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UK-EU Regulatory Cooperation in Financial Services

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Introductory

On 27 June 2023, the UK and EU signed the Memorandum of Understanding (MoU) on regulatory cooperation in financial services. In its announcement the UK government said: *“The memorandum of understanding will establish an ongoing Forum for HM Treasury and the European Commission to discuss regulatory matters of mutual interest. The Government looks forward to holding the first meeting of the Forum as soon as possible.”* This paper sets out the origins of the MoU, its content and what may be expected from it, plus some longer-term reflections.

Origins

Well before the UK’s EU Referendum in 2016 it had been recognised that UK withdrawal from the EU would open the prospect of major adaptation, if not wholesale dislocation, of the closely integrated arrangements linking the UK financial services market with the financial services markets of other EU member states. These arrangements were akin to a common policy of the kind exemplified in other EU areas such as agriculture, trade, or transport. EU financial services law and policy bear and retain for the time being a deep imprint of British influence, exerted by British officials within the institutions and by the UK government and the “industry” generally. If the Common Agricultural Policy is identifiably French, EU financial services policy was, until UK withdrawal, marked by UK DNA. The resultant arrangements represented an exceptional degree of market integration. There was a detailed web of EU legislation allowing not only for the removal of barriers to trade between financial services markets but also a shared approach to regulation, in which a financial services entity regulated in one member state could benefit from a “passport”. The passport allowed its financial services suppliers to trade their products in other member states without, generally, further regulatory requirements.

After the UK’s EU Referendum, when the terms of UK withdrawal began to be discussed, an immediate question for discussion among UK financial services providers was how far the existing framework for doing business could be preserved. Would there be a “soft Brexit” allowing for continuing UK participation in the EU Single Market? Could there be some system of mutual recognition between the UK and EU regulatory regimes, allowing for continued mutual market access on the basis of regulatory regimes that were recognised as meeting the same tests of the soundness of financial services providers and the same consumer protection requirements? All such thinking however depended on the terms chosen for UK withdrawal from the EU and for the future UK-EU trading relationship; and, in the event, neither side showed any appetite for such an approach. The UK made

little attempt to cover services, including financial services, in the Trade and Cooperation Agreement (TCA) being negotiated; and the EU took an extremely restrictive attitude to the granting of “equivalent” status to various forms of financial services business.

The terms which finally emerged in the UK Withdrawal Agreement and the EU-UK TCA were akin to those that had formed the basis for the EU-Canada Comprehensive Economic and Trade Agreement (CETA). They focused very largely on trade in goods free of import duties, with little on services, including financial services, beyond both parties’ commitments from 1997 onwards under the Fifth Protocol (Financial Services) to the WTO General Agreement on Trade in Services (GATS). There was no agreement on mutual recognition of financial services regulatory regimes, still less any agreement to replicate the previous passporting system. UK financial services suppliers were effectively placed on the same basis as suppliers from any other third country.

It was however recognised at the time of the TCA’s conclusion in 2020 that the UK and EU financial services markets could not simply go their separate ways. The markets had previously been deeply integrated, and major suppliers in each market were set to continue to operate in both: regulatory issues, including cooperation and intelligence-sharing between regulators in urgent cases, were bound to have to be addressed. It was therefore agreed that, alongside the TCA, there would be a Joint EU-UK Declaration on Financial Services Regulatory Cooperation, in which both parties committed to agreeing an MoU establishing the framework for their cooperation. The Declaration’s stated aims included “establishing a durable and stable relationship between autonomous jurisdictions” on the basis of “a shared commitment to preserve financial stability, market integrity, and the protection of investors and consumers”.

Following the Joint Declaration, there were technical negotiations on the precise content of the MoU. These concluded in March 2021. The remaining steps were then for the European Commission to submit the draft MoU to the Council for endorsement, and for the MoU to be signed by both sides. At that point however there was a hiatus, owing to worsened relations between the EU and the UK, largely caused by suggestions that the UK might not honour the Northern Ireland Protocol associated with the Withdrawal Agreement, or might even *attempt* legislation to disapply it. These problems were largely resolved in the Windsor Framework agreement, which opened the way for recasting the UK-EU relationship across a range of policy areas, including financial services. Following endorsement by the EU Council, the MoU was signed on 27 June 2023. The first Forum meeting is likely to be in October or November 2023.

What does the MoU provide for?

The MoU sets up the Joint UK-EU Financial Regulatory Forum. The key participants in the Forum are the UK Treasury and the European Commission (the Directorate-General for Financial Stability, Financial Services and the Capital Markets Union (DG FISMA)). Others who can be included are regulators, supervisors, other UK government departments, representatives from EU Member States and (“subject to prior approval by the Participants”) other relevant experts, as appropriate. The Forum will meet semi-annually, and is designated to “serve as a platform to facilitate structured regulatory cooperation in the area of financial services”.

