IRSG

INTERNATIONAL REGULATORY STRATEGY GROUP

# THE EU'S THIRD COUNTRY REGIMES AND ALTERNATIVES TO PASSPORTING

## EXECUTIVE SUMMARY

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**The International Regulatory Strategy Group**

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

Within an overall goal of sustainable economic growth, it seeks to identify opportunities for engagement with governments, regulators and European and international institutions to promote 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 industry views.

TheCityUK and the City of London Corporation co-sponsor the IRSG.

# FOREWORD

As the UK stands on the brink of a new era in its trading relationship with the EU and the rest of the world, the UK-based financial services industry is still assessing its current and future position.

In her recent speech on 17 January 2017, the Prime Minister outlined the UK Government's intention to secure a bespoke deal with the EU with the greatest possible access to EU markets. She recognised the important role the UK plays as Europe's financial centre and that the industry must be able to provide its services across national borders after Brexit. We hope that this report will help inform this debate.

The UK's intended direction of travel has now been outlined, but the complex political path to be navigated, and the demanding timescales involved, mean that it is increasingly urgent that financial services providers assess their priorities and develop their plans for Brexit.

We know that when the UK ceases to be a member of the EU, it will automatically lose the access rights which it currently has through its EU membership. The UK will become a 'third country' from the perspective of EU financial services legislation. However, the implications of being a third country have rarely been considered within the UK, and there has until now, been a lack of detailed analysis of the legal position.

The International Regulatory Strategy Group (IRSG) – co-sponsored by TheCityUK and The City of London Corporation – has established a working group, chaired by Hogan Lovells and with representatives from across the industry, to produce a clear and neutral analysis of the UK's position in relation to the cross-border provision of financial services, to and from the EU, after Brexit.

The aim is to produce an insightful analysis of the implications of the range of potential outcomes, in order to provide a practical, factual context to the industry and to assist policymakers in assessing their objectives and priorities and developing their future strategy.

We are pleased to contribute this thinking to the complex task of shaping a future relationship which works to the benefit of all those who rely on financial services in the UK and across the EU – including financial services providers themselves, their employees, and the consumers they serve.

There is currently a significant amount of cross-border business (in both directions) between the UK and the rest of the EU, and our analysis should be of benefit to financial services providers on both sides of a future UK/EU border.

We have not considered the concept of 'passporting' in detail, as the scope and availability of passporting is already well known to the industry and the UK Government has indicated that it does not intend to pursue an approach that relies on the continuation of passporting. Instead we have focused on identifying what the alternatives to passporting could be.

Under existing EU law, there are 'third country regimes' already in place, which allow financial services providers from outside the EU to have access to parts of the EU financial services market.

This report contains a factual matrix which provides details of:

- the scope of the existing third country regimes – i.e. which areas of financial services are covered by third country regimes and which are not;

- the conditions that both the UK and UK-based financial services providers would need to satisfy in order to make use of the third country regimes. In most cases, the availability of those regimes depend upon the UK's own regulatory regime being determined by the EU authorities to be 'equivalent' to the EU regime; and
- the processes for securing access under the third country regimes, both to understand the obligations that the UK and UK-based financial services providers would be subject to, and to give an indication of how quickly the necessary determinations could be obtained.

There are legitimate concerns that even if the UK's regime is actually equivalent at the date of Brexit, the question of whether the EU authorities will grant the necessary determinations – or will do so in time for the UK's exit from the EU – is unclear. That, and the narrower range of activities covered by the third country regimes, suggests that relying only on those regimes will not meet the objectives for 'maximum possible access' which have been outlined by the UK. But the Prime Minister has also stated that the if its objectives cannot be secured, then the UK may proceed on the basis of "no deal" which would, effectively, mean that the UK would be relying on the TCRs to secure on going access to the EU.

As a result, the report concludes that the UK should be looking to reach a bespoke agreement with the EU, allowing wider, mutual rights of market access, to reflect the unique position of the UK in relation to the EU and reflecting their integrated and interdependent markets. The report provides insights into some of the mechanisms which could be used to structure a relationship based on this new approach, if enhanced access across the UK/EU border can be agreed politically.

The report also provides a detailed analysis of what the position would be if the UK, after Brexit, does not secure a bespoke agreement and is not able – or not willing – to comply with the conditions of the third country regimes. This analysis includes input from a number of key EU jurisdictions regarding the extent to which a firm from a non-EU country can undertake business in those jurisdictions without obtaining a local licence – for example, by relying on reverse solicitation, and the extent to which it could outsource activities from to the UK from a subsidiary established in those EU jurisdictions.

Finally, the report considers the importance of agreeing transitional arrangements and suggests measures that the UK should be looking to agree with the EU, as soon as possible, to give reassurance to the financial services industry on both sides of the future UK/EU border.

By enhancing understanding of the additional access mechanisms which would need to be put in place at the time of Brexit to maintain continuity of provision for those who rely on financial services, in the UK and across the EU, we hope that this report will support the UK and EU in framing and transitioning to a successful new relationship for all.

We are extremely grateful for the support of all contributors to this report.

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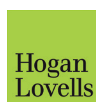


***The full version of this report is available at www.thecityuk.com***

# EXECUTIVE SUMMARY

**1** Brexit and the shape of a new relationship with the EU are critical issues for the UK-based financial and related professional services industry and for the wider economy it serves. To help the Government prepare its strategy effectively and to clearly define the industry's priorities for the forthcoming negotiations, TheCityUK has undertaken extensive work related to the decision by the UK to leave the EU. We are committed to ensuring we respond effectively to what is a fundamental change to the way that our industry has operated to date, but also a change that presents opportunities if managed in the right way.

FINANCIAL AND RELATED PROFESSIONAL SERVICES REMAINS ONE OF THE MOST IMPORTANT INDUSTRIES, DIRECTLY EMPLOYING 2.2 MILLION PEOPLE ACROSS THE UK

**2** As an industry that employs around 2.2 million people across the UK, generates more in tax revenue and attracts more foreign direct investment than any other, its continued strength is intrinsically linked to a strong and thriving economy and is a national and European asset. The UK benefits economically from having a strong financial and related professional services industry that serves the UK, Europe and the rest of the world. Meanwhile, Europe benefits from having London – one of only a handful of truly global financial centres – as its hub and entry point for companies based outside Europe wanting to access the Single Market. London and the wider UK therefore help to enable economic growth and jobs across the UK and Europe. Given how interconnected and interdependent the UK's and EU's financial markets and services have become, it will remain a political imperative to ensure that these markets continue to function in a coherent way post-Brexit.

**3** In light of the industry's importance to the UK economy, we believe that financial and related professional services issues should be prioritised in the forthcoming negotiations. This must include securing a "mutual access" arrangement, which allows as much two-way access between the UK and EU as possible. Agreeing an approach which facilitates the access to skilled talent from both the EU and the rest of the world in order to continue and boost the UK's competitiveness will also be important.

