

STUDY

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Recent trends in UK financial sector regulation and possible implications for the EU, including its approach to equivalence



Policy Department for Economic, Scientific and Quality of Life Policies
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Recent trends in UK financial sector regulation and possible implications for the EU, including its approach to equivalence

Brexit poses unique challenges for policymakers in the EU as the most important financial centre in Europe is now outside its regulatory framework. We expect significant divergence over the medium- to long-term, given recent legislative and regulatory initiatives in the UK, but also developments of the regulatory framework in the EU. However, there seem to be limited concerns of an easing of the tax evasion and Anti-Money Laundering framework in the UK. We expect a limited use of the EU equivalence regime for the UK.

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LIST OF ABBREVIATIONS

AIF	Alternative Investment Funds
AIFMD	Alternative Investment Fund Managers Directive
AML	Anti-Money Laundering
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BO	Beneficial Ownership
BoE	Bank of England
BTA	Bilateral Trade Agreements
CCP	Central Clearing Counterparty
CMU	Capital Markets Union
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
CRA	Credit Rating Agency
CRD	Capital Requirements Directive
CREST	Certificateless Registry for Electronic Share Transfer
CRR	Capital Requirements Regulation
CSD	Central Securities Depository
DLT	Distributed Ledger Technology
DTA	Digital Trade Agreement
EBA	European Banking Authority
ECB	European Central Bank
EIOPA	European Investment and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation
EP	European Parliament
ERG	European Research Group
ESA	European Supervisory Authority

ESFS	European System for Financial Supervision
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
EUWA	European Union Withdrawal Act
FCA	Financial Conduct Authority
FMI	Financial Markets Infrastructure
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act
FX	Foreign exchange
GCC	Gulf Cooperation Council
GPL	General Principles of Law
GPP	General Prior Permission
HICP	Harmonised Index of Consumer Prices
HMT	HM Treasury
HMRC	HM Revenue & Customs
IM	Internal Model
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IRB	Internal Rating Based
KYC	Know Your Customer
MoU	Memorandum of Understanding
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MRA	Mutual Recognition Agreement

MTA	Multilateral Trade Agreement
NGFS	Network for Greening the Financial System
NIP	Northern Ireland Protocol
OF	Own Funds
OTC	Over-the-Counter
PRA	Prudential Regulation Authority
REUL	Retained EU Laws
RPC	Regulatory Policy Committee
RTS	Regulatory Technical Standards
SEC	Securities and Exchange Commission
SSM	Single Supervisory Mechanism
TCA	Trade and Cooperation Agreement
TCB	Third-Country Branches
TIGRR	Taskforce on Innovation, Growth and Regulatory Reform
TPT	Transition Plan Taskforce
TTR	Temporary Recognition Regime
UK	United Kingdom
UKSDEA	United Kingdom-Singapore Digital Economy Agreement
WTO	World Trade Organization

EXECUTIVE SUMMARY

Background

Brexit poses unique challenges for financial sector policymakers in the EU as the most important financial centre in Europe is now outside its regulatory framework. The Trade and Cooperation Agreement (TCA) agreed in December 2020 between the United Kingdom (UK) and the European Union (EU) includes a very thin financial sector chapter, with eight out of 783 articles directly covering this sector. A Memorandum of Understanding to establish EU-UK structured regulatory cooperation on financial services has not been signed and any regulatory cooperation has been paused due to the conflict about the Northern Ireland Protocol, part of the UK Withdrawal Agreement.

Aim

This study summarises and discusses recent trends in financial sector legislation and regulation in the UK, divergence between the EU and the UK and threats from this divergence for financial stability in the EU. Critically, we assess the equivalence policy and strategy of the EU towards the UK and options to deepen regulatory cooperation while ensuring financial stability, market integrity and competitiveness.

Divergence of UK regulation from EU regulation is almost a given outcome following Brexit. The UK's rationale behind the will to actively diverge from the EU pertains to broader political choices and regulatory approaches and objectives: flexibility, common law principles-based, competitiveness, growth, and innovation. In addition to such active divergence, there can also be passive divergence, with the UK not keeping up with EU legislative changes or not following new EU regulation in the financial services sector.

Key Findings

The UK approach to regulation will lead to the transfer of most rules from statutory level to the regulators' rulebook, which will fundamentally reinforce the regulatory and supervisory model set by the Financial Services and Markets Act from 2000. The UK government introduced the Financial Services and Markets Bill that intends to amend, repeal or replace most of retained EU law and give regulators greater responsibility. This regulatory overhaul is led in parallel to the Retained EU Law (Revocation & Reform) Bill. In addition, secondary objectives would be added for regulators to 'facilitate, subject to aligning with relevant international standards, the international competitiveness of the UK economy (including in particular the financial services sector) and its growth in the medium to long term'². The secondary objectives of growth and international competitiveness would then differentiate the UK regulators' mandate from its EU counterparts.

The UK has replicated a number of trade agreements between the EU and third countries; it has also concluded several new ones, while others are under negotiation. The Free Trade Agreements with Australia and New Zealand include non-discrimination rules to ensure the fair treatment of financial services provided in the other parties' markets, and the free flow of financial data subject to privacy, personal data protection and public policy exceptions. Both of these as well as the Free Trade

² Jeremy Hunt, 'Recommendations for the Prudential Regulation Committee - Letter from the Chancellor' (8 December 2022) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122895/CX_Letter_to_andrew_Bailey_0812_WITH_COVER.pdf, accessed 4 January 2023; Jeremy Hunt, 'Recommendations for the Financial Conduct Authority - Letter from the Chancellor' (8 December 2022). https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122924/FCA_Remit_Letter_December_2022_with_cover.pdf, accessed 4 January 2023.

Agreement with Japan contain arrangements for regulatory dialogue, in the form of either a forum or a working group. The UK has also signed a Digital Trade Agreement with Singapore and concluded one with Ukraine, as well as a Mutual Recognition Agreement concluded with Switzerland. The UK is also negotiating with several other countries and groups of countries in a strategy geared towards the Pacific region. Overall, Digital Trade Agreements might represent a network of 'modern' Free Trade Agreements. Moreover, the inclusion of Sustainable Finance Provisions in such trade deals constitute the first provision of its kind. However, some of them could be only 'best endeavour' commitments. These developments are part of the UK diplomatic and political strategy of strengthening its global presence, but developments in the digital/sustainable finance areas will have to be assessed in the medium term as regards their effective implementation. There are several areas where the UK has already taken initiatives that could result in regulatory divergence, in particular from the EU Single Rulebook in Banking and Financial Regulation. First, proposals for the implementation of the final Basel III reforms (also referred to as Basel 3.1) differ between the UK and the EU, with the latter deviating from the Basel III agreements with consideration for proportionality concerns. Both the UK and the EU are considering reforms of the Solvency II regulatory framework for insurers with the objective of fuelling more equity investment by insurers, but through different regulatory adjustments. The UK aims at reforming different aspects of its wholesale markets regime and capital market sector, though these reforms are considered low impact. The UK aims at becoming a global centre for FinTech and crypto assets, through a number of regulatory and supervisory initiatives, including a financial market infrastructure sandbox, a FinTech hub at the Bank of England and encouraging the development and use of stablecoins. The UK government has stated the objective to be the 'world's first net zero-aligned financial centre', with multiple regulatory and supervisory initiatives. However, details, including a UK taxonomy, still have to be spelled out.

There seem to be limited concerns of an easing of the tax evasion and anti-money laundering (AML) framework in the UK. But, tax fraud and tax evasion are not reflected by accurate and verified data to date, with a missed opportunity for revenues underlined by the House of Commons' Committee of Public Account in a Report from January 2023. HM Revenue & Customs plans to calculate a new "offshore tax gap" and should address its institutional resourcing issues to bridge such gap. We observe in general no leniency or push back of AML rules. The UK has been strengthening its beneficial ownership registries framework, by increasing transparency and enforcement powers, while the EU seems to be going backward, considering a recent preliminary ruling of the Court of Justice of the EU. However, there is a willingness to overcome financial secrecy with further transparency so as to reduce tax avoidance in Crown Dependencies and Oversea Territories.

In this study, we discuss three possible scenarios of divergence. Under low divergence, there will be adjustments to some UK regulations as well as other initiatives in line with increasing the 'competitiveness' of the UK as a financial centre, but there will not be major divergence, especially in areas with international standards, such as bank capital regulation. Under medium divergence, there will be more significant divergence and fewer attempts to converge on new rules such as in the area of green finance or crypto asset developments. Divergence will be more likely and more prominent in areas where international standards are less important and where the UK has not inherited any EU regulations such as in the two areas already mentioned. Under high divergence, there would be a rather aggressive legislative and regulatory drive in the UK to diverge from EU rules. This would involve both replacing existing EU rules with new regulation and adopting divergent rules where such rules were not inherited. We expect such aggressive divergence especially in areas where UK authorities see growth opportunities and feel less constrained by international fora and cooperation initiatives, such as crypto.

Which scenario will materialise is almost impossible to predict, but will to a large extent depend on the resolution of the current stand-off between the EU and the UK over the Northern Ireland Protocol. Before the resolution of this conflict, it is difficult to see any progress happening in terms of regulatory cooperation in the financial sector.

Since the end of the transition period on 31 December 2020, the UK is a third country and therefore subject to the existing provisions in EU financial services and banking regulation that may provide for equivalence with third country regimes. Such equivalence may give access to the EU market and foster cross-border activities. The European Commission bases its equivalence decisions on the principle of proportionality and a risk-based assessment, but there is some degree of unilateralism and discretion, including political factors.

