Release March 2018

regulators with powers to introduce transitional measures that they could use to phase in any onshoring changes.

- This means that firms do not need to prepare now to implement onshoring changes in the event no deal is reached with the EU.
- Firms should continue to plan on the assumption that an implementation period will be in place from 29 March 2019 – and, therefore, that they will be able to trade on the same terms that they do now until December 2020. They will need to comply with any new EU legislation that becomes applicable during this period.

The document addresses the point about what happens if there is no 'deal' (paras 1.17 – 1.20):

- In the unlikely scenario that the UK leaves the EU without a deal, the UK would be outside the EU's framework for financial services. The UK's position in relation to the EU would be determined by the default Member State and EU rules that apply to third countries at the relevant time. The European Commission has confirmed that this would be the case.
- In light of this, our approach in this scenario cannot and does not rely on any new, specific arrangements being in place between the UK and the EU. As a general principle, the UK would also need to default to treating EU Member States largely as it does other third countries, although there are instances where we would need to diverge from this approach, including to provide for a smooth transition to the new circumstances. The principles that would lead to deviations from this approach are set out below.
- In some areas, correcting deficiencies to reflect this environment would be relatively straightforward. The UK's world-leading financial sector is overseen by HM Treasury and underpinned by a strong legislative framework with world-class regulators (the Bank of England/Prudential Regulation Authority and Financial Conduct Authority). This means that the responsibilities of EU bodies could be re-assigned efficiently and effectively, providing firms, funds and their customers with confidence after exit.
- In this scenario, EU financial services firms operating in the UK would broadly become subject to the same supervisory regime that the UK already applies to other third countries – a regime that is shaped by the highly global, cross-border nature of financial services and the UK's robust regulatory framework as set out in legislation, including in the Financial Services and Markets Act 2000 (FSMA), the Banking Act 2009 and the Bank of England Act 1998. This existing UK financial services legislative framework provides powers for extensive cooperation with global regulatory bodies. When the UK is no longer an EU Member State, and so the EU obligation of reciprocal cooperation no longer applies, this existing framework could be relied upon to ensure this important cooperation continues in this scenario.

Determination of the split of responsibilities between HM Treasury and the financial services regulators of the functions currently carried out at an EU level would need to be provided for in the UK's regulatory regime. The Treasury intends to allocate functions to UK regulators in a way which is consistent with the responsibilities already conferred by the ruling legislation – FSMA. Further information about the allocation of responsibilities can be found in the draft - Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018 –published in April 2018.

There is a general webpage dedicated to further Government announcements which will be amended as further decisions come to be made. This can be found here.

4.3 Brexit White Paper

The Brexit White Paper[15] published in July 2018 sets out the Government's ambitions for negotiations. It starts by acknowledging that the thing most wanted by many financial firms at the start of the process – passporting – was not possible and, given the importance of financial services to both, both the UK and EU would want to maintain "autonomy of decision-making and the ability to legislate for their own interests". It continues by outlining a proposed format for the future:

> 62. The EU has third country equivalence regimes which provide limited access for some of its third country partners to some areas of EU financial services markets. These regimes are not sufficient to deal with a third country whose financial markets are as deeply interconnected with the EU's as those of the UK are. In particular, the existing regimes do not provide for:
>
> a. institutional dialogue, meaning there is no bilateral mechanism for the EU and the third country to discuss changes to their rules on financial services in order to maximise the chance of maintaining compatible rules, and to minimise the risks of regulatory arbitrage or threats to financial stability;
>
> b. a mediated solution where equivalence is threatened by a divergence of rules or supervisory practices;
>
> c. sufficient tools for reciprocal supervisory cooperation, information sharing, crisis procedures, or the supervision of cross-border financial market infrastructure;
>
> d. some services, where clients in the UK and the EU currently benefit from integrated markets and cross-border business models. This would lead to unnecessary fragmentation of markets and increased costs to consumers and businesses; or
>
> e. phased adjustments and careful management of the impacts of change, so that businesses face a predictable environment.
>
> 63. In this context, the UK proposes a new economic and regulatory arrangement with the EU in financial services. This would maintain the economic benefits of cross-border provision of the most important international financial services traded between the UK and the EU – those that generate the greatest economies of scale and scope – while preserving regulatory and supervisory cooperation, and maintaining financial stability, market integrity and consumer protection.