**4** *The EU's Third Country Regime and Alternatives to Passporting* was produced by the IRSG in collaboration with Hogan Lovells. Its aim is to look at what the alternatives are if the UK does not continue to have passporting rights after Brexit – and in particular it provides a comprehensive analysis of the EU's current third country regimes (**TCRs**) for financial services. The TCRs are provisions of existing EU law that provide certain rights and protections, subject to conditions, to countries outside the EU (so-called **third countries**) and to financial services firms from those countries (**third country firms**). These rights fall short of passporting but, when granted by the EU, include the ability to conduct certain regulated activities in the EU without obtaining authorisation from the regulators in the relevant Member States. It has been suggested by some commentators that a new UK-EU relationship in financial services could be based on TCRs.

5 Based on the analysis undertaken by the IRSG, the report draws the following conclusions:

(a) Given their limited coverage (compared to current rights of access), uncertainty of availability and the lack of key safeguards associated with them, the TCRs do not provide an acceptable long-term, sustainable solution for the UK-based industry as a whole to access EU markets.

(b) Relying on the degree of access that is permitted under local laws in individual Member States does not provide a sufficient solution either. Indeed, since the UK's current regime for allowing access for overseas firms is materially more liberal than that in many individual Member States, we would be left with an asymmetric relationship.

(c) The debate should thus focus on what a bespoke agreement between the UK and the EU allowing mutual market access should look like.

(d) Transitional arrangements will have to be agreed as quickly as possible to ensure continuity of service provision until a new settlement can be implemented and to minimise unnecessary relocation or restructuring by financial firms.

**£190BN**

**FINANCIAL AND RELATED PROFESSIONAL SERVICES CONTRIBUTED £190BN TO THE UK ECONOMY IN 2014. THIS REPRESENTED 11.8% OF UK ECONOMIC OUTPUT**

6 Only a very small proportion of financial services which are currently covered by the passporting regime are the subject of TCRs:

(a) There are TCRs available for certain types of market infrastructure providers (e.g. CCPs and benchmark administrators).

(b) There is no TCR giving cross-border access for a number of key financial services, including deposit taking, lending, payment services, mortgage lending, and activities relating to UCITS funds. There is only a very limited TCR for insurance.

(c) TCRs are in the process of being introduced that may be useful to (i) firms undertaking investment business that wish to provide cross-border services (i.e. without establishing a branch in the EU) to wholesale customers in the EU (there is also a TCR for establishing branches, subject to the consent of the relevant Member State, and this could include the provision of services to retail clients); and (ii) non-EU alternative investment fund managers who wish to market funds to professional clients in the EU.

(d) The TCRs only provide very limited rights of access in relation to retail clients.

In summary, the combination of a lack of a comprehensive framework of TCRs and concerns about the way in which they operate means that even if the UK were to achieve the best possible outcomes under the existing/proposed TCRs, UK firms would still not be able to offer the full range of financial products and services that they can offer today to customers and counterparties in the EU.

7 In general, in relation to the TCRs:

(a) Most TCRs depend on the third country regime being 'equivalent' to the relevant EU regime. In relation to this:

(i) There is a lack of clarity over what 'equivalence' means in practice. The analysis is supposed to be outcomes-based, but that is not consistent with the experience

of third country firms who have applied under the existing TCRs, where the analysis has been carried out 'line by line'. It appears that some divergence between the two regimes is permitted, but it is difficult to determine what level of divergence would mean that the regimes are non-equivalent.

(ii) The requirement to be equivalent is ongoing. In order to maintain equivalence under the TCRs, the UK may end up being something of a 'rule taker' – i.e. having to implement changes in its own law to follow changes in EU law (and having less ability to influence those changes than it did as a member of the EU).

(b) The TCRs only apply if the EU authorities make a formal determination of equivalence. Although UK firms should in theory have an equivalent regime at the date of Brexit, it is not clear that the EU authorities will necessarily share that view or that they will make their formal determination before the date of Brexit.

(c) Some TCRs contain additional restrictions or limitations (e.g. requiring third country firms to submit to the jurisdiction of EU courts) – or permit Member States to impose additional restrictions or limitations of their own.

(d) Some TCRs are optional for Member States (i.e. they give the individual Member State the ability to opt out of allowing access to third country firms), so access is only available in relation to those Member States who decide to allow access.

(e) There are serious concerns regarding the processes around TCRs. In particular:

(i) the processes are unpredictable and very time consuming;

(ii) TCRs can be withdrawn or varied by the EU at little or no notice; and

(iii) there is little or no right of appeal against a determination of non-equivalence for a third country.

**8** In addition, there are also numerous provisions of EU legislation which, although they do not directly deal with access rights, impose restrictions on EU firms dealing with third country firms where the third country is not equivalent. For example, a UCITS fund in the EU will be prevented from investing into UK investment funds if the UK's regime is not considered equivalent to that of the EU. There is also concern that EU data protection laws may present a practical barrier to UK firms when dealing with EU customers and counterparties. Provisions of this nature could have a significant impact on UK firms.

**9** If neither passporting nor the TCRs are available in relation to a regulated activity and no other alternative form of access arrangement is agreed with the EU:

(a) For each Member State where it wished to conduct regulated business, a UK firm would have to consider whether national laws permitted it to carry on such business without a licence (or whether, for example, there might be an exemption available). Our analysis shows that the position differs between the different Member States, resulting in a complex patchwork of rules. There are no general exemptions across the EU.

**£1.1 TRILLION**

**EU BANKS IN THE UK HOLD OVER £1.1 TRILLION IN ASSETS OR 17% OF TOTAL BANK ASSETS IN THE UK**

(b) A UK firm could establish a subsidiary in the EU and apply for it to be authorised by the local regulator. The subsidiary would be able to use passporting rights around the rest of the EU. Our analysis shows that the subsidiary could outsource certain activities back to the UK, but it would have to satisfy 'substance' requirements in the EU Member State where it is authorised. This route to market is often inefficient (e.g. it may create new risks in the business).

(c) A UK firm could itself apply directly to a local regulator for authorisation in that Member State (i.e. instead of establishing a local subsidiary and applying for that entity to be authorised). The UK firm would typically have to establish a branch office in the Member State in order to obtain authorisation in this way. Some Member States allow this, but others impose limitations or rarely use the approach, so again it is not a universal solution.

**11.0%**

**UK FINANCIAL SERVICES ARE A VITAL SOURCE OF TAX RECEIPTS, CONTRIBUTING £67BN IN TAX REVENUE IN 2014/15, OR 11.0% OF TOTAL UK TAX RECEIPTS**

**10** Taking the above issues into account, the most favourable solution is likely to be for the UK and EU to enter into a bespoke agreement to allow mutual access to each other's markets. This could be on the basis of mutual recognition, or on the basis that the two regimes are broadly consistent (rather than strictly 'equivalent', under the approach currently used in the TCRs).

**11** Arrangements need to be put in place to protect customers who already have products in issue from the other side of the UK/EU border at the date of Brexit. This could take the form of some kind of 'grandfathering' arrangement, under which products that are already in issue at the date of Brexit will automatically be regarded as valid and can continued to be serviced across the UK/EU border for the lifetime of the product. This would also support stability and access to the full range of financial services products for businesses and consumers during the negotiation period by providing confidence that the products would not cease to be effective on Brexit.