In the case of granting equivalence to the UK, there is a trade-off: on the one hand, allowing equivalence and thus provision of financial services by UK based firms in the EU Single Market can have positive repercussions for efficiency and competition. On the other hand, there are clear stability concerns, including concerns on data exchange, supervisory cooperation and cooperation during crisis situations, and for the EU's strategic autonomy. In practice, one equivalence expired for Central Securities Depositories (CSDs) and one equivalence has been extended for UK-based Central Clearing Counterparties (CCPs) until June 2025, which is a very thin recognition of equivalence between the EU and the UK in the field of financial services. A similar equivalence has been granted to other third countries. The extension of CCPs equivalence worldwide demonstrates the EU effort to redirect clearing beyond the UK while the EU works on building its own infrastructures.

One specific challenge for European authorities is the treatment of CCPs in London. On the one hand, there is the intention to build more clearing capacity within the EU, in particular with the legislative proposals from the European Commission to further develop the EU Capital Markets Union in December 2022. On the other hand, there are financial stability concerns on having a large part of transactions be cleared outside the EU. Supervisory cooperation is therefore critical, but equivalence decisions are not exclusively driven by technical criteria but also by (legal/political) risks stemming from a scenario where such an equivalence would be withdrawn.

Against this backdrop, the study elaborates on the types of equivalence (in general) and potential scenarios for future equivalence granted to the UK. The EU may adopt different types of equivalence: (i) scope-limited and time-bound equivalence; (ii) scope-limited, also called partial equivalence, (iii) conditional equivalence, and (iv) provisional equivalence. Furthermore, scenarios for the future EU equivalence could lead to no equivalence (once the current CCPs' equivalence lapses and without any extension), no additional equivalence (should the CCPs equivalence be further extended beyond June 2025), a bundle of equivalence, and a furnished and unlimited equivalence regime (that we consider unlikely).

But, the EU equivalence regime is not without its limits. The exclusion of equivalence from some EU regulatory areas and the inadequacy of third countries' regulatory regime raise challenges. Indeed, equivalence is not always 'fit for every purpose', with issues arising when third countries do not have any, or have less effective regulatory and supervisory frameworks than the EU. Considering the limits of the equivalence regimes in EU financial services and banking regulation, equivalence is only one route available among others to build a functional and efficient connection between the EU and the UK in this area.

More generally, we consider the granting of equivalence to the UK likely and feasible for only few financial sector segments and critically dependent on the broader political relationship between the EU and the UK, again strongly related to the stand-off over the Northern Ireland Protocol. Both sides look indeed for regulatory autonomy, which might be difficult to conciliate in the current political environment.

1. INTRODUCTION AND CONTEXT

KEY FINDINGS

This study summarises and discusses recent trends in financial sector legislation and regulation in the UK, divergence between the EU and the UK and threats from this divergence for financial stability in the EU.

We gauge how the UK might change its approach to anti-money laundering and tax evasion as well as to digital finance, green finance and wholesale markets.

Critically, we assess the equivalence strategy of the EU towards the UK and options to deepen regulatory cooperation, while ensuring financial stability, market integrity and competitiveness. We rely on careful reading of recent regulatory initiatives and political statements in both the EU and the UK, political and business commentary and eleven semi-structured interviews that we held with experts and stakeholders in academia, financial sector and civil services (see Annexe).

After the Brexit referendum in June 2016 and especially after the triggering of Article 50 of the Treaty on European Union in March 2017 and increasingly tense negotiations between the UK and the EU, the financial service sector as well as regulators and supervisors prepared for a possible no-deal exit of the UK from the European Union. Since the UK's EU referendum, 44% (97 out of 222) of the largest UK financial services firms have announced plans to move some UK operations and/or staff to the EU – a figure that nearly doubled between March 2017 (53 out of 222, 24%) and March 2021 (95 out of 222, 43%)³. Moreover, the UK exports of financial services to the EU declined post-Brexit, and data confirms the narrowing of London's international hub position vis-à-vis the euro area⁴. But, the City has still a pre-eminent role in FX trading and international banking⁵.

On 31 January 2020, the United Kingdom (UK) left the EU and for the transition period some European Union (EU) Law *acquis* was quickly 'onshored' into UK law⁶. The Trade and Cooperation Agreement (TCA) agreed on in December 2020 between the UK and EU includes a very thin financial sector chapter, with eight out of 783 articles directly covering this sector. References to measures and cooperation in trade in services do explicitly exclude financial services.⁷

Brexit posed unique challenges for financial sector policymakers in the EU as, on the one hand, the EU has made lots of progress over the past decade in building the regulatory underpinning for a Financial

³ EY Financial Services Brexit Tracker: Movement within Financial Services Sector Stabilises Five Years on from Article 50 Trigger (2022).

⁴ Jakub Demski, Robert N McCauley and Patrick McGuire, 'London as a Financial Centre since Brexit: Evidence from the 2022 BIS Triennial Survey' (2022) 65 BIS Bulletin 4.

⁵ *ibid* 5.

⁶ Federico Fabbrini (ed), *The Law & Politics of Brexit*, vol 1 (Oxford University Press 2017) <https://academic.oup.com/book/26188>, accessed 18 August 2022; Federico Fabbrini (ed), *The Law & Politics of Brexit: Volume III: The Framework of New EU-UK Relations*, vol 3 (Oxford University Press 2021) <http://academic.oup.com/book/39204>, accessed 5 August 2022.

⁷ Fabbrini, *The Law & Politics of Brexit* (n 6).

Single Market⁸. On the other hand, Brexit has left the most important financial centre in Europe outside this regulatory framework⁹.

While the UK had an important impact on shaping the post-2008 regulatory framework in the EU and has been instrumental in pushing the idea of a Capital Markets Union (CMU) (including by Jonathan Hill, UK Commissioner for Financial Stability, Financial Services and Capital Markets Union until 2016), there are political pressures in London towards regulatory divergence, to 'seize opportunities' of increasing the global competitiveness of London as financial centre¹⁰. The intent of the UK to keep its ecosystem for financial services attractive and central at the international level relies on tailored changes in both regulation and taxation¹¹, with a 'once-in-a-generation review to rationalise and streamline retained EU Law', as well as 'nimble policymaking and agile regulation'. These tailored changes put UK competitiveness in financial services ahead, with reforms and new trade deals covering digital and sustainable finance, in particular to favour innovation and technology, within a broader growth strategy¹².

This change has important implications both for financial stability within the EU as long as there is a high dependence on the London financial centre and for regulatory cooperation between EU regulatory authorities and UK authorities. Actually, the international position of London as financial centre from a historic perspective with long-standing advantages in innovation and resilience¹³ has already been disrupted by the relocation of different actors into different financial centres across EU Member States. The latter span across five main cities, Dublin, Paris, Luxembourg, Frankfurt, and Amsterdam (all in euro area Member States). This multicentre shows a functional specialisation with a selective relocation by the financial firms within different financial centres hosting banks, asset and investment management, insurance firms, auxiliary financial services, and legal service firms, which moved from London¹⁴.

This study summarises and discusses recent trends in financial sector legislation and regulation in the UK, divergence between the EU and the UK and threats from this divergence for financial stability in the EU. We will gauge how the UK might change its approach to anti-money laundering and tax evasion as well as for digital finance, green finance and wholesale markets¹⁵. Critically, we assess the equivalence strategy of the EU towards the UK and options to deepen regulatory cooperation, while ensuring financial stability, market integrity and competitiveness. We rely on careful reading of recent

⁸ Thorsten Beck, Elena Carletti and Itay Goldstein, 'Financial Regulation in Europe: Foundations and Challenges' in Barbara Chizzolini and others (eds), *Economics without Borders: Economic Research for European Policy Challenges* (Cambridge University Press 2017) <https://www.cambridge.org/core/books/economics-without-borders/financial-regulation-in-europe-foundations-and-challenges/B4DC2B9BA53D379CE8E4C2C536639849>, accessed 6 January 2023.

⁹ Thorsten Beck and others, 'Macro-Financial Policy in an International Financial Centre: The United Kingdom Experience Since the Global Financial Crisis' in Edward Robinson, Claudio Borio and Hyun Song Shin (eds), *Macro-financial Stability Policy in a Globalised World* (World Scientific Publishing 2022) <https://papers.ssrn.com/abstract=4026743>, accessed 6 January 2023.

¹⁰ 'Bank of England Battle Looms over Plans for Second "Big Bang"' *Financial Times* (17 July 2022) <https://www.ft.com/content/89c5979f-dda3-49cd-be6d-6f737b067111>, accessed 19 July 2022.

¹¹ HM Government, 'The Benefits of Brexit: How the UK Is Taking Advantage of Leaving the EU' 105, 48.

¹² Financial Services is among the five key growth sectors, see HM Treasury, 'Financial Services: The Edinburgh Reforms' (GOV.UK, 9 December 2022) <https://www.gov.uk/government/collections/financial-services-the-edinburgh-reforms>, accessed 4 January 2023.

¹³ Catherine R Schenk, 'The City and Financial Services: Historical Perspectives on the Brexit Debate' (2019) 90 *The Political Quarterly* 32; Youssef Cassis, *Capitals of Capital: The Rise and Fall of International Financial Centres, 1780-2009* (Cambridge University Press 2010).