The MoU simply sets up a framework for enhanced dialogue to take place in the Forum, and sets out, in very broad terms, some shared objectives. In no way does it represent an accord or even a pathway towards rebuilding the integrated market structures that existed before UK withdrawal from the EU. It can however be viewed as signifying an intention to find means of cooperating on issues of shared concern, which may gradually contribute to improving UK-EU relations in the field of financial services. By setting up a Forum the MoU also provides an added degree of formality to the existing relations between UK and EU regulators. This, as predicted in March 2023 by the House of Lords European Committee, will have value as a mechanism for strategic dialogue, even though a series of other MoUs for technical cooperation between regulators is already in place.

The MoU sets out a shared objective of preserving financial stability, market integrity and the protection of investors and consumers, which will be achieved by:

1. bilateral exchanges of views and analysis relating to regulatory developments and other issues of common interest;
2. transparency and appropriate dialogue in the process of adoption, suspension, and withdrawal of equivalence decisions;
3. bilateral exchanges of views and analysis relating to market developments and financial stability issues; and
4. enhanced cooperation and coordination including in international bodies as appropriate.

The bilateral exchanges and dialogue will predominantly take place twice-yearly in the Forum, with the first meeting due to take place in autumn 2023. In particular, the Forum is “intended to take stock of progress and to undertake forward planning of regulatory cooperation with general operational objectives to:

1. improve transparency;
2. reduce uncertainty;
3. identify potential cross-border implementation issues, including concerns linked to potential regulatory arbitrage by firms;
4. as appropriate, consider working towards compatibility of UK/EU standards;
5. when relevant, promote domestic implementation consistent with international standards;
6. share knowledge to facilitate a common understanding of the EU and UK's regulatory frameworks; and
7. exchange information and views on other issues of common interest within the scope of these regulatory cooperation arrangements.”

The MoU is explicit in providing that “the regulatory cooperation should not restrict the ability of either jurisdiction to implement regulatory, supervisory or other legal measures that it considers appropriate.”

Much of the rest of the MoU is concerned with the practical running of the Forum (such as establishment of sub-groups or the ability to issue reports of proceedings). There is a

provision for either side to signal its wish to revise or end the MoU. While designating Commission DG FISMA and HM Treasury as the principal Forum participants, the MoU is silent on the precise level of participation. This could prove unfortunate if it were used as a means of deflecting any pressure at the political level for progress to be maintained. It is noteworthy that the House of Lords European Affairs Committee has secured confirmation from the Economic Secretary to the Treasury that the MoU does not exclude the possibility of Ministers and EU Commissioners participating in the Forum and that the Economic Secretary and Commissioner McGuinness will continue to work closely with officials to set the political direction for Forum discussions and the wider relationship, with an expectation on the UK side that they will meet between Forum meetings to ensure that UK government and Commission positions are clear and that policy direction is shaped at the political level.

Paragraph 11 sets out an illustrative list of Forum activities which “in a manner consistent with applicable policy, law and good administrative practices” may include:

- the promotion of timely domestic implementation of relevant international regulatory Standards [...];
- the sharing of information on regulatory developments, [...] particularly where measures may have, or have had, a significant impact on the financial services sector from either jurisdiction or may result in market fragmentation;
- exchanges of views on the respective policies, rules and processes concerning deference regimes, such as equivalence, or other tools used to address cross-border issues;
- dialogue on the Participants’ autonomous decisions to adopt, suspend or withdraw equivalence relevant to one or the other side;
- exchanges of views, as appropriate, about risk analyses and the potential economic impacts of proposed measures [...];
- discussions on macro-prudential developments and financial stability risks [...];
- exchanges of views on regulatory issues, in a bilateral context, paying due respect to the regulatory interests of supervisory and resolution authorities and incorporating the views of EU and UK supervisory and resolution authorities;
- discussions on issues of cooperation in multilateral contexts as appropriate [...];
- where practicable, sharing positions on agenda items prior to key G20 or other international meetings;
- keeping each other informed, through the exchange of relevant supervisory and enforcement policies [...] about how effective supervision and enforcement of rules for implementing internationally agreed standards have been provided for, in particular in the areas where the UK or EU relies on the regulatory and supervisory framework of the other side; and
- keeping each other informed about efforts to prevent and combat money laundering and terrorist financing as they relate to the financial services sector.