**12** It is essential for the UK and EU to agree transitional arrangements as quickly as possible in order to maintain continuity of service provision by UK and EU firms until a negotiated settlement can be achieved and a smooth and orderly transition to the longer term arrangements implemented. These transitional arrangements should ideally cover all the areas covered by the current passporting regime, so that existing businesses can continue to service their customers across the UK/EU border.

**13** TheCityUK has been playing a central role in defining and delivering the industry's priorities for the Brexit negotiations and beyond, to ensure the UK remains the world-leading centre for financial and related professional services. The cooperative relationship between the UK and the rest of Europe needs to be retained. This will mean avoiding the imposition of new barriers between the two markets when Brexit occurs.

# OVERVIEW

## Background and context

**1** The UK Government has said that it wants to retain as much access to the 'Single Market' as possible.[1] UK firms currently use the passporting regime set out in EU laws to access the Single Market, but those laws will cease to apply to the UK on Brexit. The ability of EU firms to rely on passporting to access the UK will also lapse on Brexit. Unless a replacement arrangement is agreed, UK firms wishing to access the Single Market (and EU firms wishing to access the UK market) will need to find another route to provide those services after the UK leaves the EU.

**2** The 'Single Market' covers the relationships within the EU itself and the relationships that the EU and its members have with the other members of the EEA. The UK will be considering how to maximise its post-Brexit access to all of this market.

**3** It is in the interests of both the UK and the EU (and of consumers in each) to retain some degree of access to each other's markets:

(a) For the UK, financial services remains one of its most important industries, directly employing 2.2 million people across the UK and generating an estimated £60-67 billion of taxes each year. It also supports a wider ecosystem of employment and tax contribution (e.g. from related professional services), as well as providing access to finance needed in daily life and across all other industries. The EU is the biggest market for UK exports of financial services, generating 41% of the UK's total trade surplus in financial services in 2015.

(b) The UK is an important financial and related professional services centre for the rest of the EU. The extent of the UK's trade surplus with the EU in relation to financial services demonstrates the demand in other EU Member States for the UK's financial services and products. The strength of London as a financial centre attracts capital and investment into Europe, which flows through to the EU. The EU would therefore potentially stand to lose from a reduction in the UK's position as a global financial hub.

(c) It appears unlikely that any of the other cities in the EU could, in the short or medium term at least, absorb the whole financial services ecosystem which exists in the UK. A number of factors contribute to that, including that the requisite capacity to do so does not currently exist in any one EU city in terms of scale of infrastructure (business or domestic) and resident talent pool.

(d) As a result, if Brexit means that firms need to relocate, this (as well as differing preferences of location) is likely to result in the fragmentation of financial services across the EU. Many commentators have noted that weakening London's position as a global financial hub is likely to strengthen other global centres, such as New York or Singapore, rather than purely benefitting other cities in the EU.

(e) If the result of Brexit is that the costs of doing business in EU markets would increase (e.g. because UK firms need to establish separate EU subsidiaries to carry

THE EU IS THE UK'S BIGGEST MARKET FOR EXPORTS OF FINANCIAL SERVICES, GENERATING A TRADE SURPLUS OF £19.9BILLION – OVER A THIRD OF THE UK'S TRADE SURPLUS IN FINANCIAL SERVICES IN 2013.

[1] See the speech by the Prime Minister dated 17 January 2017: "An important part of the new strategic partnership we seek with the EU will be the pursuit of the greatest possible access to the single market, on a fully reciprocal basis, through a comprehensive free-trade agreement."

on doing business with EU consumers), that may increase costs to consumers in those markets or lead firms to consider that it is no longer cost-effective to service smaller markets and withdraw.

**4** There is scope for debate over exactly what 'access' means in this context. In this report, we use the term 'access' to refer to the ability of a financial services firm to rely on an authorisation provided by its regulator on one side of the EU/UK border in order to provide regulated financial services to customers or counterparties on the other side of that border, either directly from its home state or through a branch established on the other side of the border.

**5** A loss of passporting would mean that if a UK firm wishes to perform a regulated activity in another country, it will usually need to be authorised in that country in accordance with local laws. If a regulated activity is performed in multiple countries, separate authorisations will be required. The Single Market Directives introduced passporting (and, to a lesser extent, third country regimes in order to avoid the need for multiple authorisations.

**6** An issue also arises in relation to 'products in issue' by a UK firm with an EU customer at the date of Brexit. In relation to some regulated activities, such as 'dealing in investments', the activity is concluded as soon as a trade is completed. In such cases, if firms cease their trading activity they will not be continuing to do regulated activities in such a way as to require authorisation. In other cases, such as investment management agreements and insurance policies, the regulated activity takes place on a continuing basis. On a loss of passporting, it will be necessary to consider the ability of firms to continue providing such services and products to customers. This is likely to be a more significant issue for firms with a branch in the EU.

**7** There are essentially four potential outcomes for the UK's future relationship with the EU on access for financial services post-Brexit:
(a) having passporting rights, via EEA membership;
(b) agreeing a bespoke arrangement with the EU;
(c) relying on the existing TCRs; or
(d) not seeking to rely on existing TCRs (see paragraph 18(a) of this overview).

These possibilities are considered in more detail in sections 2, 3, 7 and 8 of the report.

**8** This report analyses the TCRs and other options for providing access for financial services providers across a UK/EU border post-Brexit if passporting is no longer available. The report is focussed on how (and whether) potential alternatives to passporting would work. It does not analyse in detail the possibility of passporting under EEA membership nor the terms which may need to be accepted by the UK in order to become a member of the EEA.

## The TCRs

**9** The TCRs are provisions of existing EU law that provide certain rights and protections, subject to conditions, to countries outside the EU (so-called "third countries") and to

**35%**

AROUND 35% OF EU WHOLESALE FINANCIAL SERVICES ACTIVITY TAKES PLACE IN LONDON

financial services firms from those countries ('third country firms'). These rights fall short of passporting but include the ability to conduct certain regulated activities in the EU without obtaining authorisation from the regulators in the relevant Member States.

**10** Usually, where a TCR is available, it is on the condition that the EU authorities must first make a determination that the legal and regulatory system in the relevant third country is equivalent to that in the EU. The issues relating to equivalence are considered below, in paragraph 13(c) of this overview.

**11** Our review of the scope of the TCRs (sections 3 and 4 of the report) has shown that only a very small proportion of the areas of financial services which are currently covered by the passporting regime are the subject of TCRs.

**10** Specifically:

(a) The only areas where TCRs currently offer a level of access that is likely to be useful to UK firms is in relation to certain areas of market infrastructure – for example, allowing UK clearing houses and benchmark administrators to provide services to EU customers. These TCRs are only likely to be directly applicable to a relatively small number of UK financial services providers (although they have a broader role in supporting the UK's position as a global financial centre).