¹⁴ Robert Panitz and Johannes Glückler, 'Relocation Decisions in Uncertain Times: Brexit and Financial Services' (2022) 98 *Economic Geography* 119, 134; see also Eivind Friis Hamre and William Wright, 'Brexit & the City: The Impact so Far - an Updated Analysis of How the Banking & Finance Industry Has Responded to Brexit - and Who Is Moving What to Where' (New Financial 2021) <https://newfinancial.org/brexit-the-city-the-impact-so-far/>, accessed 21 November 2022.

¹⁵ HM Treasury, 'Edinburgh Reforms Hail next Chapter for UK Financial Services' (GOV.UK, 9 December 2022) <https://www.gov.uk/government/news/edinburgh-reforms-hail-next-chapter-for-uk-financial-services>, accessed 4 January 2023.

regulatory initiatives and political statements in both the EU and the UK, political and business commentary and eleven semi-structured interviews that we held with experts and stakeholders in academia, financial sector and civil services (see Table in Annex).

The Declaration on Financial Services annexed to the TCA is the basis for regulatory cooperation between the UK and the EU. Notwithstanding its non-binding nature, this still formalised the UK-EU initial commitment to establish joint cooperation by March 2021. The EU and the UK adopted this Joint Declaration on Financial Services Regulatory Cooperation, including principles for transparency and dialogue on equivalence decisions, in December 2020. However, the Memorandum of Understanding (MoU) to establish joint EU-UK structured regulatory cooperation on financial services has not been formally signed yet. Technical discussions have taken place for EU-UK regulatory cooperation but the implementation has stalled since March 2021¹⁶, and has been considered a ‘collateral damage’ of the Northern Ireland protocol (part of the Withdrawal Agreement between the UK and the EU)¹⁷ situation, as noted in Lord Kinnoull’s testimony¹⁸. A report from the UK European Affairs Committee confirmed the wider tensions that are withholding any progress in financial services¹⁹. In any event, the discussions on regulatory cooperation in the financial sector area²⁰ cannot be completely separated from the overall political relationship between the UK and the EU. The on-going conflict over the Northern Ireland Protocol has dominated the political relationship in a negative way (most clearly seen in the exclusion of UK-based researchers from Horizon 2020) and might also feedback negatively on the cooperation in the financial sector area²¹. It remains to be seen if the positive ‘mood music’ observed at the end of 2022 and beginning of 2023 translate into concrete solutions to the satisfactions of all UK, Northern Ireland and EU parties²².

Considering the decision made in the WA/TCA, some UK firms decided to relocate their activities by establishing firms in the EU (with various legal forms, from subsidiaries to branches). Data is being processed across the financial sector to quantify this relocation. Some findings were published by ESMA regarding investment firms, trading venues, and fund managers²³. Such findings, collected through a peer review exercise and relying on the Supervisory Coordination Network experience established across the EU 27 Member States, demonstrate how key jurisdictions dealt with the authorisation requests from UK relocating firms. The critical points concern on the one hand the limited human, sometimes financial and technical resources in the firms that relocated, due to divergent interpretations of proportionality by EU competent authorities²⁴. On the other hand, the report found

¹⁶ HM Treasury, ‘Technical Negotiations Concluded on UK – EU Memorandum of Understanding’ (GOV.UK, 26 March 2021) <https://www.gov.uk/government/news/technical-negotiations-concluded-on-uk-eu-memorandum-of-understanding>, accessed 27 January 2023.

¹⁷ Federico Fabbrini (ed), *The Law & Politics of Brexit: Volume IV: The Protocol on Ireland / Northern Ireland*, vol 4 (Oxford University Press 2022).

¹⁸ ‘UK Financial Services Co-Operation with EU Hit by Northern Ireland Row’ *Financial Times* (22 June 2022) <https://www.ft.com/content/68726353-c3f3-4524-9c3b-c3208ff36975>, accessed 19 July 2022.

¹⁹ European Affairs Committee, ‘The UK-EU Relationship in Financial Services’ (Authority of the House of Lords 2022) HL Paper 21 1st Report of Session 2022–23 <https://publications.parliament.uk/pa/ld5803/ldselect/ldaff/21/21.pdf>, point 110.

²⁰ Thorsten Beck, ‘Regulatory Cooperation on Cross-Border Banking – Progress and Challenges After the Crisis’ (2016) 235 *National Institute Economic Review* R40.

²¹ ‘UK Financial Services Co-Operation with EU Hit by Northern Ireland Row’ (n 18).

²² ‘Much Better Mood Music’ in EU-UK Relations than at Any Period since Brexit Referendum - Taoiseach’ *The Irish Times* (25 January 2023) <https://www.irishtimes.com/politics/oireachtas/2023/01/25/much-better-mood-music-in-eu-uk-relations-than-at-any-period-since-brexit-referendum-taoiseach/>, accessed 30 January 2023.

²³ ESMA, ‘Peer Review into the NCAs’ Handling of Relocation to the EU in the Context of the UK’s Withdrawal from the EU - Peer Review Report’ (ESMA 2022) ESMA42-111–7468.

²⁴ See Table 1 *ibid* 11–12.

an extensive and inconsistent use of outsourcing and delegation arrangements across the jurisdictions, which may cover letter-box entities that should have been avoided in the first place.

The remainder of the study is structured as follows. Section 2 discusses recent regulatory developments in the UK, including financial service chapters in recent international trade agreements negotiated by the UK government with third countries. Section 3 presents in more depth specific areas where divergence either has been happening or is being planned, ending with different scenarios on future divergence. Section 4 discusses the current EU approach towards equivalence, equivalence decisions in the area of central clearing, and the options for future EU-UK regulatory cooperation.

2. RECENT REGULATORY DEVELOPMENTS IN THE UK

KEY FINDINGS

Regulatory developments for UK financial services are assessed through the lenses of divergence. This concept, which is most often defined in opposition to convergence and integration among two (or more) jurisdictions, is informative in a threefold dimension. First, one can observe different levels of divergence, namely regulatory divergence, supervisory/institutional divergence, and divergence of standards. Second, regulatory divergence may be active or passive, in our focus, between the UK and EU legal orders. Third, these different types of divergence can be exacerbated over time. This section outlines in general terms the different time horizons of divergence of UK financial services regulation from the EU framework. This general approach sets the foundations for a granular analysis of prospective evolutions of UK financial services regulation and the design of scenarios about future developments of the UK regulatory framework.

Supervisory and institutional divergence may (theoretically) be one additional driver in the divergence between the UK and the EU legal frameworks for financial services. In practical terms, supervisory cooperation should remain at a functioning level, regardless of the new secondary objectives for growth and international competitiveness added to the UK regulators' mandate.

The UK has exercised its trade policy sovereignty since it effectively left the EU: new trade deals have been concluded, while a number of them are under negotiation. The continuity agreements had replicated the EU's trade agreements and preferential arrangements to ensure trade relationships between the UK and some third countries are not disrupted after leaving the EU. The UK Government had envisaged that such continuity agreements would need to be revised with 'bespoke agreements'.

The following trends have been identified as evolving practices in UK trade deals negotiation, gathering data from the recently adopted trade agreements to the ones still under negotiation or renegotiation (as of end of December 2022):

- Enhanced regulatory cooperation for financial services through regulatory cooperation forums.
- Digital Finance and Digital Trade Agreements as part of a network of 'modern' Free Trade Agreements.
- Sustainable Finance Provisions: focus on sustainability is the first provision of its kind when considering the recent FTAs adopted by the UK with third countries.

Financial services constitutes one of the priority areas in dealing with retained EU Law. Several initiatives in regulatory changes build upon the Future Framework for Financial Services released by the UK Treasury in June 2021. Such regulatory changes rely on two Bills in the financial services sector, namely the Retained EU Law (Revocation & Reform) Bill and the UK Financial Services and Markets Bill.

These strategic and regulatory developments showcase a change of the UK approach to regulation in the financial services sector. The UK approach to regulation is focused on a common law principles-based approach, also following the recommendations of the Report of the Taskforce on Innovation, Growth and Regulatory Reforms from 2021.

On 1 July 2021, Rishi Sunak, then Chancellor of the Exchequer, gave a speech on the future of the UK financial services industry. He stressed the strategic changes in a range of areas, from strengthening the position of the UK as a globally competitive financial hub, to developing trade relationships with other countries (e.g. Singapore, Switzerland, and the US) as well as stressing the importance of digital and sustainable finance²⁵. The recent developments in trade deals concluded and negotiated with third countries by the UK grasp these strategic priorities. Section 2.1 examines the divergence of UK financial services regulation from the EU regulatory framework, by framing different approaches and definitions of divergence, and, the regulatory and supervisory model operating in the UK. Section 2.2 analyses bilateral trade agreements and cooperation agreements with third countries through their financial services chapters and provisions, including the settings for regulatory cooperation. This analysis also considers the trade deals that are under negotiation in the light of the findings of the ones adopted since the Brexit. Section 2.3 sets the main initiatives and legislative bills in UK financial services regulation.

2.1. Divergence of UK financial services regulation from EU legislation

2.1.1. Approaches to divergence in financial services regulation

Divergence of UK regulation from EU regulation is almost a given outcome following Brexit. However, depending on the fields and sectors concerned, there might be a diverse scope and different speeds of divergence. In financial services, regulatory divergence started with the loss of passporting rights – effective at the end of the transition period, 31 December 2020. In the last two years, the UK Government has undertaken and announced changes in different areas of financial services regulation (see section 3). Before discussing such evolutions, we elaborate on the definitions of divergence, which underpins the scenarios (both for the future regulatory developments, see section 3.2, and the potential equivalence regimes, see section 4.3).