An assessment

At this stage, before the first Forum meeting has even been convened, any assessment is bound to be preliminary. It seems clear that the Forum will help re-establish and enhance personal contacts and networks between the participants and the wider community of stakeholders, who already meet in international fora, industry associations, and in other ways. Their existing familiarity with each other's concerns, personalities and motivations will help the Forum immeasurably (literally, because the benefits are likely to be considerable but very hard to quantify). That said, how the Forum will work, and the success it will have, must depend on the degree of shared common purpose between the participants, and the willingness of both sides to make progress by volunteering genuine exchanges of ideas, rather than confining the dialogue to a formalistic six-monthly exercise in comparing notes on prescribed topics.

In that regard, the MoU is very open and non-prescriptive. It simply creates a framework for dialogue, noting that transparency and dialogue will be important in such areas as the maintenance of financial stability and observance of equivalence, suggesting some objectives, and offering a non-exclusive list of potential topics for dialogue. It does not suggest any overarching objective such as maintaining a degree of alignment between the UK and EU regulatory regimes: indeed it underlines the importance of preserving the regulatory autonomy of both parties. Nor does it speak of any shared destination towards which both parties might be travelling, such as the creation of a shared UK-EU market in financial services for the benefit of business end-users of those services in both jurisdictions, in the interests of joint wealth-creation, growth and jobs. It offers an available vessel, without prescribing what the content of the vessel should be.

There are precedents for the MoU in the record of both the UK and the EU towards other trade partners. Both have agreed to a range of dialogues that include financial services. On the EU side, dialogues have been established with third countries covering financial regulatory issues, including:

- Four **EU-US** dialogues:
 - The EU-US Economic and Financial Dialogue
 - The EU-US Joint Financial Regulatory Forum
 - The EU-US Trade and Technology Council
 - The EU-US Insurance Dialogue
- The **EU-Canada** Financial Services Committee and Financial Regulatory Forum
- The **EU-Japan** Joint Financial Regulatory Forum
- The **EU-India** Macroeconomic Dialogue

The UK also has established similar dialogues – some resulting from FTAs - including:

- The **UK-Australia** Regulatory Dialogue
- The **UK-US** Financial Regulatory Working Group (FRWG)
- Three types of **UK-India** Dialogues:
 - The UK-India Economic and Financial Dialogue (EFD),

- The UK-India Financial Markets Dialogue (FMD),
- The UK-India Working Groups on Sustainability and FinTech
- The **UK-Japan** Financial Regulatory Forum and Financial Dialogue

The UK also runs a series of periodic Economic and Financial Dialogues and Financial Dialogues with other key markets in the rest of the world (China and Singapore are examples). Both the EU and the UK run less formalised dialogue processes with Switzerland.

Many of these dialogues, whether EU or UK creations, are at a relatively early stage of existence. But some differences between the EU and the UK approaches are already observable. For instance, EU dialogues seem rarely have a mandate to address market access issues or deepen trade and investment between the parties. The terms of reference for EU regulatory dialogues with third countries tend to focus on transparency, reducing uncertainty, and supporting financial stability, without a wider mandate for enhancing trade and investment. This is consistent with the arrangements that the EU was ready to countenance for the MoU and Forum, which do not provide for additional market access rights or shared rules, and do not restrict the unilateral equivalence or regulatory processes of either party. No “rights or obligations under international or domestic law” are created, and in several places the MoU makes specific reference to safeguarding “the ability of either jurisdiction to implement regulatory, supervisory or other legal measures that it considers appropriate”.

The UK’s approach to regulatory dialogues provides something of a contrast. For instance, in its recent FTA negotiations with Japan and Australia the UK has aimed at securing commitments for regulatory dialogue aimed at: “enhancing bilateral trade and investment in financial services between the Parties” (UK-Japan CEPA) and “enhancing financial services trade and investment between the Parties” (UK-Australia FTA). The MoU, and the Forum it establishes, seems not to contain any such explicit objective. Perhaps this is unsurprising: after all, the MoU sits alongside the TCA, an agreement which, unlike most trade agreements, actually reduced the previous degree of economic integration between the two parties. This aspect may come to speak volumes as to what can be expected from the Forum, at least in its early stages. As shown in accounts of the TCA negotiations, the EU negotiators were generally well satisfied with the TCA as an agreement which safeguarded the integrity of the EU Single Market and set limits to expectations of greater market integration between the UK and the EU. (See, for instance, Michel Barnier: “My Secret Brexit Diary: A Glorious Illusion” (2022), or Stefaan De Rynck: “Inside the Deal: How the EU Got Brexit Done” (2023)) To the extent that the Commission has so far offered indications of its approach to the Forum, that appears to remain the prevailing attitude, suggesting that the opening stages of the Forum’s operation are likely to be exploratory and limited, at least until mutual trust has been established.