(b) A number of important areas of financial services currently covered by passporting have no TCR which allows for cross-border access. These areas include:
(i) banking (deposit taking);
(ii) lending;
(iii) payment services;
(iv) mortgage lending;
(v) insurance mediation and distribution; and
(vi) activities relating to UCITS funds.

(c) There is a very limited TCR in relation to the issuing of contracts of insurance. EU Member States have an absolute discretion about whether to grant direct authorisation to branches of third country insurance firms. If a Member State decides that it will grant direct authorisation to a third country insurance firm, the TCR sets minimum standards that the Member State must apply when doing so.[2] However, the TCR does not require EU Member States to allow such branches to be established in the first place. EU Member States could therefore effectively 'opt out' of allowing access to UK insurers, even if the UK regulatory system had the requisite degree of equivalence.

(d) There are TCRs which are still in the process of being introduced that may, following their introduction, be useful to the following types of firm:

(i) third country firms wishing to provide investment services to wholesale

**112 COMPANIES FROM EU MEMBER STATES ARE LISTED ON THE LONDON STOCK EXCHANGE**

[2] This is not the case in relation to pure reinsurers (i.e. insurers who only enter into reinsurance contracts and do not enter into primary contracts of insurance). For pure reinsurers, the relevant Directive (the Solvency II Directive) does not set any standards for the establishment of a branch; it simply requires that pure reinsurers from third countries should not be treated more favourably than a pure reinsurer from the EU that was relying on passport rights.

customers on a cross-border services basis (i.e. without establishing a branch) under MiFID II. However, there will be no right to provide such services to retail clients and the rights under this TCR are subject to limitations (including in particular an obligation on the third country firm to submit disputes to the jurisdiction of a court or arbitral tribunal in an EU Member State); and

(ii) 'non-EU alternative investment fund managers' who wish to market to alternative investment funds to professional clients in the EU (although the introduction of this TCR, which is found in the AIFMD, has already been the subject of some delay).

Each of these TCRs is considered in the case studies in section 5 of the report.

(e) The TCRs only provide for very limited rights of access in relation to retail clients. The proposed TCR for investment services under MiFID II allows for branches of third country firms to service retail clients, but there is no obligation on Member States to allow such branches to be established – i.e. Member States can opt out of it. Other than in this specific situation, there are no TCRs allowing rights of access in relation to retail clients.

(f) UK investment firms and credit institutions will lose rights of access to EU trading venues, central counterparties and clearing and settlement systems after Brexit. There is no TCR which provides similar rights, so it will be up to individual EU Member States to determine whether UK firms will be able to have such access after Brexit.

(g) Some of the TCRs contain additional restrictions which may prove to be an obstacle to access. For example, EU firms are normally restricted from relying on credit ratings issued by credit ratings agencies ('CRAs') from third countries. There is a TCR under which third country CRAs can apply to be certified, which would allow their credit ratings to be used by EU firms. However, certification is only available where the credit ratings are not of 'systemic importance'. If the credit rating is of systemic importance, the credit rating produced by the third country CRA could only be used by an EU firm if the credit rating had been endorsed by an EU CRA.

**13** Our review of the general nature of TCRs (see section 3 of the report) also shows that:

(a) TCRs have arisen in a piecemeal manner over time and are contained in separate EU Directives, depending on the activity covered, with differing processes and requirements applying. Each TCR was influenced by different policy priorities at the time it was created.

(b) Where they do exist, TCRs offer rights and protections that are much less extensive and less reliable than passporting. In particular:

(i) they are frequently subject to specific restrictions and limitations (e.g. regarding the type of customer that can be serviced);

(ii) some are optional for Member States (i.e. individual Member States can opt out of allowing the third country firm to access their market); and

(iii) Member States are often able to impose additional restrictions on third country firms (i.e. above and beyond the requirements that would apply to a firm from within the EU).

(c) There are considerable concerns regarding the determination of equivalence of a third country. In particular:

(i) There is a lack of clarity over what 'equivalence' means in practice. The answer can differ as between different TCRs and different industry sectors. The assessment of 'equivalence' is meant to be outcome-based, so potentially it allows some scope for divergence between the respective regimes of the EU and the third country. In the absence of more detailed guidance from the EU authorities, however, it will be difficult for the UK law makers and regulators to know how far they can diverge from the EU standards without ceasing to be regarded as equivalent.

(ii) The experience of third countries who have applied for determinations of equivalence under existing TCRs shows that the processes followed by the EU authorities are unpredictable and time consuming. Even though equivalence assessments are supposed to be outcomes-based, the practical experience under the existing TCRs is that the process has involved comparing the respective regimes "line by line". There is no set timetable for equivalence decisions and most decisions have taken between two and four years to complete. Section 5 of the report contains case studies illustrating the actual experience of third countries seeking a determination of equivalence.

(d) There is uncertainty regarding the ease with which the UK, as a third country post-Brexit, could obtain a determination that its legal and regulatory system is equivalent to that of the EU. Assuming that the UK effectively imports EU laws wholesale to take effect on Brexit (as is the UK Government's stated intention, via the Great Repeal Bill), its legal and regulatory system ought, in principle, to be equivalent with that of the EU at the date of Brexit. However, the UK's new legal framework will need to be available in adequate time for the assessment to be made and there is no assurance as to how quickly the EU authorities will consider any application for equivalence by the UK and whether they would complete their deliberations before the date of Brexit itself. The EU has indicated that the UK will be treated as a third country as soon as it serves notice to leave the EU, which should facilitate the commencement of any processes for determining equivalence.

(e) Under the TCRs, the requirement to be equivalent is ongoing. In order to maintain equivalence (and subject to the point about some degree of divergence potentially being acceptable), the UK is likely to become something of a "rule taker" – i.e. it will have to:

(i) follow developments in EU law on an ongoing basis and enact them into UK law; and

(ii) refrain from making changes to the UK's own regulatory framework which would result in it ceasing to be equivalent.

It may be possible, however, for a third country to operate a "dual regime" (i.e. with separate parallel regimes or a tiered rule book), one of which has equivalent standards to the EU and one of which does not.

(f) There is currently no forum through which the UK and EU could collaborate into relation to changes in regulation and maintaining equivalence (although there are relevant examples in other contexts).

(g) Unlike passporting rights, TCRs are capable of being withdrawn or varied by the EU – either for:

(i) third countries as a whole (in respect of which there is no formal process for the withdrawal of equivalence); or

(ii) individual third country firms (where some of the TCRs have a formal process for the withdrawal of recognition, but most do not). Where there is a formal process for withdrawal, the notice period can be as little as 30 days.

(h) There is also currently no mechanism through which a third country or third country firm can appeal against a determination relating to a third country as a whole. The possibility of an equivalence determination being withdrawn at little or no notice could affect the willingness of UK firms to rely on TCRs. To date, however, the EU has not withdrawn any determination of equivalence that it has made under the existing TCRs.

(i) In circumstances where a third country has been determined to be equivalent under an existing TCR, a third country firm that has its recognition withdrawn may have standing to challenge such a decision in the Court of Justice of the European Communities (but only if the decision affects it as an individual firm, as opposed to affecting a category of firms in which it belongs).