The UK's rationale behind the will to actively diverge from the EU pertains to broader political choices and regulatory objectives: flexibility, principles-based, competitiveness, growth, innovation (see also section 2.3.2). Furthermore, the ideology behind Brexit has been articulated around the regulatory and business 'opportunities'²⁶ it should bring. For instance, these opportunities were allegedly said to reduce burden on businesses in terms of administrative work, ease or reduce reporting requirements and enable some agility and flexibility. This regulatory approach relies on less stringent rules and their transfer into administrative, technical guidance or in the UK regulators' rulebook, making them easier to adjust (instead of 'hard' law, see section 2.1.2.).

The following paragraphs distinguish between regulatory divergence, supervisory divergence, and divergence of standards, and define active and passive divergence. These distinctions lay the foundations for the approach of the study that differentiates between low, medium and high divergence (section 3.2.1.) scenarios that can take place differently on the short, medium and long term.

First, divergence can take place at different levels: regulatory divergence, supervisory/institutional divergence, and divergence of standards. These different levels showcase how the frameworks between the EU and the UK may grow apart from each other by taking into account not only the rules, the supervisory authorities (or regulators), but also some norms that are applicable alongside the

²⁵ HM Treasury, 'A New Chapter for Financial Services'.
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/998102/CCS0521556086-001_Mansion_House_Strategy_Document_FINAL.pdf, accessed 2 May 2022.

²⁶ HM Government (n 11).

regulatory framework. These norms or standards can stem from the UK, the EU, and the international level with global standard-setting bodies (see section 3.1 on the importance of such standards for instance, for AML and for the greening of the financial system). Before Brexit, the UK-EU frameworks were more than converging: there were harmonised rules (i.e. the Single Rulebook) as well as supervisory cooperation and convergence of practices, with the UK authorities being members of the different supervisory systems (i.e. the European System of Financial Supervision and its European Supervisory Agencies – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Securities and Markets Authority (ESMA), and the European Systemic Risk Board (ESRB)).

Second, if we focus in particular on regulatory divergence, some authors have differentiated active from passive divergence. Active divergence would occur when UK 'deliberately legislates to move away from retained EU Law'.²⁷ Passive divergence would reflect a status of the UK not keeping up with EU legislative changes (due to lack of resources, among other reasons). In any event, most observers have reported that major divergence of UK financial services regulation from EU rules has a low probability in the short term. However, such divergence has a higher probability in the medium- to long-term, a finding confirmed by our interviewees, see the Annex, and academia).²⁸

Third, divergence of UK financial services regulation will occur at different time horizons, from the short to medium and long term. The outcomes of the UK departure from the EU will make the two legal orders diverge increasingly more over time, with regulatory and policy changes undertaken on both sides. In the short term, the UK and EU financial industries have simply moved on and industry participants have accepted situations considered cumbersome such as having no equivalence in the financial services sector (beyond clearing services provided by UK Central Clearing Counterparties (CCPs), see section 4.2.), as the interviews with industry members echoed. The loosening of regulation is most often associated with the reach for immediate competitiveness (e.g. section 3.1). In the medium to long term, further divergence is inevitable considering the powers that regulators and supervisors are mandated to assume on both sides, with different regulatory and supervisory models (see section 2.1.2.). Should the UK still be in the EU Single Market for financial services, the responsibility for measures would have been otherwise drafted by the European Supervisory Authorities (ESAs), adopted by the European Commission (second level legal acts of the Single Rulebook) and applicable across the single market for financial services. Even though the UK is no longer part of the EU legislative process and decision-making, at the regulatory level, it is undebatable that the UK had a unique influence on the Single Rulebook developments at the time²⁹. This legacy may last for some time in the EU regulatory framework. It remains to be seen to what extent the upcoming reviews of EU financial and banking regulation will keep integrating in one way or another what was formerly brought to the legislative negotiations table by the UK.

In section 3.2., we discuss different scenarios of divergence including which segments of the financial sector will likely be most affected under which scenarios. A specific point concerns divergence of case-

²⁷ Joel Reland, Jill Rutter and Anand Menon, 'UK-EU Regulatory Divergence Tracker' (UK in a changing Europe 2021) 1st edition 1 <https://ukandeu.ac.uk/wp-content/uploads/2021/10/Divergence-tracker-Oct-2021-final-1.pdf>, accessed 1 December 2021; and the latest edition, see Joel Reland, 'UK-EU Regulatory Divergence Tracker: Fifth Edition' (2022) 5th edition <https://ukandeu.ac.uk/wp-content/uploads/2022/10/Divergence-Tracker-5.pdf>, accessed 21 October 2022.

²⁸ See for instance Niamh Moloney, 'Financial Services' in Federico Fabbrini (ed), *The Law & Politics of Brexit: Volume III: The Framework of New EU-UK Relations*, vol 3 (Oxford University Press 2021) 127 <http://academic.oup.com/book/39204>, accessed 5 August 2022; Scott James and Lucia Quaglia, 'Rule Maker or Rule Taker? Brexit, Finance and UK Regulatory Autonomy' (2022) 43 *International Political Science Review* 390; Nicolas Véron, 'Brexit and European Finance: Prolonged Limbo' (2021) 22 *CESifo Forum Research Paper* 33; for the TCA, see Jannike Wachowiak and Fabian Zuleeg, 'Brexit and the Trade and Cooperation Agreement: Implications for Internal and External EU Differentiation' (2022) 57 *The International Spectator* 142.

²⁹ David Howarth and Lucia Quaglia, 'Brexit and the Single European Financial Market' (2017) 55 *JCMS: Journal of Common Market Studies* 149.

law. There is now a separation between the UK Courts and the Court of Justice of the EU/Member States' Courts (except for NIP-related provisions that foresee the jurisdiction of the CJEU), with distinct legal systems between UK law and EU law. These judicial systems will develop different case-law to apply and interpret legal provisions from their respective legal orders. This divergence in case-law might also concern those UK legal provisions that would remain unchanged in UK Law, as part of retained EU Law (see section) but still subject to UK Courts' interpretation in potential litigation. Furthermore, regulators will exert their powers independently and differently, by relying on a different rulebook and diverse soft law (despite potential working channels of regulatory/supervisory cooperation, see section 3.2.2).

2.1.2. Regulatory and supervisory model in the UK

The significant reshaping of UK financial services regulation is to take place within the scope of the limits set by the UK Parliament³⁰ – a stark point when one thinks of the overriding rule review power that was first envisaged for the executive over UK independent regulators. In any event, the task of UK regulators in reshaping such regulatory framework will span over several years (e.g. the Financial Conduct Authority (FCA) with at least 40 files or subject areas). The Treasury, the Bank of England (BoE), the FCA, the Prudential Regulation Authority (PRA), the Financial Reporting Council and the Pensions Regulator have published Regulatory Initiatives Grids biannually since 2020 (five grids between May 2020 and May 2022), which constitute key information sources for the analysis developed in section 3 and 4.

We examine hereinafter the general trends in the evolutions of the UK regulatory and supervisory model with what has been called 'FSMA+' in reference to its evolution from the 2000 Financial Services and Markets Act. These trends also concern the objectives set within the mandate of the regulators, i.e. in terms of growth, competitiveness, and consumer protection (given to one authority, the FCA, for the latter) in addition to the objectives of financial stability, market integrity, and safety and soundness of financial institutions.

FMSA 2000 to FSMA+ or Model of Regulation: rule review power dropped

The UK approach to regulation will lead to the transfer of most rules from statutory level to the regulators' rulebooks³¹, which will fundamentally reinforce the regulatory and supervisory model set by the Financial Services and Markets Act from 2000 (FSMA 2000, and following the review, FSMA + as a FSMA model of regulation). Since the Future Regulatory Framework Review launched mid-2019,³² the UK has already developed its own position that is diverging from EU Law in a number of fields. Those fields are part of initiatives and upcoming legislation analysed in section 3.1, including the proposed mechanism for the government to use a 'rule review' power towards regulators, though this proposal has been dropped from the Financial Services and Markets Bill. The Taskforce on Innovation, Growth and Regulatory Reform (TIGRR) initiated the debate to delegate to regulators the responsibility for

³⁰ Treasury Committee, 'Future Parliamentary Scrutiny of Financial Services Regulations' (House of Commons 2022) Second Report of Session 2022–23-HC 394 <https://committees.parliament.uk/publications/22745/documents/167188/default/>, accessed 2 August 2022 point 10.

³¹ Treasury Committee, 'The Future Framework for Regulation of Financial Services' (House of Commons 2021) Fifth Report of Session 2021–22 HC 147 <https://committees.parliament.uk/publications/6570/documents/71188/default/>, accessed 3 August 2022.

³² See context, and the proposals that followed public consultation, HM Treasury, 'Financial Services Future Regulatory Framework Review: Proposals for Reform' (2021) CP 548 10. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032075/FRF_Review_Consultation_2021_-_Final_.pdf, accessed 4 August 2022.

developing and changing rules without new legislation adopted by the UK Parliament, in a report published in May 2021³³.