Industry objectives for the Forum

Following the signature of the MoU on 27 June a process of discussion has begun within the UK financial services sector, as to what may be expected from the Forum, particularly at a time when the UK Chancellor of the Exchequer has created expectations in the sector resulting from the Edinburgh Reforms announced in December 2022 and from the Mansion House reforms announced in July 2023. UK-based financial services have varying interests,

with some US-owned financial services providers nursing a hope that the Forum might, ultimately, develop into a tripartite UK-EU-US framework for co-implementation of global standards. There is also an industry interest in how far EU member-states will be involved in the Forum, given the extent to which member-states' supervisory authorities may vary in their approach. The debate within the sector has led to a question as to whether there should be structures or "portals", perhaps agreed by both sides, for the UK and EU financial services sectors to make a formal input into the work of the Forum. At the same time, at least one UK financial services association has already put proposals to the UK Treasury and the European Commission. (The UK Investment Association put proposals to both in July 2023) All these discussions over industry input are set to continue. The motivation for them is unsurprising: the Forum is likely to be particularly relevant when either side is making fresh regulatory advances and when there is any prospect of fragmentation or policy divergence that could disrupt the free flow of capital or provoke concerns over financial stability. Divergence could be highly topical, given that the UK Financial Services and Markets Act received Royal Assent on 29 June 2023. The Act provides for a staggered process for amending, repealing, or replacing most of retained EU law relating to financial services, opening the potential for UK regulators to make changes in the interests of securing a "Brexit dividend". The precise steps to be taken under the Act have yet to be established. But the passage of the Act provides an immediate context for deepened business interest.

Added to this is the fact that two significant measures relating to market access for UK and EU financial services are set to expire. First, the UK Temporary Permissions Regime (TPR), allowing EEA-based financial services businesses to maintain "passporting" rights when accessing the UK market), ends on 31 December 2023. Second, there is the question of equivalence decisions and whether the Forum can be expected to discuss additional EU and/or UK equivalence decisions in the near future. It is noteworthy that the UK continues to have fewer EU equivalence determinations in its favour (one only) compared with the third countries such as the US, Singapore, or Switzerland. What is more, the EU equivalence determination that permits UK-based clearing houses to service EU firms expires on 30 June 2025, and it is not clear whether it will be extended. All these are factors intensifying industry interest in whether the Forum will have a role in dealing with such issues, and how it will act. It is helpful that in correspondence with the House of Lords European Affairs Committee the Economic Secretary to the Treasury has confirmed his expectation that the Forum will be used to discuss equivalence issues, and that this will help to ensure that each side has foresight of the decision-making process.

The future

When the UK was an EU member, the depth and range of its financial services interests always set it somewhat apart from other member states – an "outlier" factor that was frequently evident in the EU's negotiation of Free Trade Agreements that went less far in the area of financial services than UK business might have wished. Yet the UK was the undoubted international financial centre within the EU. It still retains that position in the wider European context. But there are evident challenges. One of these is the EU's growing preference for a greater degree of "strategic autonomy", enabling it to exert an enhanced degree of control over the regulation and development of financial markets within its jurisdiction. This preference may be natural in a polarising world, and is not confined to financial services: it is evident in other areas of EU policy.

Yet it may come to be a key factor at the heart of what can be expected from the MoU and the Forum. A comparison with the recent past may be instructive. At the time of the EU-US Transatlantic Trade and Investment Partnership (TTIP) negotiations, which went into abeyance in 2016, much of the negotiating effort centred on the extent to which both sides could create a genuine transatlantic marketplace in goods and services, through deepened economic relationships, in the interests of jobs and growth in the EU and US economies – an objective which the UK, as a then EU member, strongly supported. In the area of financial services, the focus on a transatlantic *marketplace* led to criticisms of the functioning of the then EU-US regulatory dialogue as inadequate to tackle divergences in regulation that prevented business end-users of financial services from accessing both the EU and US markets to secure the widest choice in catering for their needs. Much emphasis was placed on the need for transatlantic regulatory dialogue to go further than periodic meetings and comparing of notes among EU and US regulators, and instead to take a much more forward-leaning approach to active cooperation in the interests of creating a shared market focused on enhanced growth and jobs.

The same question arises - for both sides - in relation to the UK-EU MoU on regulatory cooperation in financial services and the work of the Forum. It is essentially a question of motivation over the long run. Are both parties ready to be guided by a forward-looking Forum agenda for enhanced mutual trade, investment, and growth? Or, as the Forum develops, will a more limited role for it be preferred? Many factors will contribute to the outcome, not least the political changes that may result from the European Parliament election and the appointment of a new European Commission in 2024, and a UK general election by 2025. Other external factors will also influence how far the EU and the UK choose to integrate their interests. All these will form the wider background to how the Forum develops.

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