**14** If a bespoke agreement is being put in place, the UK may wish to consider whether it is possible to agree safeguards with the EU regarding equivalence determinations – e.g. so that a determination of equivalence cannot be withdrawn at little or no notice, or without the UK itself or UK firms having a formal opportunity to respond or remedy the situation before withdrawal occurs. There may also be scope for the UK and EU to agree that disputes regarding equivalence could be resolved by an arbitral or judicial body appointed for that purpose.

**15** Although the focus of this report is on the availability of TCRs as an alternative to passporting, it is important to note that there is also EU legislation which does not directly address the question of third country access, but which imposes restrictions on EU firms dealing with third country firms. In a number of cases, these restrictions do not apply in relation to third country firms who can demonstrate equivalence, and are thus another example of the importance of equivalence issues to third country firms. Although they only affect third country firms indirectly, these so-called "indirect TCRs" can have an adverse impact on firms from non-equivalent third countries. For example:

(a) EU Member States are permitted to impose regulatory restrictions on the ability of EU insurers to reinsure with third country reinsurers in non-equivalent third countries. If the UK is not formally determined to be equivalent by the EU, this could affect the ability of UK reinsurers to do business with EU insurers; and

(b) EU UCITS funds would be prevented from investing in UK investment funds unless the home Member State of the UCITS fund considers the UK investment fund to be subject to supervision equivalent to that laid down in EU law. If the UK is non-equivalent, this source of investment into UK funds will be cut off.

**16** There are a number of these provisions in EU law, which could also affect the willingness of EU firms to have exposures to UK firms post-Brexit, the way in which international groups have to organise themselves and the ability of UK firms to offer products and services into the EU. Appendix 3 sets out the main examples of these provisions. In the post-Brexit world, the UK will want to ensure that it has been determined to be equivalent in relation to these provisions.

**17** This report does not address all the ways in which the UK being a third country may affect the UK financial services industry. In addition to the issues relating to financial services, there are issues which may apply all industries. Any future inconsistency between the UK and EU in relation to data protection law may affect the ability of firms to transfer data across the UK/EU border and act as a practical impediment to cross-border business. Access to talent is also a concern for the UK financial services sector.

## Access options other than relying on the existing TCRs or entering into a bespoke agreement

**18** If neither passporting nor the TCRs are available in relation to a regulated activity, and no bespoke agreement can be secured, it is likely that UK-based financial services firms would have only limited access options available to them after Brexit. The main options would be as follows:

(a) **Carry on such cross-border activities as are permitted under local laws**

In this situation, the UK firm would be seeking to provide cross-border services from an establishment in the UK to customers or counterparties based in EU Member States. The ability of the UK firm to do so will depend on whether local laws require them to obtain a licence to do so or whether there are any relevant exemptions that it can make use of.

In connection with this, we have considered whether it could be argued that certain forms of business carried on from the UK with EU counterparties or customers are being carried out only in the UK and not in the EU Member State, such that no need for a licence arises. Our conclusion is that there would be material risk associated with relying on such an argument, not least because many EU Member States take a different interpretation and it is the law in those Member States that is relevant.

There are no general exemptions that UK firms could use in order to secure access (such as the UK's 'overseas persons exemption' which the UK currently applies to non-EU firms). In some individual Member States, there are exemptions that might assist, but a UK firm would need to consider its position separately in each Member State. We have reviewed the law in several key EU Member States and concluded that UK firms would have limited scope to conduct regulated activities in those Member States without a local licence.

In relation to some of the Member States we reviewed, UK firms could accept business from EU customers or counterparties on a 'reverse solicitation' basis (i.e. where the business resulted from the EU customer approaching the UK firm, rather than through the UK firm soliciting the business). Even where reverse solicitation is permitted, however, it is often subject to limitations. In any event, UK firms are likely to find that an inability to actively solicit customers means that reverse solicitation of very limited practical use.

(b) **Establish a subsidiary in the EU**

Many UK firms who currently rely on passporting rights are considering establishing a subsidiary in the EU and applying to get it authorised by the local regulator. The subsidiary would be able to passport services from that Member State around the rest of the EU.

In relation to this approach:

(i) A UK firm currently using passporting to conduct an activity in other Member States would need to transfer all or part of its business into a regulated EU subsidiary to continue conducting it. That is likely to involve considerable disruption to the UK firm's existing business.

(ii) Establishing a new subsidiary would be significantly less efficient than the position that a UK-based financial services business which currently has a passport finds itself in (e.g. from a regulatory capital position, as well as operationally).

(iii) In many of the key EU Member States, it would be possible for the new EU subsidiary to outsource critical functions back to its parent company in the UK. There has been speculation about whether a UK firm could use a so-called 'brass plate' approach – i.e. under which it puts the minimum resources into the EU subsidiary and outsources everything back to the UK. The answer is that there is a balance to be struck. The new EU subsidiary would have to be an entity of substance, with real decision making being undertaken within that entity itself (which may mean, amongst other things, having to find additional directors in the relevant Member State). Subject to those requirements, however, it would be possible for the new EU subsidiary to rely on the UK parent company to provide support on an outsourced basis to a significant degree. The exact extent of delegation possible may vary between the different types of regulated activity and as between the Member States in which the subsidiary could be based. See section 7 of the report.

Some firms may choose to curtail the business they conduct cross-border, reducing their offering to businesses and consumers across the EU or only provide the services to Member States which permit direct access.

(c) **Apply to individual EU Member States for direct authorisation of a branch**

EU Member States sometimes permit third country firms to obtain authorisation directly from the local regulator – usually to establish a branch of the third country firm itself in that Member State. Our review of key jurisdictions showed that some Member States impose limitations or that the approach is rarely used in practice. In some instances, the relevant Directives expressly prohibit it, so it would not be a universal solution.

Even if this option is available, the UK firm would need to obtain direct authorisation separately in every jurisdiction in which it wished to operate.[3]

Each of the options discussed above is considered in more detail in section 7 of the report.

## Access options – with extension of access beyond the scope of the current TCRs (including through a bespoke agreement)

**19** The UK should consider whether to engage with the EU on proposals to extend the scope of access beyond the TCRs, to give a wider coverage and/or to address 'process' issues (such as those highlighted in paragraph 13 of this overview) that could provide a smoother transition and greater predictability.

**20** In doing this, a number of important political and strategic decisions will need to be made around priorities for a future EU trading relationship – such as:

(a) whether the optimum route would be to make piecemeal changes for specific priority areas of financial services activity (which the UK Government would need to identify in advance of the negotiations) or seek to introduce a more comprehensive approach, as has been advocated by proponents of the so-called 'omnibus' approach;

(b) whether changes should be sought in areas that relate solely to the UK-EU relationship (at least in the first instance, given the timing constraints) – or whether an expanded TCR should be put in place that would improve access to the EU generally and apply to the benefit other third countries as well (the so-called 'universal' approach); and

(c) whether changes should be developed on a 'top-down' basis (i.e. with a high level principle of mutual access being established) or on a 'bottom-up' basis, using the existing rights of access under the TCRs as the starting point and seeking to expand those rights.

