EUROPEAN CAPITAL MARKETS INSTITUTE

ECMI Commentary no 72 | March 2021

On the fringes: EU-UK financial services under the TCA

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The outcome of the Trade and Cooperation Agreement (TCA) for trade in financial services between the EU and UK deal was even more paltry than expected. The TCA does not even institute a dedicated financial services committee, but rather a general one for services. Nevertheless, there is a deal that provides for an umbrella, a governance structure, and a mechanism for dispute settlement and cooperation in a variety of fields, as might be expected for a former member and close neighbour. Joint actions have also been envisaged on money laundering (which remains problematic even within the EU), cybersecurity, and in financial programmes of the European Investment Bank (EIB). The agreement contains a long list of member states' specific market access reservations, notably on financial data processing services – a clear sign that this is no longer a Union but a loose trade agreement. Only supervisory equivalence agreements between both parties covering some aspects of the free provision of financial services could somehow maintain the appearance of the frictionless trade of before.

From a once intense relationship in financial services, which was measured by the number of 'passports' or single licenses used, capital flows and the high number of transactions in both directions, the TCA is a huge climbdown from the former close trade relationship. However, it was years in the making and thus allowed all providers to prepare for the new normal, which banks, insurance companies, financial infrastructures and related service providers have largely done.

The first working day of the new TCA, in its provisional form, saw no great change; there were no major hiccups and some businesses had already relocated to the EU with the new framework, often on platforms created by UK-based providers. But this likely heralds the beginning of the slow decline of the all-powerful City of London, whose rise coincided with the launch of the single market and expanded ever since thanks to passporting, and the renewed fragmentation of financial services over several European financial centres.

The agreement has a dedicated chapter on cross-border financial services and investment, following the (most favoured) national treatment and anti-discrimination rules (Section 5.37 of the TCA). But it provides for a prudential carve-out, as in other international trade agreements, allowing each party to adopt or maintain measures deemed necessary for consumer and

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investor protection or the stability of its financial system. This clause can easily be invoked in the financial services domain for protectionist reasons, and has never been challenged in international courts.

The City's disappointment at the non-existence of a dedicated financial services committee in the TCA was understandable. The UK's first draft of the Comprehensive Free Trade Agreement (CFTA) featured a financial services committee, which is obvious given the importance of this sector to the UK economy. This committee was supposed to function as a first-level dispute settlement entity and be composed of competent persons from each side. The draft also contained a specific annex related to the functioning of equivalence decisions. None of this is in the final TCA, as other issues seem to have taken priority, given their importance for the UK electorate. But the text had been kept among a close circle before the deal was formally announced on the 24 December 2020, hence the surprise at the change. Nevertheless, financial services will be dealt with in a generic services committee, and the respective EU supervisory and regulatory entities have announced several Memoranda of Understanding (MoUs) with their counterparts in the UK.

Other parts of the agreement and its various provisions are also important to maintaining market access for finance providers. Key parts in this regard are free cross-border data flows and the cooperation for cybersecurity.

- Cross-border data flows (Part 2, Title III): the UK can be part of the EU data space, or a single data space, with no requirements for data or server localisation, and all this implies for business. This will require adequacy decisions between the EU and UK data protection rules, which still need some additional rulemaking on both sides, a GDPR-equivalent regime on the UK side, and an additional proposal by the EU Commission on data flows.
- Cybersecurity (Part 4, Title II): the UK will also participate in the EU's cyberspace, and both will cooperate on international fora to promote cyber-resilience. Moreover, the UK will be part of the EU's Computer Emergency Response Team (EU-CERT), in the cooperation group of the Network Security Directive (EU/2016/1148), and in the EU Agency for Cybersecurity (ENISA) (subject to an appropriate financial contribution).

In addition, combating money laundering is a specific engagement of the parties in the TCA (Part2, Title X), with provisions regarding the exchange of information, mutual assistance and the transparency of beneficial owner registers, while there was only one reference to money laundering in the UK's first draft. Furthermore, there is a requirement to provide information on bank accounts and transactions (Part 3, Title XI), and to assist with judicial prosecution in the case of money laundering.

Equivalence assessments of each other's supervisory systems are not referred to in the FTA, but in a Joint Declaration that states: "the EU and the UK agree to establish structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions." This includes: bilateral exchanges of views relating to regulatory initiatives; transparency and appropriate dialogue in the adoption, suspension and withdrawal of equivalence decisions; and enhanced cooperation and coordination, including in international bodies as appropriate.

So far, the EU concluded one agreement of importance, the equivalence of the supervision of UK clearing facilities, as contained in the 2014 European Market Infrastructures regulation (EMIR). This is far less than what the EU has concluded with other third countries so far, but is also less than the temporary relief which the UK has granted to EU service providers, as can be observed in this table. Although the European Commission has received the UK's replies to the Commission's questionnaires covering 28 equivalence areas, further clarifications are needed[1]. Decisions will be assessed only "when they are in the EU's interest".

As a step towards more equivalence decisions, but mostly to enhance supervisory cooperation, the EU, the member states and UK authorities have concluded a series of MoUs. The directorate general in charge, DG FISMA, and the UK Treasury plan to conclude an MoU on regulatory cooperation. However, this broad and non-binding commitment (more of an administrative than a policy tool), which is to be agreed by March, is noticeably different from the guaranteed single market access that UK financial service firms enjoyed until 31 December 2020.

The equivalence process should however not be seen as a unilateral process only. The UK itself will undoubtedly know where to go for equivalence, and where it should go its own way now that it can decide more quickly than as a member of the EU. The UK has already indicated that it will diverge in certain areas, such as on the settlement regime as contained in the central securities depositories regulation (CSDR), on the prudential regime for investment firms as contained in the investment firm regulation (IFR), or on the listing rules.

The strict EU bonus regime for financial services providers was never endorsed by the UK either, so change can be expected here. But the EU itself has already changed laws as well, as in the MiFID quick- fix amendments adopted in February 2021. These changes are certainly not to the liking of the UK authorities because they hinder equivalence in investment services.

The TCA sections on the level playing field (LPF), which mostly concern the manufacturing sector, will likely have no effect on financial services but could cause problems for the relationship overall. If there are significant divergences (e.g. on labour and social regulations, environment and climate, taxation levels of protection), that could have a material impact on trade or investment between the EU and UK. Rebalancing measures may be introduced to address the distortions, potentially ahead of an arbitration panel. The same applies for subsidies, where remedial measures could be requested.

The LPF debate demonstrates the EU's fear of having a serious competitor following other rules at its backdoor, particularly one that is a significant competitor in financial services. Financial regulation is only one of the elements on which a financial centre competes; there is also human capital (expertise); a critical mass of players, activities and professions; infrastructure and interconnectedness; and reputation and proximity.

[1] In particular regarding how the UK will diverge from EU frameworks, how it will use its supervisory discretion regarding EU firms, and how the UK's temporary regimes will affect EU firms.

As a leading financial centre on all these aspects, the City of London – and more broadly the UK – will continue to play an important role in European and global financial services, until a true competitor emerges on the continent. But this competition is emerging – given the obligation to be established within the EU to provide certain services, such as share trading.

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