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IRSG

INTERNATIONAL REGULATORY STRATEGY GROUP

Hogan Lovells

A NEW BASIS FOR ACCESS TO EU/UK FINANCIAL SERVICES POST-BREXIT

BRIEFING PAPER

The International Regulatory Strategy Group

The International Regulatory Strategy Group (IRSG) is a practitioner-led group comprising senior leaders from across the UK-based financial and related professional services industry. It is one of the leading cross-sectoral groups in Europe for the industry to discuss and act upon regulatory developments.

With an overall goal of promoting sustainable economic growth, the IRSG seeks to identify opportunities for engagement with governments, regulators and European and international institutions to advocate an international framework that will facilitate open and competitive capital markets globally. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing views.

The IRSG is co-sponsored by TheCityUK and the City of London Corporation

A FRAMEWORK FOR THE FREEST POSSIBLE TRADE IN FINANCIAL SERVICES IN THE EU/UK AGREEMENT

INTRODUCTION

The International Regulatory Strategy Group[1] has a membership reflecting the diverse nature of financial and professional services firm operating in London. Its members are headquartered across the world – in the UK, Europe, the US and the Far East.

This note is a short summary of the Group's third report[2] ("A New Basis for Access to EU/UK Financial Services post-Brexit") on the future direction of financial services after the UK leaves the European Union.

The report has been produced for the IRSG by the international law firm, Hogan Lovells.

The starting point for the report is that both the EU and the UK have, in their own ways, expressed the desire to secure future arrangements for free trade in financial services.

It is also based on the premise that a free-flow of trade in financial services is economically and socially beneficial both to EU member states and to the UK and their respective citizens. Unrestricted capital flows across Europe, and the ability of European business to access finance, are vital to maintaining a robust economy.

THE KEY RECOMMENDATION

The report's core recommendation is that the EU and UK forge a bold and ambitious free trade agreement (FTA) for financial services, with limited exceptions, that builds on the advantageous position that both parties start from a position of alignment on the laws and rules governing the sector.

The main beneficial feature of the EU/UK FTA would be that firms could have mutual access to each other's markets without having to obtain a licence in the other market.

Such an enhanced FTA is technical and legally entirely feasible. It would be likely to form a financial services 'chapter' of a wider EU/UK agreement. Indeed, the cross-border supply of financial services under the FTA we envisage (using the parties' uniquely aligned starting point as a means to develop a detailed and workable template) could be a catalyst for accelerating other discussions.

1 https://www.irsg.co.uk/about-us/council/

2 "Third Country Regimes and Alternatives to Passporting", IRSG Phase 1 Report, published 23 January 2017; "Mutual Recognition: A Basis for Market Access after Brexit", IRSG Phase 2 Report, published 11 April 2017.

THE BASIS FOR MUTUAL ACCESS

The EU/UK Agreement could have different bases for mutual access based on different scenarios. These could include:

- Mutual access to qualified counterparties (e.g. other regulated financial services firms and large corporates) which does not depend on alignment.
- Special arrangements for particular types of firm, such as market infrastructure firms.

In most cases, however, mutual access would be based on the premise that the UK and EU regulatory frameworks for financial services are already highly aligned, and that this alignment can be maintained in the future at the level that would give respective jurisdictions the confidence to allow firms licensed in the other jurisdiction to operate in their markets.

The report recommends that, on an ongoing basis, potential divergence of the respective regimes should be managed through mechanisms established in the FTA. The main features of these mechanisms would be as follows:

- An approach to assessing divergence based on an assessment of outcomes, rather than a formal, legalistic test.
- A shared Forum for Regulatory Alignment, which would facilitate an ongoing regulatory dialogue around the adoption of new global standards, and new regulatory initiatives, which would promote ongoing alignment between the EU and UK regimes.
- A new dispute resolution body, modelled on precedents from existing FTAs, to issue rulings on whether material divergence has occurred and whether, as a result, some element of market access should be withdrawn.

Existing FTAs contain a 'Prudential Carve Out' (PCO) – a sort of emergency brake allowing the suspension of access in certain situations where there are concerns about prudential matters (such as financial stability, and the adequacy of the governance arrangements). It is accepted that a PCO will form part of an EU/UK FTA, but its potential application should be tightly defined.

SUPERVISION OF FIRMS UNDER MUTUAL ACCESS

Both the EU and the UK will want to be sure that firms are properly supervised under the arrangements set out above, to protect consumers and to promote financial stability.

This will mean being clear about who is responsible for supervising whom. The suggested FTA should provide for a framework (like that for colleges of supervisors) with clearly defined responsibilities for the supervision of individual firms.

The proposed Financial Services Forum would be well-placed to promote joint working on common standards and approaches.

WTO CONTEXT

Both the EU and the UK are members of the WTO, which means that favourable terms offered to each other under a new FTA might have to be extended to all WTO members under the 'most-favoured nation' (MFN) principle.

In order to avoid the application of the MFN principle, the EU and UK will need to agree a broad FTA with "substantial sectoral coverage" – which means that it should not be limited to financial services but should also cover other sectors (e.g. agriculture, fishing and pharmaceuticals).

CONCLUSION

Maintaining mutual market access under a new EU/UK FTA should be achievable because the starting point is maximal alignment. Indeed, initiating mutual access should be possible without any formal assessment of alignment precisely because of this, ensuring smooth transition to the new arrangements.

Timing is a critical issue for the financial services sector due to the long lead-times involved in becoming established and authorised in another jurisdiction.

The EU and UK should seek as early as possible to agree a framework for their future relationship, which commits to preserving current access arrangements for financial services while the EU/UK agreement is being negotiated and finalised.

FOR FURTHER INFORMATION

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