**21** If the UK is looking for a top-down approach, it could consider a 'mutual access' arrangement, under which the UK and EU allow access to each other's markets on the basis that their respective regimes are broadly consistent. If possible, the UK should try to avoid having rights of access tied to the existing concept of 'equivalence', as used in the TCRs.

[3] There is an exception to this principle for a firm that is doing wholesale business under the MiFID II TCR. In that situation, the branch itself would have passport-like rights: see paragraph 4.11(c) for further information.

**22** The nature of the changes being sought by the UK will determine what steps need to be taken to implement the changes – and in particular whether changes will have to be made by changing EU legislation or whether they could be achieved through a bespoke agreement with the EU. The processes and timing considerations of each approach differ and are considered in section 8 of the report.

**23** If a broad arrangement for mutual access cannot be agreed, the UK needs to decide what changes to the existing rights of access for third countries might be appropriate. Possible changes that might be appropriate (and which the UK could consider asking for) include:

(a) removing conditions for access;
(b) introducing procedural protections; and/or
(c) mitigating the impact of establishing an EU subsidiary.

Further detail on each of these possibilities is set out in section 8 of the report.

## Allowing access to the UK market

**24** Post-Brexit, EU Member States will no longer have the right to passport into the UK. The UK has an existing regime for non-EU countries to access the UK market cross border under the "overseas persons" exemption. The UK also allows non-EU firms to establish branches in the UK. The approach that the UK is willing to offer to EU firms should be taken into account when considering what arrangements to put in place with the EU. See section 10 of the Report.

## Transitional arrangements

**25** The relatively short timeframes under Article 50 of the Treaty on European Union (TEU), and the length of time it typically takes to activate TCRs or to establish subsidiaries within the EU and get them authorised, means that transitional arrangements will be essential for maintaining continuity of service provision by UK and EU firms to businesses and consumers in their respective territories until a negotiated settlement can be agreed.

**26** To avoid the cost, distraction and disruption of UK and EU firms needing to implement contingency plans, potentially unnecessarily, before the new operating environment becomes clear, it would be beneficial if the UK and EU could agree a transitional arrangement under which the current status quo will be preserved while a longer term solution is being negotiated. More detailed transitional arrangements would be agreed during the withdrawal period if necessary.

**27** The most desirable arrangement for the transition period would be if the UK and EU could agree that current passporting rights can continue (or similarly extensive rights of access be applied), in both directions, during the transition period. That way, existing businesses on both sides of the UK/EU border will be able to continue their current activities, until such time as the longer term arrangements have been agreed and fully implemented. It is acknowledged, however, that a complex matrix of rights and obligations would be involved in continuing such arrangements after Brexit, and that some additional questions would need to be addressed in relation to this.

**28** We note that the Treasury Select committee is currently consulting on the transitional arrangements. The consultation closes on 31 January 2017.

# SUMMARY TABLE – SECTOR SPECIFIC ANALYSIS

| Type of business | Passport available? | TCR for cross-border access without a branch? | TCR for branch access? |
|---|---|---|---|
| **Banking and related services** | | | |
| **Deposit-taking** | Yes | No | Potentially, but subject to the discretion of individual Member States.<br>There is no right to establish a branch, but if a Member State permits a third country firm to establish a branch, CRD IV sets out the criteria it must apply. |
| **Lending (non-consumer)** | Yes, but only for credit institutions | No | No |
| **Lending (consumer)** | Yes, but only for credit institutions | No | No |
| **Providing mortgages** | Yes, but only for credit institutions | No | No |
| **Foreign exchange services** | Yes, but only for credit institutions | No | No |
| **Payment services** | Yes, but only for credit institutions | No | No |
| **E-commerce and issuing electronic money** | | | |
| **E-commerce** | No, but information society services can be provided freely from one Member State into others. | No | No |
| **Issuing electronic money** | Yes | No | No |
| **Investment Services** | | | |
| **Retail investment services and activities (retail client and elective professional clients)** | Yes | No | Potentially, but subject to the discretion of individual Member States.<br>Member States may "opt in" to allowing a third country firm to establish a branch. If they do, access must be subject to the following conditions:<br>• the third country firm is authorised in the third country;<br>• the third country firm fulfils conditions regarding capital, management and investor compensation;<br>• the third country takes an acceptable approach to AML and financial crime; and<br>• there is a cooperation agreement in place.<br>The branch could provide services to retail clients and elective professional clients.<br>(TCR not yet in force) |

| Type of business | Passport available? | TCR for cross-border access without a branch? | TCR for branch access? |
|---|---|---|---|
| **Investment Services** | | | |
| **Wholesale investment services and activities (per se professional clients and eligible counterparties)** | Yes | Yes, there is a right to provide cross-border services if the conditions are satisfied.<br>The conditions are that:<br>• there is an equivalent regulatory regime in the third country;<br>• the third country firm is authorised and subject to effective supervision and enforcement;<br>• there is a cooperation agreement in place; and<br>• the third country firm agrees to submit to the jurisdiction of an EU court.<br>(TCR not yet in force) | Potentially, but subject to the discretion of individual Member States.<br>The relevant Member State will need to "opt in" to the branch regime, as described above.<br>A third country firm providing services to retail clients via a branch (see above) will be able to provide wholesale services from the branch as well.<br>A branch that undertakes wholesale activities will also be permitted to provide cross-border services from the branch into other Member States.<br>(TCR not yet in force) |
| **Data reporting services** | No. When MiFID II comes into effect, an authorised data reporting services provider will be able to provide services in any Member State of the EU. | No | No |
| **Portfolio managers** | Yes | Yes, there is a right to provide cross-border services to per se professional clients and eligible counterparties if the conditions are satisfied.<br>The conditions are that:<br>• there is an equivalent regulatory regime in the third country;<br>• the third country firm is authorised and subject to effective supervision and enforcement;<br>• there is a cooperation agreement in place; and<br>• the third country firm agrees to submit to the jurisdiction of an EU court.<br>There is no TCR providing cross-border access without a branch in relation to retail clients.<br>(TCR not yet in force) | Potentially, but subject to the discretion of individual Member States.<br>Member States may 'opt in' to allowing a third country firm to establish a branch. If they do, access must be subject to the following conditions:<br>• the third country firm is authorised in the third country;<br>• the third country firm fulfils conditions regarding capital, management and investor compensation;<br>• the third country takes an acceptable approach to AML and financial crime; and<br>• there is a cooperation agreement in place.<br>The branch could provide services to retail clients and elective professional clients.<br>(TCR not yet in force) |

