



UK-EU Trade Agreement: What's next for financial services?

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In brief...

On 24 December 2020, after intensive down-to-the-wire negotiations, the European Commission and the UK government reached an agreement on the terms of future trade and cooperation between the EU and UK.

Trade and Cooperation Agreement

The Trade and Cooperation Agreement (the Agreement) outlines the future economic relationship between the EU and UK. A significant component of the Agreement is on free trade, ensuring that no tariffs or quotas are put in place for the cross-border trade of rule-compliant goods. The Agreement also puts in place a framework for cooperation on energy, transport, social security and standard-setting, including in relation to climate change, labour rights and tax transparency.

One area where the Agreement is noticeably light on detail is in relation to financial services. As widely anticipated by the industry, the Agreement does not extend an automatic right to access EU markets to banks, insurers and other financial services firms authorised in the UK.

The end of passporting

Under a variety of European directives and regulations, UK financial services firms have been able to undertake regulated business in the EU (and vice versa) using so-called European financial services passports.

Provided firms were appropriately licensed and regulated in their home country, these firms could use either a services or branch passport to undertake their business across EU markets under the supervision of local EU member state regulators without the need for a local presence and/or licence.

The UK left the EU on 31 January 2020 and entered into a transitional period where European law continued to apply until 31 December 2020. UK firms were able to continue to rely on their European passports during the transitional period. The absence of equivalency decisions and the fact that the Agreement does not provide for broad-based market access rights means that after the end of the transitional period, UK firms no longer have automatic access to EU markets, whereas EU firms continue to have access to the UK market for a further transitional period under the terms of the UK's temporary permissions regime.

Reflecting these concerns, the UK Prime Minister stated in the *Sunday Telegraph* that the Agreement "perhaps does not go as far as we would like" on financial services. The Chancellor of the Exchequer has sought to provide reassurance to the City of London in the *Times* noting the Agreement provides for a regulatory cooperative framework between the EU

and UK while giving the UK the opportunity to regulate “a little bit differently” than it has done in the past.

Financial services in the Agreement

The Agreement commits both the UK and EU to maintain their markets as being open on a non-discriminatory basis to firms in the UK and EU provided these firms are appropriately established in the relevant country. The parties to the Agreement also commit to ensuring that internationally agreed standards in the financial services sector are implemented and applied in their territories.

Financial services are expressly excluded in the Agreement from the most-favoured nation clause in terms of any future trade deal with a third country. Financial services are also excluded from the provisions in the Agreement on services more generally and from the requirement to review trade in services and investment relations in the future.

As noted by the Chancellor, both the EU and the UK committed in the Agreement to establishing a Memorandum of Understanding, by March 2021, for establishing a framework for regulatory cooperation on financial services. UK and EU regulators already have a range of memoranda of understanding. For example, the Financial Conduct Authority has a memorandum of understanding in place with the European Securities and Markets Authority (ESMA) as well as national EU regulators covering supervisory cooperation, enforcement and information exchange. The Agreement’s proposed Memorandum of Understanding should build on the existing good work of EU and UK regulators in terms of fostering cooperation.

The Agreement commitment to a Memorandum of Understanding does fall short, however, of the provisions of other such free trade agreements. For example, the free trade agreement between the EU and Japan expressly put in place regulatory cooperation measures in the free trade agreement itself.

Unsurprisingly, both the UK and EU have also preserved their respective rights to put in place measures for prudential reasons (being the “prudential carve-out”). This prudential carve-out permits the Bank of England and the European Central Bank to act independently of one another when acting to preserve financial stability and/or the integrity of financial markets.

What about equivalency decisions?

The Agreement does not include any decisions under equivalency frameworks for the financial services industry. Decisions on equivalency are unilateral decisions and not subject to negotiation. This is the case both for financial services and other areas such as data protection.

Generally, certain legislative frameworks in both the UK and the EU allow for third countries to be assessed as having “equivalent” legislative safeguards and standards. Where such a decision is reached, market access arrangements open up for firms to do cross-border business between the UK/EU and those third countries. Since 1 January 2021, the UK is considered a third country under EU law. Similarly, the UK now considers the EEA member states as third countries for the purposes of market access. Under this framework it is the European Commission and HM Treasury that may make such an equivalency decision about a third country’s legislative framework.