15 HM Government; The Future Relationship Between the United Kingdom and the European Union Cm 9593; July 2018

> 64. This new economic and regulatory arrangement would be based on the principle of autonomy for each party over decisions regarding access to its market, with a bilateral framework of treaty-based commitments to underpin the operation of the relationship, ensure transparency and stability, and promote cooperation. Such an arrangement would respect the regulatory autonomy of both parties, while ensuring decisions made by either party are implemented in line with agreed processes, and that provision is made for necessary consultation and collaboration between the parties.
>
> 65. As part of this, the existing autonomous frameworks for equivalence would need to be expanded, to reflect the fact that equivalence as it exists today is not sufficient in scope for the breadth of the interconnectedness of UK-EU financial services provision. A new arrangement would need to encompass a broader range of cross-border activities that reflect global financial business models and the high degree of economic integration. The UK recognises, however, that this arrangement cannot replicate the EU's passporting regime.
>
> 66. As the UK and the EU start from a position of identical rules and entwined supervisory frameworks, the UK proposes that there should be reciprocal recognition of equivalence under all existing third country regimes, taking effect at the end of the implementation period. This reflects the reality that all relevant criteria, including continued supervisory cooperation, can readily be satisfied by both the UK and the EU. It would also provide initial confidence in the system to firms and markets.
>
> 67. Although future determinations of equivalence would be an autonomous matter for each party, the new arrangement should include provisions through the bilateral arrangement for:
>
> a. common principles for the governance of the relationship;
>
> b. extensive supervisory cooperation and regulatory dialogue; and
>
> c. predictable, transparent and robust processes. In our new strategic partnership agreement we will be aiming for the freest possible trade in financial services between the UK and EU Member States.[16]

The immediate response of the 'City' to the proposals in the Brexit White Paper was that, according to TheCityUK, they were "regrettable":

> The overriding issue for financial and related professional services firms is the ability to continue serving customers and clients. Mutual recognition would have been the best way to achieve this. It's therefore regrettable and frustrating that this approach has been dropped before even making it to the negotiating table. In hundreds of discussions across the EU, the industry has never come across an unanswerable technical or commercial barrier to this approach. The EU's objections have always been political.
>
> Our priority now is to examine the proposals in the White Paper and engage with government on how this new approach can be made to work in the interests of our customers. We are reassured that the government continues to reject the current form of

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16 HM Government; The Future Relationship Between the United Kingdom and the European Union Cm 9593; July 2018

> equivalence. It does not meet any of the requirements for success.
>
> Brexit was always going to result in access to the EU market being more difficult. Therefore, an effective and secure future regulatory relationship is vital. It is now urgent that we make rapid progress on the negotiations, both around the future relationship and on immediate issues for customers such as contract continuity.[17]

The City of London Corporation called the proposals a 'blow':

> Today's Brexit white paper is a real blow for the UK's financial and related professional services sector.
>
> With looser trade ties to Europe, the financial and related professional services sector will be less able to create jobs, generate tax and support growth across the wider economy. It's that simple.
>
> […]
>
> The sector has been clear since the referendum: Equivalence in its current form is not fit for purpose so any "enhancements" to this regime would have to be substantial.[18]

However, a Financial Times leader the following day, described the plan as a 'plausible vision' and the Chancellor, Phillip Hammond, writing an accompanying article, acknowledged that the proposal was "less than mutual recognition [his previous preference], but it is more than the EU's equivalence regime" he said "This arrangement would have at its heart a bilateral agreement [..] defining how the relationship will be managed. It would ensure that any changes to the equivalence decisions are proceeded by appropriate dialogue […] It would give both sides the most effective tools to maintain compatible rules over time".[19]

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17 TheCityUK press release 12 July 2018
18 City of London Corporation press release 12 July 2018
19 Financial Times 13 July 2018

5. Brexit Reports

There have been several 'where are we now' Reports by interest groups or academics. Three recent ones are shown below:

- A report published in March 2018 Article 50 one year on - by UK in a Changing Europe summed up the current state of where we are and, in particular how access might work going forward.[20]
- Another general resume is Brexit and the financial services industry: The story so far, published by the Centre for European Reform in March 2018.
- Linklaters and the International Regulatory Strategy Group have published The Architecture for Regulating Finance after Brexit in December 2017.
- A slightly older and very positive view on the potential of Brexit vis a vis financial services is the Report by the Leave Means Leave Group Why our financial services need a clean Brexit, published in October 2016.
- Slightly different still is a section of the Bank of England's Financial Stability Report, November 2017, which sets out the risks of a 'disorderly Brexit' as it feeds into its stress test model. This can be found here. The heightened risks range from macroeconomic slowdown to legal uncertainty over financial instruments.

20 UK in a Changing Europe; Article 50 one year on; March 2018

BRIEFING PAPER
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19 July 2018

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