| Type of business | Passport available? | TCR for cross-border access without a branch? | TCR for branch access? |
|---|---|---|---|
| **Funds and fund management** | | | |
| **Acting as a fund (UCITS or ELTIFs)** | Yes | No | No |
| **Fund management (UCITS or ELTIFs)** | Yes | No | No |
| **Fund management and marketing of AIFs in the EU (AIFs and AIFMs)** | Yes, but currently only for EU AIFMs of EU AIFs.<br>Where there is no passport, the AIFMD provides common standards for private placement regimes, but Member States are not obliged to allow access. | Yes, if the third country AIFM obtains a "proper authorisation".<br>The conditions for proper authorisation include that:<br>• there is a cooperation agreement in place; and<br>• the third country does not have in place laws or regulations that would prevent effective supervision.<br>(TCR not yet in force) | Yes, if the proper authorisation is obtained (see adjacent column).<br>(TCR not yet in force) |
| **Insurance and reinsurance** | | | |
| **Insurance and reinsurance undertakings** | Yes | No | Potentially, but subject to the discretion of individual Member States.<br>There is no right to establish a branch, but if a Member State permits a third country firm (other than a pure reinsurer) to establish a branch, Solvency II sets out the criteria it must apply.<br>There is no TCR |
| **Insurance mediation and distribution** | Yes | No | No |
| **Credit ratings agencies** | | | |
| **Issuing of credit ratings** | No, but EU firms can generally only use a credit rating produced by an EU CRA (except where the TCR applies). | Yes, subject to either endorsement by EU CRA or certification (including requirement for equivalence decision). | N/A |

| Type of business | Passport available? | TCR for cross-border access without a branch? | TCR for branch access? |
|---|---|---|---|
| **Market infrastructure** | | | |
| **Trading platform activities** | | | |
| **Operating an MTF or OTF** | Yes | Yes – as for wholesale investment services (see above).<br>(TCR not yet in force) | Yes – as for wholesale investment services (see above).<br>(TCR not yet in force) |
| **Provision of trading platform services, other than via MTF or OTF, to EU firms** | Yes, "passport-like" rights are available.<br>An EU regulated market in one Member State is permitted to operate in other Member States for the purposes of facilitating trading by members in those Member States.[4] | No[5] | No |
| **Access to EU CCPs** | No, but third country trading venues can request access to EU CCPs on a non-discriminatory basis. | Yes, subject to an equivalence decision and reciprocity. | N/A |
| **Access to EU benchmarks** | No, but MiFIR will require a person with proprietary interest in a benchmark to grant non-discriminatory access to EU trading venues. | Yes, subject to an equivalence decision and reciprocity. | N/A |
| **Provision of benchmarks by third country benchmark administrators** | No, but third country benchmarks already referenced in financial instruments, financial contracts, or used to measure the performance of investment funds, by or on 1 January 2020 can continue to be used after that date. | Yes, if the third country benchmark is registered with ESMA, recognised by the local regulator in the Member State of reference, or endorsed by an EU benchmark administrator by 1 January 2020. | N/A |
| **Central counterparty activities** | | | |
| **Provision of services to EU clearing members** | Yes | Yes.<br>A third country CCP can apply for recognition in order to offer services to EU firms. The conditions are that:<br>• there is an equivalent regulatory regime in the third country (including AML systems);<br>• the third country has reciprocal arrangements to allow foreign CCPs access;<br>• the third country firm is authorised and subject to effective supervision and enforcement; and<br>• there is a cooperation agreement in place.<br>Recognition will also allow the CCP to have access to EU trading venues. | N/A.<br>A CCP would not set up a branch in the EU to carry out clearing services in the EU. |

| Type of business | Passport available? | TCR for cross-border access without a branch? | TCR for branch access? |
|---|---|---|---|
| **Central counterparty activities** | | | |
| **Access to EU benchmarks** | No, but MiFIR will require a person with proprietary interest in a benchmark to grant non-discriminatory access to EU trading venues. | Yes.<br>The requirements and conditions are essentially the same as in the row above.<br>(TCR not yet in force) | No |
| **Central securities depository activities** | | | |
| **Provision of CSD services to issuers and market participants and establishment of links with EU CSDs** | Yes | Yes<br>The third country CSD must apply to ESMA for recognition, which is subject to the following conditions:<br>• the third country must have an equivalent regulatory system;<br>• the third country firm must be subject to effective authorisation, supervision and oversight by home state;<br>• there must be a cooperation arrangement in place; and<br>• the CSD must allow users to comply with applicable national law. | Yes, subject to an equivalence decision and reciprocity. |
| **Trade repository activities** | | | |
| **Acting as a trade repository** | No, but EMIR requires a trade repository operating in the EU to be registered with ESMA. The registration is then effective across the EU. | Yes.<br>A third country repository must be recognised by ESMA. To be recognised, the third country firm must show that it is authorised and subject to effective supervision in a third country which has:<br>• an equivalent and enforceable regulatory and supervisory framework; and<br>• cooperation and other agreements in place with the EU/ESMA. | N/A |

[4] There is no formal passporting regime for regulated markets in MiFID II. However, the UK provides regulated markets providing services into or out of the UK with passporting rights under sections 312A to 312D of the FSMA.

[5] It may be possible for exchanges based outside the EU to have members in the EU – but in the absence of authorisation under MiFID II as a "regulated market", there is no obligation on Member States to allow such exchanges to facilitate trading for members based in their territory.

# RECOMMENDATIONS

## The new arrangement

**1** Securing access to the Single Market through membership of the EEA would allow UK-based financial services firms to maintain their current level of access to the Single Market after Brexit, as they would continue to be able to use the passporting regime. It is likely, however, that significant political compromises would need to be made by both the UK and EU for that outcome to be acceptable to both parties. The UK Government has already indicated that its proposals will not involve membership of the Single Market.[6] We have therefore not covered this option in detail in the Report.

**2** As the UK will become a third country on Brexit, it would be entitled to seek to secure access for UK firms under the EU's existing TCRs. However, given their limited coverage, uncertainty of availability (at least by any particular date) and the lack of key safeguards associated with them, the TCRs do not currently provide a sufficiently robust basis for the UK financial services sector to access the EU market in the longer term. The TCRs that exist have been helpful in relation to the discrete areas that they cover. They have not, though, been used, nor were they designed, to provide an access regime for an entire financial services industry the size of the UK's. Nor were they intended to provide transitional arrangements for an exiting Member State.

**3** Wider rights of access for UK firms could be secured by extending and enhancing the existing TCRs (potentially for the benefit of all third countries). However, this would require legislative change which is unlikely to be achieved within a short period (such as the two year period triggered by the UK giving notice under Article 50). The UK may also find that by seeking to improve its position from the relatively unhelpful starting point under the existing TCRs, it is able to achieve less than it would do under a more general right of access which is not determined by reference to the existing TCRs.

**4** The UK should instead seek to agree a bespoke agreement with the EU to allow for mutual rights of access to each other's markets.

**5** In reaching any agreement with the EU, the following factors should be taken into account:

(a) **Basis for access**

Mutual access to each other's markets could be granted on the basis that the respective regimes of the UK and EU are broadly consistent with one another (in that they have consistent regulatory objectives and aim to deliver the same outcomes). At the date of Brexit, they should be almost entirely consistent.

If possible, the UK should try to avoid having rights of access tied to the existing concept of 'equivalence' as it is currently applied by the EU, since the history of the current TCRs shows that analysis of equivalence has been very granular and less focussed on 'outcomes' (as intended). This makes it time consuming to apply in the first place and makes unwieldy the introduction of new law.