In the absence of passporting rights, equivalency decisions are sometimes seen as a way of replicating the ease of cross-border business that previously was the status quo. The application of an equivalence regime is a very different proposition to the ease of market access provided by passporting. Financial services are regulated by a range of laws across the EU with few containing substantive equivalence regimes which enable third country firms to provide services to local customers/counterparties without local authorisation. The ability of UK firms to operate in the EU under equivalency decisions and vice versa is much more limited than the soon-to-end passporting arrangements. Importantly, equivalency decisions may also be withdrawn unilaterally on very short notice.

Equivalency decisions to date

There are around 40 areas where the EU may consider the UK regulatory framework as equivalent in respect to financial services.

In September 2020, the European Commission made one such decision with respect to central counterparties (CCPs).

ESMA then proceeded to determine that the three UK-based CCPs should be recognised as third country Central Counterparties (TC-CCPs). As TC-CCPs, they continue to be eligible to provide their services in the EU following the end of the transition period on 31 December 2020.

In November 2020, HM Treasury announced that the UK would be granting a package of equivalence decisions to EEA states for certain intragroup transactions, regulated markets, market-making exemptions from short selling restrictions, the certification for credit rating agencies and under the Benchmarks regulation¹. These equivalency decisions came into effect at the end of the transitional period.

In the Questions and Answers to the Agreement, the European Commission noted that it is currently assessing the UK's responses to the Commissions' equivalency questionnaires in 28 areas. According to the Commission, it is seeking further clarifications on how the UK will diverge from EU frameworks after 31 December 2020 and so, accordingly, cannot finalise its assessment at this time. Notably, the Commission acknowledged "the UK's equivalence decisions announced in November, adopted in the UK's interest. Similarly, the EU will consider equivalence when they are in the EU's interest."

Dialogue in respect to equivalency decisions

In 2018 the UK had floated the idea of a "mutual recognition" regime going well beyond the current piecemeal "equivalence" patchwork, but it was firmly rejected by the EU negotiators and did not gain traction.

Clause 1 of the accompanying Joint Declaration on Financial Services Regulatory Cooperation (Joint Declaration) stated that the EU and the UK would "establish structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions" which will allow for "transparency and appropriate dialogue in the process of adoption, suspension and withdrawal of equivalence decisions" and "enhanced cooperation and coordination."

The concern is that a unilateral withdrawal of an equivalency decision represents a significant cliff-edge for firms and their customers in the sector. The UK's position had been to propose an initial period of consultation on possible solutions to maintain equivalence, and then clear timelines and notice periods "appropriate for the scale of the change before it takes effect" rather than the present 30-day period. Additionally, the UK had proposed "a safeguard for acquired rights" and that intractable disputes between the UK and the EU would ultimately be resolved by independent arbitration.

As at 26 March 2021, HM Treasury confirmed that technical discussions on the text of the Memorandum of Understanding with the European Commission have concluded. The Memorandum of Understanding will establish a Joint UK-EU Financial Regulatory Forum, which will serve as a platform to facilitate dialogue on financial services issues. Formal steps need to be undertaken on both sides before the Memorandum of Understanding can be signed, but it is expected that this can be done expeditiously.

What's next for financial services?

The failure to replicate market access arrangements under passporting in the Agreement does not come as a surprise or shock to the financial services industry.

UK and EU firms, as well as national and pan-EU regulators, have been putting in place contingency measures to allow cross-border business to continue in the event that no agreement is reached.

In the UK, these measures have primarily consisted of a temporary permissions regime which allows EU firms to continue doing business in the UK without local authorisation for a period of time. No pan-EU temporary permissions regime exists for UK firms seeking continuity of business. Instead, UK firms have proceeded to either scale back their EU business, subsidiarise and seek EU member state authorisation and access to passporting, or rely on local EU27 national measures (such as overseas persons regimes, which exist in certain countries) and/or on conducting business with EU customers on a reverse solicitation basis.

Following the end of the transitional period on 31 December 2020, more friction in cross-border financial services has necessarily occurred. The extent of that friction continues to depend on the willingness of regulators and governments to act on equivalence decisions, regulatory cooperation and the acknowledged shared interest in a vibrant financial services sector.

¹ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014

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