



# Towards a framework for financial services in an EU - UK trade agreement

## Key points

Large volumes of financial cross-border trade in banking and capital markets services between the EU and the UK will switch from being internal economic activity within the EU single market to being international trade with the UK withdrawal from the EU. This has profound consequences, as much of what is permissible within the single market is heavily restricted between the EU and third country markets outside it.

To achieve a high level of cross-border market access, it will be important to reproduce the elements that underpin it in an EU context in a bilateral future free trade agreement (FTA) between the EU and the UK. Although historically coverage of trade in services in FTAs has been limited there is nothing that prevents it from being used to enable cross-border trade in financial services, while recognising that political or other considerations may impose some practical constraints.

Both sides recognise the need to move the existing FTA framework on. In March 2017, Michel Barnier stated *"We agree with Theresa May when she recently called for a "bold and ambitious free-trade agreement"*. An FTA that reflects the desire for a shared interest in a close economic relationship build on shared rights and obligations will go a long way in achieving this.

A framework for trade in banking and capital markets services based on mutual recognition

provides for an ambitious and achievable model that would allow the EU and UK to align their regulatory practices and for the mutual recognition of the authorisations provided to certain financial services firms and that takes into account the unique starting point between both sides. Such a framework would be built on the following elements:

- **An assessment of the financial sophistication of users:** An assessment needs to be made of the different kinds of users of cross-border financial services, their capacity to procure cross-border and the various roles that their activity plays in their businesses and the wider economy. A framework should reflect the fact that it is not necessarily appropriate to treat cross-border procurement of financial services by an EU government or large multinational company the same way as similar activity by a small business.
- **A high level of regulatory and supervisory cooperation:** A framework based on mutual recognition must be underpinned by a high degree of regulatory and supervisory cooperation, which regulators and policymakers cooperating transparently on regulation and working together where necessary on supervision.

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- **A level playing field between cross-border and local firms:** As much as possible a level playing field needs to be provided between cross-border and local banks and financial service providers. Where firms hold a recognised authorisation from a home supervisor they should not be subject to additional licensing or authorisation requirements or rules in the host market that duplicate requirements already applied by home regulators.
  - **Clear and robust mechanisms to deal with divergence and disputes:** A framework needs to be institutionalised with clear and robust mechanisms for resolving any divergence in regulatory regimes and any disputes. It should aim to protect firms from the sudden withdrawal of market access rights in the event of regulatory divergence in two ways. First, by making such withdrawal subject to consultation and transparent engagement. Second, by ensuring that rights can only be withdrawn over a timeframe that provides time for users to adapt.
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## Beyond the Single Market

What is possible inside the single market is generally not possible between the EU and markets outside it. A FTA between the EU and the UK should aim to preserve a high level of cross-border trade in financial services between the two markets.

Every day thousands of users conduct tens of millions of euros worth in trade in financial services between the EU and the UK. These users for sophisticated banking, investment and risk management services range from governments, large companies and banks to professional investors and small firms. While the UK remains part of the EU, this 'trade' is simply economic activity within the single European market for financial services. After the UK withdrawal from the EU, it will become international trade.

This poses a number of challenges for customers and businesses on both sides. Most importantly, what is possible inside the single market, underpinned by the EU's single rulebook for financial services and liberalised framework for buying and selling financial services, is generally not possible between the EU and markets outside it. The EU has developed - although not fully implemented - some limited ways for firms to sell to EU customers from outside the EU, and individual EU member states have national regimes that allow such contracting in limited areas. However, in general, EU-based customers are restricted from buying many banking and investment services directly from companies outside the EU and European Economic Area (EEA).

If the current ecosystem of cross-border trade in banking and capital markets services is not to be faced with a 'cliff edge' effect and be severely disrupted by the UK withdrawal from the EU, it will be important for the EU and the UK to agree on the scope the two sides want to continue to preserve for the cross-border contracting of financial services as part of the future relationship. A FTA between the EU and the UK should aim to preserve a high level of cross-border trade in financial services between the two markets. Not simply for the sake of avoiding disruption but because it is good for choice and diversity of service on both sides.

As part of this a number of important questions need to be addressed by the EU and the UK:

- What types of services and users should be covered?
- What conditions should be attached to the granting of market access rights?
- What mechanism will take on the function of the EU's single rulebook in giving regulators on both sides confidence in the supervision and prudential standards applicable to the firms providing cross-border services?

## The basic principles for a cross-border EU - UK trading model for financial services

Three overarching principles should underpin the design of a model based on mutual recognition for the cross-border trade in financial services between the EU and the UK:

- **Mutual recognition of regulatory approaches:**

It must be based on common approaches to regulating financial services and mutual recognition of the quality and robustness of regulation and supervision. This can be determined in a range of ways;

- It can operate both at the level of regulators themselves, via a process in which EU and UK regulators recognise the comparability of their general approach to financial markets regulation and the intensity and focus of their supervision and enforcement activity.
- It can also be determined at the level of rules and regulations in which specific frameworks for regulated activities are recognised as closely aligned in content, guided by the same intent and achieving of comparable outcomes.

The material outcome in either case is a framework in which both sides agree to recognise authorisations for defined activities in the other jurisdiction as carrying the same weight in their own. Both at the EU and member state level there are a range of approaches to recognising the quality of third country supervision as the basis for trading or operating rights in the EU. There is no reason why similar approaches cannot be lifted into an FTA.