[6] Speech by the Prime Minister: "Blueprint for Brexit" (17 January 2017).

A genuinely outcomes-based approach would be preferable. This would be consistent with the intention behind some of the current TCRs, although past experience with those TCRs shows that that has sometimes been overlooked. A renewed focus on outcomes would be welcome. The UK and the EU should also seek to be more collaborative and to focus on influencing and implementing the wider international regulatory agenda going forwards.

(b) **Scope of access**

The UK should seek to ensure that rights of access cover as broad a scope of activities as are currently covered under the passporting regime – including areas such as deposit taking, lending and payment services (which are not covered by the TCRs at all) and insurance (which is only covered by the TCRs to a very limited degree). The EU financial services market is an integrated market, and if the UK was only able to secure access to parts of that market it would potentially lose the benefits of accessing the integrated market as a whole.

The UK should also seek to secure rights of access to all categories of client. The current TCRs provide only very limited coverage in relation to retail clients. The protection of retail clients may be a particularly sensitive question in some Member States, and so the UK should be prepared to accommodate such concerns by incorporating appropriate consumer protections into any bespoke agreement.

(c) **A stable arrangement**

The arrangements that are put in place should include robust processes and procedures that provide legal certainty, such as:

(i) clear criteria for securing rights of access (either at a national level or for individual firms);

(ii) a clear, predictable process for termination of the arrangement (either at a national level or for individual firms), with objective criteria;

(iii) an adequate notice period for withdrawal of the arrangement, so that affected firms have adequate opportunity to make alternative arrangements; and

(iv) an independent tribunal to determine whether the criteria are satisfied.[7]

(d) **Uninterrupted access**

The transition into the new arrangements should allow for continuous and uninterrupted access to products and services for firms and customers.

When the criteria for mutual access have been agreed, the UK and EU should also seek immediate recognition that the other party meets the relevant criteria and implement efficient systems to migrate firms to the new structure. For example, any firm which currently has a passport between the UK and another Member State should automatically be granted rights of access under the new arrangements .

(e) **Rights of access for EU-regulated entities**

The arrangement should also be designed to preserve continuity of operation for UK-based entities regulated at an EU level, e.g. CRAs. Alternatives might include the EU

[7] In the EEA, it is the EFTA Surveillance Authority and the EFTA Court; a similar mechanism could be used for this arrangement as well. The EFTA Court decisions operate a principle of "homogeneity" with the CJEU, which has the advantage of giving the EU comfort on alignment of interpretation. It was also proposed by the EU to Switzerland as an option for their relationship.

recognising the UK's ability to regulate such entities directly or the UK and EU agreeing alternative ways of regulating such entities.

(f) **Regulatory collaboration**

An essential element of a successful arrangement will be cooperation between the respective regulatory authorities. That will be necessary to ensure day-to-day cooperation, but more generally it will also help ensure that the respective regimes remain broadly consistent and deal appropriately with the incorporation of international standards.

Both the UK and EU will be participating in and following developments at a global level (e.g. through IOSCO and the BCBS) and collaboration will help to ensure that they have a stronger voice and that they implement global changes in a consistent way.

Mechanisms available to members of the EEA, such as the EEA EFTA Experts engagement on legislative committees, could be considered. The UK could also consider asking for observer status in relation to EU decision making.

## Structure for relationships with other countries

**6** A mutual access arrangement (such as that set out above) could be used by the UK as the basis for its relationships with other third countries going forwards. In a world where the UK will be increasingly looking to global trade, a mutual access arrangement may offer a better structure for access to the UK than the UK's current 'overseas persons exemption' regime.

**7** A mutual access arrangement may also offer the EU a new way of dealing with other third countries – for example, to streamline the current processes the EU has in place with Switzerland, or to form the basis of new arrangements with third countries other than the UK.

## Issues prior to concluding a new arrangement

**8** Prior to concluding a new arrangement, the UK should consider the following issues:

(a) **Demonstrating mutuality of interest**

The key to establishing a new relationship is to demonstrate that the UK and EU have integrated economies and that it is in the interests of the EU, as well as the UK (and consumers across Europe), for the EU and UK to have access to each other's markets.

Further economic analysis may be necessary to demonstrate the continuing value to the EU's existing and developing financial centres and capital markets of maintaining access to the UK market. Various studies are currently underway.

(b) **Agreeing transitional arrangements**

An immediate priority for the both the UK and EU should be to agree a transitional arrangement to maintain continuity of service and enable a smooth and orderly transition to any new long-term arrangement. The UK and EU should aim to reach agreement on the transitional arrangements as soon as possible – either before the withdrawal notice is served or shortly thereafter.

The transitional arrangements would cover the period up to the date on which the new long term post-Brexit arrangements have been fully implemented. Those long term arrangements could take the form of a negotiated agreement or, in the absence of agreement, they could involve the UK having no additional rights of access beyond that of any other third country. Whatever the outcome, the transitional arrangements should be designed to allow firms sufficient time to adapt to that outcome.

Until the new long-term arrangement has been implemented, there should be continuation of access for all types of activities currently conducted cross-border until the relevant long-term arrangement has been implemented and there has been an opportunity for firms to adapt to the new arrangements.

Prior to the date of Brexit, continuation of access would be through the passporting rights that the UK has as a member of the EU. After the date of Brexit, the most beneficial arrangement would be that the current passporting arrangements continue (or similarly extensive rights of access be introduced), in both directions, on a temporary basis, while the Brexit arrangements are implemented. It is acknowledged, however, that a complex matrix of rights and obligations would be involved in continuing such arrangements after Brexit, and that some additional questions would need to be addressed in relation to this.

If a transitional arrangement is not agreed in the near future, firms which currently provide services using the passport – either from the UK to the rest of the EU, or vice versa – may find that (in view of the long lead times required to secure alternative routes to, or withdraw from, markets) they will need to take steps imminently to maintain continuity of service and to transfer their business out of the UK. It could even lead to business being moved out of Europe altogether, for example, if the challenges of transferring business into Europe outweigh the benefits of relocating.

Moving business out of the UK could prove to be unnecessary, depending on the scope of any new long term arrangements. Early agreement on transitional arrangements would help avoid unnecessary steps being taken or businesses being distracted by a concern that they may not have sufficient time to implement their contingency plans.

We note that the UK Government is currently consulting on the transitional arrangements.

(c) **Agreeing appropriate arrangements for existing products and services**

The UK and EU should agree appropriate arrangements which ensure that products or services acquired by consumers prior to Brexit can continue to be serviced across an EU/UK border without interruption post-Brexit. This is necessary to avoid legal uncertainty.

This solution could take the form of some kind of ‘grandfathering’ arrangement, under which products which are already in issue at the date of Brexit will automatically be regarded as valid and can continued to be serviced across the UK/EU border for the lifetime of the product.

Appropriate arrangements should be agreed as a matter of priority, to reassure customers that they can continue to retain the benefits of products and services and to discourage any action which might negatively affect their financial position.

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**The full version of this report is available at www.thecityuk.com**

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