Regulators' responsibility and objectives for UK growth and competitiveness

Following the proposals for reform within the Future Regulatory Framework Review, the UK government introduced the Financial Services and Markets Bill that intends to repeal most of retained EU law and give regulators greater responsibility³⁴. The UK aims at keeping a coherent, agile approach to financial services regulation including for the purpose of enhancing the international competitiveness of the UK financial service sector³⁵. In particular, the objectives to stimulate investment in infrastructures favourable to growth and employment in the long term could lead to embed legally a new secondary objective for growth and competitiveness for the PRA and the FCA at statutory level. The review of the regulators' mandate would result in an amendment of the FSMA 2000 with a secondary objective for both to 'facilitate, subject to aligning with relevant international standards, the international competitiveness of the UK economy (including in particular the financial services sector) and its growth in the medium to long term' as indicated in two 'remit letters' from the Chancellor of the Exchequer Jeremy Hunt sent to the FCA and the PRA in December 2022³⁶.

This secondary objective assigned to the FCA and the PRA, and as conceptually envisaged in the Future Framework Review, will come in addition to existing primary objectives for financial stability, consumer protection and market integrity, safety and soundness of financial institutions³⁷. The secondary objective of long-term growth and competitiveness is part of the UK strategy to build a 'smarter' financial services framework, reiterated in the Treasury's policy statement in December 2022³⁸.

This development with an additional secondary objective is not seen as contradictory to existing primary objectives, as the interviewees pointed out. This secondary objective would also not be at the expense of the required level of independence of the regulators. The specific focus on consumer protection is attributed to the FCA. The measures envisaged for consumer protection include safeguarding the access to cash, protecting against fraudulent payment, and ensuring transparent financial promotions³⁹. The FCA is seen as having a strong mandate and taking consistent actions to preserve such consumer protection. Within the EU, those concerns are inserted in legislation across fields, and captured under the principle of market integrity.

³³ TIGRR, 'Independent Report - Taskforce on Innovation, Growth and Regulatory Reform' (2021) 7 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994125/FINAL_TIGRR_REPORT_1.pdf, accessed 23 November 2022 point 14.

³⁴ HM Treasury, 'Financial Services Bill to Unlock Growth and Investment across the UK' (GOV.UK, 20 July 2022) <https://www.gov.uk/government/news/financial-services-bill-to-unlock-growth-and-investment-across-the-uk>, accessed 21 July 2022.

³⁵ HM Treasury, 'Wholesale Markets Review Consultation Response' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1057897/Wholesale_Markets_Review_Consultation_Response.pdf, accessed 2 May 2022.

³⁶ Hunt, 'Recommendations for the Prudential Regulation Committee - Letter from the Chancellor' (n 2); Hunt, 'Recommendations for the Financial Conduct Authority - Letter from the Chancellor' (n 2).

³⁷ See the financial stability mandate of the BoE and other authorities Christy Ann Petit, 'The ECB Mandate - a Comparative Constitutional Perspective' in Thomas Beukers, Diane Fromage and Giorgio Monti (eds), *The New European Central Bank: Taking Stock and Looking Ahead* (Oxford University Press 2022); Rosa M Lastra, 'The Role of Central Banks in Monetary Affairs: A Comparative Perspective' in Thomas Cottier and others (eds), *The Rule of Law in Monetary Affairs* (Cambridge University Press 2014) https://www.cambridge.org/core/product/identifier/9781107479920%23c06363-806/type/book_part, accessed 16 August 2020.

³⁸ HM Treasury, 'Building a Smarter Financial Services Framework for the UK - Policy Statement' (2022) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1122734/Building_a_smarter_financial_services_framework_for_the_UK.pdf, accessed 26 January 2023.

³⁹ HM Treasury, 'Financial Services Bill to Unlock Growth and Investment across the UK' (n 34).

2.2. Bilateral trade agreements (BTA) and cooperation agreements with third countries

This subsection deals with UK trade negotiations, and some recent trade agreements, which aim to incorporate financial services provisions in trade deals between the UK and non-EU countries. This incorporation takes the form of financial services chapters in such trade agreements, and/or joint declarations, which are not legally binding for the latter.

The UK overall objective in international trade is to establish Global Britain⁴⁰. The UK Government declared its objective to ‘cement [the UK] status as an international financial services hub’⁴¹. This relies on an intensification of global trade flows and requires attracting investments. The UK wants to promote international standard setting with high consistent standards. Financial services provisions in trade agreements are seen as a vehicle to keep the global financial system open⁴².

The stocktaking of UK trade deals negotiation shows how the UK is exerting its regained competence for international trade policy (formerly, as one of the EU 28 Member States at that time, the EU had exclusive competence for trade policy also for the UK, in accordance with Article 3 TFEU), under World Trade Organization (WTO) rules. In early 2020, the UK announced its objective to ensure signing FTAs with countries that taken together represent 80% of UK trade within the next three years. As of the end of 2022, the UK has still some way to go considering the open negotiations (or renegotiations) with third countries as shown in tables 3 and 4 below. The negotiations of UK Bilateral Trade Agreements (BTAs) and Multilateral Trade Agreements (MTAs) are examined together with the space created for the adoption of new Digital Trade Agreements (DTAs) and Mutual Recognition Agreements (MRAs), with Switzerland as the first ‘ground-breaking’ MRA case⁴³, which was concluded in November 2022.

Since the UK left the EU, the UK has negotiated and signed some trade agreements with specific financial services provisions (2.2.1) and is still negotiating several agreements (2.2.2) with different negotiating objectives. Overall, the agreements aim to ensure some regulatory cooperation (with different kinds of settings), and differ in their approach to sustainable finance and digital finance (depending on the jurisdiction and the time when it is negotiated). The negotiation of new agreements and renegotiation of existing agreements demonstrate that the UK follows indeed a strategy towards the Pacific (with the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, India, Australia and New Zealand), as well as a digital strategy to foster digital trade and services⁴⁴, as observed with Singapore and Ukraine. For the FTAs in negotiation, the UK will depart further from the EU’s trade agreements, e.g. with the trade deals under negotiation with Canada, Mexico, and Israel.

2.2.1. Adopted trade agreements (2020-2022): financial services chapters and provisions

We give first the overview of the FTAs adopted from the transition period onwards before focusing on some substantive elements in relation to financial services, and the specific format of trade agreements focusing on Digital Trade Economy. Lastly, we consider the Mutual Recognition Agreement the UK and Switzerland have just concluded, which focuses on conformity assessment in the area of goods but also contains relevant features for financial services, as we will see.

⁴⁰ UK Government, ‘Global Britain: Delivering on Our International Ambition’ (GOV.UK, 13 June 2018) <https://www.gov.uk/government/collections/global-britain-delivering-on-our-international-ambition>, accessed 15 November 2022.

⁴¹ HM Government (n 11) 48.

⁴² *ibid*; see also Ilaria Fusacchia, Luca Salvatici and L Alan Winters, ‘The Consequences of the Trade and Cooperation Agreement for the UK’s International Trade’ (2022) 38 *Oxford Review of Economic Policy* 27.

⁴³ HM Government (n 11) 48

⁴⁴ Issam Hallack, ‘UK Trade Agreements with Third Countries: Implications for the EU’ (2020) PE 659.432 EPRS Briefing paper 1.

FTAs were concluded by the UK with third countries, including Australia in December 2021 and New Zealand in February 2022 (not yet in force at the date of writing). The UK agreed an FTA with Japan in October 2020 before the end of the transition period. These newly adopted FTAs epitomise the exercise of UK trade policy sovereignty since the UK has effectively left the EU with an ‘independent’ trade policy⁴⁵. The Comprehensive Economic Partnership concluded with Japan was the first FTA negotiated by the UK since its EU exit (with its sub-section 5 on Financial Services), see Table 1.

Table 1: UK trade agreements with third countries (2020–2022)

Parties	Name of the Trade Agreement	Date of adoption
UK-Japan	Agreement between the United Kingdom of Great Britain and Northern Ireland and Japan for a Comprehensive Economic Partnership	October 2020
UK-Australia	Free Trade Agreement between the United Kingdom of Great Britain and Northern Ireland and Australia	December 2021
UK-New Zealand	Free Trade Agreement between the United Kingdom of Great Britain and Northern Ireland and New Zealand	February 2022
UK-Singapore	Digital Economy Agreement between the United Kingdom of Great Britain and Northern Ireland and the Republic of Singapore	February 2022
UK-Switzerland	Agreement between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on Mutual Recognition in relation to Conformity Assessment	November 2022
UK-Ukraine	UK-Ukraine Digital Trade Agreement	November 2022

Source: Authors’ own elaboration.

Let us turn to the analysis of financial services chapters of these agreements adopted by the UK and third countries. Provisions regarding financial services are mostly similar to Chapter 9 of the UK-Australia FTA and Chapter 11 of the UK-New Zealand FTA. They both include some non-discrimination rules to ensure the fair treatment of financial services provided in the other parties’ markets, the free flow of financial data subject to privacy, personal data protection and public policy exceptions⁴⁶. These two FTAs both innovated with a provision on Financial Data that does not require local storage of such data for market access. Financial services market access cannot be conditioned upon using, storing or processing information locally. In other words, financial data does not have to be stored on local computers. In practice, the reality of anti-money laundering, know-your-customer and GDPR requirements may still lead to locate some in the UK, but not as a market access requirement.⁴⁷ As we will see, each FTA has some special provisions in respective financial services chapter, e.g. for innovation, insurance, and sustainability.

⁴⁵ Department for International Trade, ‘New Bill to Enable Implementation of Australia and New Zealand Trade Deals’ (GOV.UK, 11 May 2022) <https://www.gov.uk/government/news/new-bill-to-enable-implementation-of-australia-and-new-zealand-trade-deals>, accessed 14 November 2022.