- **Different users have different levels of sophistication:** A model for defining rights to contract financial services cross-border

between the EU and the UK should start with the needs of users, and recognise that different kinds of user can be treated in different ways. For example, an EU government or large company or bank raises different kinds of prudential issues from a retail user or small business when contracting in any context, but especially between different jurisdictions. There is no reason why this cannot be recognised and reflected in a framework for trade between the EU and the UK, with higher and more detailed levels of regulatory alignment required for services to users with lower levels of financial sophistication. This principle is already widely recognised in both EU and UK financial regulation.

- **Regulatory and supervisory cooperation:**

Finally, any framework for cross-border trade in financial services must be based on a very high level of regulatory and supervisory cooperation. This should be institutionalised in a permanent structure of consultation, cooperation and aspects of shared oversight with clear and defined protocols for dispute resolution both at the level of regulators and the parties themselves. While both the EU and the UK are likely to want to maintain regulatory autonomy, this is nevertheless fully compatible with a transparent, and collaborative approach to financial regulation that aims at maintaining aligned approaches to financial markets supervision. This is important not only for maintaining the foundation for cross-border trade and operations, but as the cornerstone of a shared European regional approach to capital markets and to banking and markets regulation globally.

## A level playing field and robust rights

A number of other factors will be important to put at the centre of a designing an EU - UK model for trade in banking and financial services.

A cross-border trading relationship should aim to preserve a level playing field between EU-based and UK-based banks selling services to users in each jurisdiction. This is important with respect to cross-border trade, where requiring an importing bank to comply with local rules when they are

already subject to comparable obligations in their home market can easily negate the value of cross-border market access. It is important that an EU - UK FTA ensures that the basic corollary of mutual recognition of authorised firms is that in general no further local authorisation or licensing requirements are imposed on them, and that they are wherever possible not subject to local requirements that duplicate rules to which they

Rights that can be withdrawn quickly or with little consultation can easily undermine 'market access in principle' with uncertainty in practice.

are already subject in their 'home' jurisdiction. In all respects, importing firms should generally be able to expect the same treatment as accorded to local firms – taking into account the rules they are already subject to in the other jurisdiction.

A cross-border trading relationship also needs to address the issue that rights that can be withdrawn quickly or with little consultation can also easily undermine 'market access in principle' with uncertainty in practice. There is an inevitable degree of contingency where rights are based on mutual recognition and regulatory alignment – as both sides retain autonomy over their rules there can never be a complete guarantee that divergence in approaches does not cause rights to be withdrawn. However, it is important to ensure that such withdrawal of commitments is rendered less likely through close cooperation, transparency and consultation on regulation. The same should be true of any 'prudential

carve-outs' allowing regulators on either side to withdraw commitments in the face of prudential concerns. To the greatest extent possible, these should be subject to clear rules of proportionality, transparency and consultation.

Acknowledging that such withdrawal of commitments is nevertheless a possibility if regulatory approaches diverge in a fundamental way, it is vital that any framework for the withdrawal of rights provides sufficient scope for users to identify alternative financing providers. There is a strong case for considering a variable approach to certain cross-border rights, so that even if the EU and the UK were to diverge at the level of specific rule frameworks at some point in the future in a way that saw rights withdrawn in some areas, a basic element of market access for some services would remain as long as high-level recognition between regulators was maintained.

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## From principles to practice

An FTA between the EU and the UK should include a separate financial services chapter given the inclusion of mode 1 cross-border supply commitments and the detailed and specific nature of the commitments where regulators will play a central role

There are many ways in which an agreement based on such principles could be calibrated or designed at a detailed level. It is inevitable that the final shape of an agreement will reflect prudential, practical and political prerogatives on both sides. Starting by establishing clear principles is thus an important way of developing a conceptual approach to trade in financial services between the EU and the UK that is acceptable to both sides, before negotiating the detail and calibrating any approach to their preferences.

It is often noted that no FTA has ever covered cross-border trade in financial services in any detail. This is not a reflection of the inherent limitations of an FTA framework in itself. Rather, it reflects the fact that most FTA partners have separate regulatory frameworks for financial services, limited histories of supervisory cooperation and limited appetite or incentive for maintaining convergence. None of these things can be said of the UK and the EU. While the challenges of constructing a basis for cross-border trade in mutual recognition, regulatory alignment and supervisory cooperation cannot

be underestimated, the EU and the UK are nevertheless as well positioned as any two trading partners could be to attempt it.

Recent EU FTAs have covered financial services in a separate chapter, and an EU - UK FTA should do the same. Many horizontal commitments in areas such as data transfer, investor protection and general rights of foreign ownership will be relevant and important for banking and financial services. However, as with, for example, trade in ambient foods, the specific questions raised by financial services trade – not least the necessary prudential conditions – require separate treatment. One past argument for not including financial services in conventional FTAs has been the lack of Mode 1 cross-border supply commitments. An EU - UK agreement should anticipate such commitments and should cover them in a specific chapter. Similar to areas such as Sanitary and Phyto-Sanitary standards regulatory convergence in financial services is a complex area in which commitments will not be generic but detailed and specific and where the engagement of regulators will be central.

## See also

- BQB # 1 Staying in or leaving the EU Single Market.
- BQB # 2 An orderly exit from the EU.
- BQB # 3 What is 'passporting' and why does it matter?
- BQB # 4 What is equivalence and how does it work?
- BQB # 5 Data protection and transfer.
- BQB # 6 Time to adapt – the need for transitional arrangements.
- BQB # 7 The Repeal Bill – providing certainty and continuity.
- BQB # 8 External trade policy and a UK exit from the EU - clarifying the UK's WTO profile and beyond.
- BQB # 9 Impact of Brexit on cross-border financial services contracts.