⁴⁶ Department for International Trade, ‘Impact Assessment of the Free Trade Agreement between the United Kingdom of Great Britain and Northern Ireland and New Zealand’ (2022) 20; Department for International Trade, ‘Impact Assessment of the Free Trade Agreement between the United Kingdom of Great Britain and Northern Ireland and Australia’ (2021) 19.

⁴⁷ See question 48 ‘Oral Evidence - International Agreements Committee, UK-NZ Free Trade Agreement’ <https://committees.parliament.uk/oralevidence/10071/pdf/>, accessed 29 December 2022.

Before these two FTAs, the UK signed an FTA with Japan on 23 October 2020, which builds on the existing EU-Japan Agreement for a Comprehensive Economic Partnership⁴⁸. The objectives of the FTA were not only to foster digital trade and services but also to improve market access for financial services. The commitment to undertake regulatory dialogues demonstrates enhanced regulatory cooperation for financial services between the UK and Japan, reiterated in the context of the FTAs with Australia and New Zealand as discussed hereinafter.

Financial Services Regulatory Cooperation

Financial Services Regulatory Cooperation takes place either in forums or in working groups, which is a standard practice among trade partners globally. In the FTAs with Australia and New Zealand, the parties have an obligation 'to promote and seek to further develop regulatory cooperation in financial services' (Article 9.24 UK-Australia FTA and Article 11.16 UK-New Zealand FTA). But, we observe different settings for regulatory cooperation in the two FTAs' financial services chapters.

For the FTA with Australia, the framework for regulatory cooperation relies on the creation of a **Joint Financial Regulatory Forum** (Annex 9C), comprising representatives from the Government and financial service regulators. This platform aims to enhance and promote financial services and markets, and protect consumers, amongst other objectives (Articles 9C.1 and 9C.4)⁴⁹. In the context of the FTA with New Zealand, a **Financial Services Working Group** was created, and not a forum. This Working Group gathers representatives responsible for financial services, namely, an official from the UK HM Treasury and an official from the NZ Ministry of Foreign Affairs and Trade, in coordination with financial services regulators (Article 11.16). It is a working group to discuss and review the implementation of the financial services chapter, to consider financial matters coming from the implementation of the FTA and, to provide implementation reports (Article 11.16 (2)). Regarding the CEPA with Japan, regulatory cooperation in financial services takes the form of a **Financial Regulatory Forum** that was organised for the first time in 2022 (delayed due to Covid). This annual dialogue aims to strengthen cooperation, reduce market fragmentation, 'promote fair and competitive markets and explore opportunities to enhance financial services trade and investment'⁵⁰ between the UK and Japan global financial centres.

These forums for regulatory cooperation are essential additions (or alternatives) to the financial services chapters in trade deals, despite their voluntary character. Beyond the semantics, the settings chosen in these two FTAs – a forum and a working group – may reflect a different intensity in regulatory cooperation and a diverse regularity of meetings. It is too early to assess them, but observation of their respective practices may confirm if there is any material difference among the two, and if one setting can be privileged over the other when parties wish to establish closer and regular cooperation. However, the approach for regulatory dialogue set here has been criticised for its lack of ambition and being too closely modelled on the EU's approach⁵¹. It should be noted that the FTAs with Australia and New Zealand foresee some dispute settlement mechanisms within their financial services chapters (with some requirements as to the expertise of appointed panellists). The effectiveness of the dispute mechanisms and the possible remedies for non-compliance cannot be assessed to date.

⁴⁸ Hallack (n 44) 4.

⁴⁹ Department for International Trade, 'UK Trade Negotiations: Agreement with Australia' (House of Commons 2022) 2nd points 197-198.

⁵⁰ 'UK-Japan Financial Regulatory Forum 2022 – Joint Statement' <https://www.gov.uk/government/publications/inaugural-uk-japan-financial-regulatory-forum/uk-japan-financial-regulatory-forum-2022-joint-statement>, accessed 16 November 2022.

⁵¹ See question 60 'Oral Evidence - International Agreements Committee: UK-Australia Trade Negotiations' <https://committees.parliament.uk/oralevidence/3313/pdf/>, accessed 29 December 2022.

Digital Finance in Digital Trade Agreements

Since Brexit, the UK has explored the establishment of Digital Trade Agreement (DTA) in addition to existing FTAs with the same parties, with the first DTA concluded with Singapore, and another signed with Ukraine in November 2022⁵². The UK signed the Digital Economy Agreement (UKSDEA) with Singapore in February 2022, which entered into force in June 2022. This agreement, negotiated expediently with less than a year between the start of the negotiation and the entry into force, is the first to cover digital financial services to this extent, with a declared ambition: ‘The DEA is the most innovative trade agreement ever signed’⁵³. The UK and Singapore agreed to ‘collaborate, share knowledge, experiences and developments’ in financial services areas in order to support to innovation, with a particular mention of FinTech and RegTech, and aiming at: ‘advancing financial integrity, consumer protection, financial inclusion, financial stability, operational resilience, sustainability and facilitating cross-border development of new financial services’ (Article 8.53 (2)). As for Ukraine, the negotiations for a DTA were launched in August 2022 and concluded in November⁵⁴. The objective is to cover digital trade in the UK-Ukraine relationship as well as supporting the Ukrainian government in building a modern economy as part of the reconstruction. The Secretary of State for International Trade, Anne-Marie Trevelyan stressed how this DTA is part of the UK strategy to develop a ‘network of modern [FTAs]’ and reinforce its status as ‘global hub for services and digital trade’⁵⁵. This DTA is said to cover financial services, tech partnerships, and ‘new’ financial services⁵⁶ (which can favour the development of FinTech and RegTech), as does the DTA for Singapore.

In sum, these trade deals focusing on the Digital Economy are new developments expected to remain long-term trends for the UK trade strategy at the global level. These trends relate to the evolution of society and the economy, beyond the UK exit from the EU. But, it remains to be seen to which extent these agreements and their implementation contribute to the development of digital finance in these economies. These agreements may also be used to showcase the UK diplomatic and political strategy of strengthening its global presence, without, however, leading to immediate and significant developments in this area (as one could imagine in the difficult situation of the Ukrainian economy). Moreover, as we will see, the EU may well have a first mover advantage to benefit from in the field of digital finance (see section 3.1.4.).

Sustainability in the Financial Trade Agreements with Australia, New Zealand and Japan

Both the UK-Australia FTA and the UK-New Zealand FTA cover sustainable finance in their financial services chapter (respectively, Article 9.19 and Article 11.14). The provision is declarative for its main part and reiterates standards and commitments discussed in other global fora (e.g. the Task Force on Climate-Related Financial Disclosures, the Bank for International Settlements, Basel Committee on Banking Supervision and the Network for Greening the Financial System (NFGS)). In the context of the

⁵² Department for International Trade, ‘UK and Ukraine Launch Talks on Digital Trade Deal to Support Ukrainian Businesses’ (GOV.UK, 23 August 2022) <https://www.gov.uk/government/news/uk-and-ukraine-launch-talks-on-digital-trade-deal-to-support-ukrainian-businesses>, accessed 17 November 2022; Department for International Trade, ‘UK and Ukraine Agree Ground-Breaking Digital Trade Deal’ (GOV.UK, 30 November 2022) <https://www.gov.uk/government/news/uk-and-ukraine-agree-ground-breaking-digital-trade-deal>, accessed 6 January 2023.

⁵³ Department for International Trade, ‘UK and Singapore Sign New Innovative Digital Trade Deal’ (GOV.UK, 25 February 2022) <https://www.gov.uk/government/news/uk-and-singapore-sign-new-innovative-digital-trade-deal>, accessed 14 November 2022.

⁵⁴ Department for International Trade, ‘UK and Ukraine Agree Ground-Breaking Digital Trade Deal’ (n 52).

⁵⁵ Anne-Marie Trevelyan, ‘Letter from ANNE-MARIE TREVELYAN MP Secretary of State for International Trade & President of the Board of Trade to Angus Brendan MacNeil MP International Trade Committee’ (23 August 2022) <https://committees.parliament.uk/publications/28583/documents/172360/default/>, accessed 29 November 2022.

⁵⁶ The DTA itself is not published at the time of writing, see Department for International Trade, ‘UK-Ukraine DTA: Agreement in Principle Explainer’ (GOV.UK, 30 November 2022) <https://www.gov.uk/government/publications/uk-ukraine-digital-trade-agreement-agreement-in-principle-explainer/uk-ukraine-dta-agreement-in-principle-explainer>, accessed 30 January 2023.

UK-New Zealand FTA, these objectives have been described as ‘best endeavours commitments’⁵⁷ raising some legitimate questions as to their effective implementation.

Nevertheless, this focus on sustainability is the first provision of its kind when considering the FTAs adopted by the UK with third countries since its exit from the EU. The FTAs emphasise the importance of international cooperation:

- to facilitate the inclusion of environmental, social, and governance (ESG) considerations in investment decision-making and business activities (paragraph 1 of Article 11.14 and Article 9.19);
- to develop and adopt international standards for ESG considerations included in such investment and activities (paragraph 4 of Article 11.14 and Article 9.19).

This approach to sustainable finance requires some more technical resources and relies on additional disclosures. These requirements include the ‘assessment and pricing of climate-related risks and opportunities, and the exploration of environmental and sustainable projects and infrastructure’ Article 11.14 (2) / Article 9.19 (2), as well as climate-related financial disclosures for financial service suppliers with a forward looking approach Article 11.14 (3) / Article 9.19 (3). The UK-Australia FTA specifically allows firms to provide insurance on a cross-border basis for additional categories of large risks (e.g. fire and natural resources⁵⁸) which can include transitional risks.

The UK-Japan trade agreement does not have a specific provision on sustainable finance within the agreement itself. Annex 8-A on regulatory cooperation instead recognises the importance of a sustainable economy (Point 16) and the exchange of best practices in sustainable finance (Point 24. (d)). On this basis, the UK and Japan established a dedicated sustainable finance working group during the June 2022 Joint Regulatory Forum, in order to build trust in ESG investment products and markets, support the net zero transition and financial disclosures. This approach developed on the outskirts of the existing UK-Japan trade deal is therefore mostly aligned with the FTAs with Australia and New Zealand.

Mutual Recognition Agreement adopted

The UK and Switzerland are trading partners in the context of a continuity trade agreement (based on the EU-Switzerland agreement from 1972). The UK Government has launched consultation in April 2022 stressing the absence of adequate provisions for services and digital trade⁵⁹. The Mutual Recognition Agreement (MRA) format has been proposed to remove technical and regulatory barriers to trade⁶⁰. The distinctive feature here is in the nature and ultimate scope of the trade arrangement that is a *Mutual Recognition* agreement, and not only a trade agreement. The UK-Switzerland MRA has been concluded with the objective to reduce non-tariff barriers related to conformity assessment in five sectors but none of them are related to financial services⁶¹.

⁵⁷ International Trade Committee, ‘UK Trade Negotiations: Agreement with New Zealand’ (House of Commons 2022) Third Report of Session 2022–23 point 155.

⁵⁸ Department for International Trade, ‘Impact Assessment of the Free Trade Agreement between the United Kingdom of Great Britain and Northern Ireland and Australia’ (n 46) 19.

⁵⁹ ‘Switzerland Trade Policy Update - Statement Made on 28 April 2022’ <https://questions-statements.parliament.uk/written-statements/detail/2022-04-28/hcws805>, accessed 16 November 2022.

⁶⁰ HM Treasury, ‘Financial Services Bill to Unlock Growth and Investment across the UK’ (n 34).

⁶¹ Department for International Trade, ‘UK-Switzerland Mutual Recognition Agreement’ (GOV.UK, 17 November 2022) <https://www.gov.uk/guidance/uk-switzerland-mutual-recognition-agreement>, accessed 29 November 2022 The explanatory memorandum will be published by early December and the agreement might apply from January 2023, depending on Parliamentary approval.

This development with Switzerland is revealing of a type of agreement that covers specifically goods and borrows a well-known concept in EU Law; namely, the mutual recognition principle⁶². It is not directly related to the Financial Services sector in this specific case but demonstrates the increasing use of supporting tools to assist the UK global strategy in trade. In particular, MRA has been described, in the context of the June 2022 Joint Regulatory Forum with Japan, as a novel form of agreement to enhance UK financial services relationships with other third countries after Brexit⁶³.

Table 2: MRA adopted by the UK and Switzerland

	Name	Date of adoption	Status	Comment
UK-Switzerland	UK-Switzerland Mutual Recognition Agreement	April 2022	Concluded	The agreement will be applied provisionally from 1 January 2023, pending Parliamentary approval. It will enter into force no later than 28 February 2023.

Source: Authors' own elaboration.

2.2.2. International trade cooperation agreements under negotiation

We cover first the negotiations of FTAs and then the MTAs.

Negotiations of Free Trade Agreements

The ongoing UK FTA negotiations with third countries include new FTAs but also the replacement of continuity agreements⁶⁴. Some FTAs are now being renegotiated to replace these continuity agreements with renegotiations being held with Canada, Israel and Mexico since 2022. The UK had started negotiating a DTA with Ukraine in August 2022 and already concluded it on 30 November 2022 as seen above. On the other hand, the UK has negotiated a trade agreement with the US and India since May 2020 but these remain pending (see Table 3). The ongoing negotiations do not always stress the financial services area similarly in the negotiating objectives. The following highlights similarities or differences in such objectives with each third country for Canada, Mexico, and Israel.

First, the UK and Canada have been negotiating since March 2022 with the main objectives in the financial services area to provide a 'comprehensive, transparent and modernised arrangement' and increase opportunities for UK financial services as well as facilitate cross-border trade and investment⁶⁵. Second, the negotiations with Mexico started in May 2022 with the same objectives in the financial services area⁶⁶ as for the approach developed in the Canadian negotiation. Third, regarding the renegotiations of the FTA with Israel that started in July 2022, the UK negotiating objectives include to modernise rules for the financial services industry, with ambitious provisions supporting opportunities for UK financial services as well as ease frictions to trade⁶⁷. At the date of writing, the negotiations have not been successful yet for the UK-US FTA despite five rounds of negotiations⁶⁸. Unlike the previous US

⁶² Laurence W Gormley, *EU Law of Free Movement of Goods and Customs Union* (Oxford University Press 2009); Catherine Barnard and Steve Peers (eds), *European Union Law* (Second Edition, Oxford University Press 2017).

⁶³ 'UK-Japan Financial Regulatory Forum 2022 – Joint Statement' (n 33).

⁶⁴ Dominic Webb, 'Progress on UK Free Trade Agreement Negotiations' (House of Commons Library 2022) Research Briefing 9314 <https://researchbriefings.files.parliament.uk/documents/CBP-9314/CBP-9314.pdf>, accessed 13 November 2022.

⁶⁵ Department for International Trade, 'UK-Canada - Free Trade Agreement: The UK's Strategic Approach' (2022) 23.

⁶⁶ Department for International Trade, 'UK-Mexico - Free Trade Agreement - The UK's Strategic Approach' (2022) 20.

⁶⁷ Department for International Trade, 'UK-Israel Free Trade Agreement: Strategic Approach' (2022) 18, 19.

⁶⁸ Webb (n 64) 8.

administration, the current US administration has made it clear that such an agreement is not at the top of its foreign policy agenda. This non-priority is also due to the US administration stance in relation to the Northern Ireland border political situation⁶⁹.

Table 3: Current FTAs negotiations

	Name of the FTA	Start of negotiations	Status	Comments
Canada - UK	Canada-UK Bilateral Comprehensive Free Trade Agreement	24 March 2022	Ongoing	The current UK-Canada Trade Continuity Agreement replicates the agreement Canada has with the EU.
Israel - UK	United Kingdom-Israel free Trade Agreement	20 July 2022	Ongoing	Updating the existing UK-Israel agreement, which largely replicates the agreement Israel has with the EU.
Mexico - UK	Free Trade Agreement between the UK and Mexico	May 2022	Ongoing	Negotiations launched to update the existing UK-Mexico trade agreement, which largely replicates the agreement Mexico has with the EU.
India - UK	UK-India Free Trade Agreement	May 2020	Ongoing	There is no current trade agreement between the UK and India.
US - UK	UK-US Free Trade Agreement	May 2020	Latest round of negotiation concluded in October 2020.	There is no current Trade Agreement between the UK and the US. An Agreement is not expected soon.

Source: Authors' own elaboration.

Negotiation of Multilateral Trade Agreements

The UK is negotiating some Multilateral Trade Agreements (MTAs). The UK has requested formally to access and join a cooperation partnership – the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which includes 11 members, namely Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. Negotiations have been ongoing since September 2021⁷⁰. Some of the above mentioned FTAs (e.g. with Australia, New Zealand) are supposed to be instrumental to facilitate the UK's access to the CPTPP. The advantages the UK see in joining this MTA relate to access to the members' financial services markets while

⁶⁹ Financial Times, 'Joe Kennedy Appointed US Special Envoy to Northern Ireland' Financial Times (19 December 2022) <https://www.ft.com/content/b166bf24-681e-4cb0-8ba5-1c4f300338c1>.

⁷⁰ Webb (n 64) 6–7.

members keep their freedom to regulate their markets ‘appropriately’⁷¹, with opportunities facilitated by regulatory dialogue and cooperation⁷². Some private actors also see this MTA as an opportunity to export the UK’s ‘philosophy, regulatory practice and approach’⁷³.

The UK has also been negotiating with the Gulf Cooperation Council (GCC) since June 2022. This would be an MTA including six countries – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates – with the main objectives in the financial services area to ‘expand opportunities for UK financial services and ease frictions to cross-border trade and investment’⁷⁴.

Table 4: Current MTAs negotiations

	Name of the MTA	Start of negotiations	Status	Comments
Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam	Comprehensive and Progressive Agreement for Trans-Pacific Partnership - CPTPP	September 2021	Ongoing	The UK applied to join in February 2021.
Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE	UK - Gulf Cooperation Council Free Trade Agreement – GCC	June 2022	Ongoing	The UK currently does not have an FTA with any of these countries.

Source: Authors’ own elaboration.

Yet, it is difficult to anticipate how the UK and its trade partners will draft their financial services chapters: either following the example of the two FTAs with Australia and New Zealand or a new model combining the digital, sustainability and regulatory cooperation strategy for financial services within an all-encompassing financial services chapter. The provision not to require financial data located on local computer for market access, common to the FTA with Australia and New Zealand, has been considered a modern practice to reiterate in UK trade deals strategy⁷⁵.

2.3. Future (de/re)regulation of UK financial services

Financial services were mostly left outside the scope of the TCA between the UK and the EU.⁷⁶ Therefore, financial services and capital markets are one of the priority areas in dealing with retained EU Law for the UK.⁷⁷ Political intentions of the current UK government are that the financial sector will see significant de-regulatory evolutions, called a ‘Big Bang 2.0’ by former Chancellor Rishi Sunak⁷⁸, which were based on a proposal for the future framework for UK financial services’ regulation made by

⁷¹ UK Government, ‘Government Response to IAC CPTPP Negotiating Objectives Report’ <https://committees.parliament.uk/publications/8577/documents/86605/default/>, accessed 16 November 2022.

⁷² International Agreements Committee, ‘UK Accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP): Scrutiny of the Government’s Negotiating Objectives’ (2021) 10th point 67.

⁷³ See the evidence by London Market Group, *ibid* point 69.

⁷⁴ Department for International Trade, ‘UK-Gulf Cooperation Council Free Trade Agreement - The UK’s Strategic Approach’ (2022) 24.

⁷⁵ See Question 48 ‘Oral Evidence - International Agreements Committee, UK-NZ Free Trade Agreement’ (n 47).

⁷⁶ Fabbrini, *The Law & Politics of Brexit* (n 6).

⁷⁷ European Scrutiny Committee, ‘Retained EU Law: Where Next?’ (House of Commons 2022) HC 122 points 100-101.

⁷⁸ ‘Bank of England Battle Looms over Plans for Second “Big Bang”’ (n 10).

the Treasury in mid-2021⁷⁹. We will discuss the different proposals in more depth below in section 3. The regulatory developments include two important Bills in the financial services sector: the Retained EU Law (Revocation & Reform) Bill and the UK Financial Services and Markets Bill.

2.3.1. Retained EU Law and the UK Financial Services and Markets Bill

The Retained EU Law (Revocation & Reform) Bill is being discussed with several types of changes forthcoming concerning EU-derived domestic legislation, retained EU legislation, retained EU law provisions, retained EU and domestic case law, and retained General Principles of EU Law⁸⁰. Therefore, retained EU Law includes not only the provisions of EU law that are preserved and converted, but also retained case-law and general principles of law (GPLs)⁸¹. In the approach put forward by Prof. Catherine Barnard, preserved EU law corresponds to secondary EU Law implemented into UK Law when it was still a Member State and that continues to have legal effect⁸². Converted EU law corresponds to secondary EU Law with direct effect (e.g., EU Regulations or implementing and delegated acts, but also directly effective provisions).

The UK Cabinet Office published a dashboard that lists retained EU laws (REUL) in June 2022. Called 'Brexit Opportunities Catalogue', this interactive tool classifies the number of REUL by Department, and maps their status, i.e. unchanged, amended, repealed or replaced.⁸³ Financial and insurance activities form part of the top sectors with 443 REUL (third position after i) Agriculture, Forestry and Fishing and ii) Transportation and storage) as of the update made on January 30, 2023⁸⁴. However, only few acts have been amended, replaced or repealed (see Table 5). Therefore, regulatory divergence is minimal for the moment, but will significantly increase in the medium to long term, as we will discuss in section 3.2 below.

Table 5: Unchanged and changed retained EU laws (REUL)

Total REUL	Unchanged	Amended	Repealed	Replaced
443	431	3	6	3

Source: Adapted from UK Government, 'Retained EU Law Dashboard' (2023)⁸⁵, as of 30 January 2023.

The Impact Assessment by the UK government for the REUL Bill has highlighted three options, among which the status quo (option 1 or the 'do-nothing'), adopt laws with a sunset date of 31 December 2023 (REUL Bill, option 2), or adopt laws with a sunset date to be determined later (REUL Bill with later sunset

⁷⁹ Treasury Committee, 'The Future Framework for Regulation of Financial Services' (n 31).

⁸⁰ Graeme Cowie, 'Retained EU Law (Revocation and Reform) Bill 2022-23' (2022) CBP-9638 House of Commons Library <https://researchbriefings.files.parliament.uk/documents/CBP-9638/CBP-9638.pdf>, accessed 23 November 2022.

⁸¹ Catherine Barnard, 'Written Evidence Submitted by Catherine Barnard, University of Cambridge - Retained EU Law in the UK Legal Orders: Continuity between the Old and the New' point 3 <https://www.ssrn.com/abstract=3947215>, accessed 2 August 2022; see also Catherine Barnard, 'Retained EU Law in the UK Legal Orders: Continuity between the Old and the New' in Adam Lazowski and Adam Cygan (eds), Research Handbook on Legal Aspects of Brexit (Edward Elgar 2022).

⁸² Barnard (n 81) point 4.

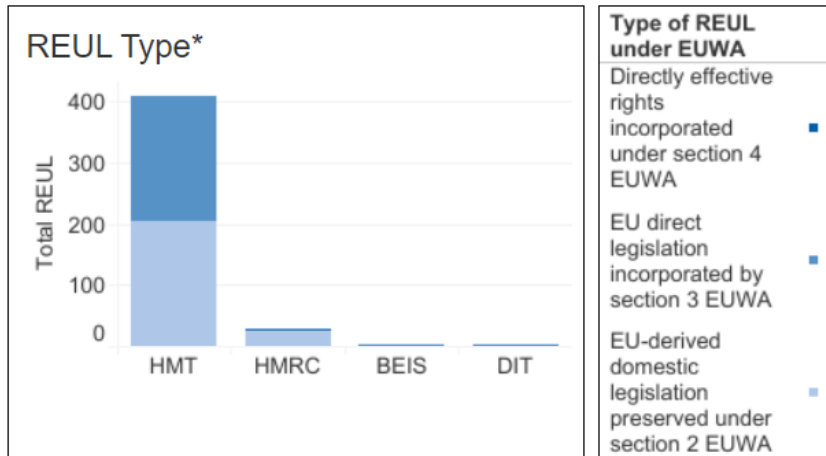
⁸³ UK Government, 'Retained EU Law Dashboard' (Tableau Software, June 2022) https://public.tableau.com/views/UKGovernment-RetainedEULawDashboard/Guidance?%3Adisplay_static_image=y&%3AbootstrapWhenNotified=true&%3Aembed=true&%3Alanguage=en-US&embed=y&:showVizHome=n&:apiID=host0#navType=0&navSrc=Parse, accessed 23 November 2022; see also Department for Business, Energy & Industrial Strategy, 'Retained EU Law (Revocation and Reform) Bill 2022: Impact Assessment' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1119530/retained-eu-law-revocation-reform-bill-2022-impact-assessment.pdf, accessed 23 November 2022.

⁸⁴ UK Government, 'Retained EU Law Dashboard Updated 30 January 2023' (Tableau Software, 2023) https://public.tableau.com/views/UKGovernment-RetainedEULawDashboard/Guidance?%3Adisplay_static_image=y&%3AbootstrapWhenNotified=true&%3Aembed=true&%3Alanguage=en-US&embed=y&:showVizHome=n&:apiID=host0#navType=0&navSrc=Parse, accessed 31 January 2023.

⁸⁵ *ibid*; together with data from UK Government, 'Retained EU Law Dashboard - Excel Sheet' (GOV.UK, 30 January 2023) <https://www.gov.uk/government/publications/retained-eu-law-dashboard>, accessed 31 January 2023.

date, option 3).⁸⁶ The preferred option for the current UK government is the second with the adoption of a 31 December 2023 sunset date, which implies a choice to (i) repeal, (ii) restate REUL as domestic law, or (iii) preserve it as ‘assimilated’ law by end of 2023⁸⁷. This option also includes the end to the principle of supremacy of EU Law (ending the directly applicable EU rights and General Principles of Law – GPLs) in the UK. However, the ongoing review of EU-derived law may require a longer time, with some stakeholders requesting a delayed sunset date⁸⁸.

Figure 1: Retained EU Laws type under European Union (Withdrawal) Act 2018 (EUWA)



Source: Adapted from UK Government, ‘Retained EU Law Dashboard’ (2023)⁸⁹, as of 30 January 2023.

In the financial services area, the Impact Assessment stresses that another piece of legislation – the Financial Services and Markets Bill 2022 – is to address REUL that impacts financial and insurance activities (see Table 5 and Figure 1 of REUL concerned by the financial services and insurance activities sector). In further details, the 443 REUL are divided following ‘Lead departments’ and, within the Financial and Insurance activities, the bigger shares correspond to HM Treasury (HMT) and HM Revenue & Customs (HMRC).

Data was updated in January 2023 following the identification of further pieces of legislation by the UK Government, increasing to 3,200 items of REUL that have been verified⁹⁰. As Figure 1 above shows, as of January 2023 there were 207 EU direct legislation incorporated by section 3 EUWA and 203 EU-derived domestic legislation preserved under section 2 EUWA under the responsibility of HMT. For HMRC, there are: 1 directly effective right incorporated under section 4 EUWA and 26 EU-derived domestic legislation preserved under section 2 EUWA. There is 1 EU direct legislation incorporated by section 3 EUWA under the Department for Business, Energy & Industrial Strategy, and 2 of the same category falling under the Department for International Trade. It must be noted that this data will be revised quarterly, and such revisions will cover both the quantitative and qualitative dimensions, i.e. the numbers/identification of amendment, repeal, or replacement of REULs.

We expect these REULs to be further amended, repealed, and replaced in the short to medium term, hence diminishing the share of unchanged REUL (currently at 431 out of 442 as illustrated by Table 5). These numbers exhibit, for now, a low divergence of UK financial services regulation from the EU rules

⁸⁶ Department for Business, Energy & Industrial Strategy, ‘Retained EU Law (Revocation and Reform) Bill 2022: Impact Assessment’ (n 83) 2.

⁸⁷ Regulatory Policy Committee, RPC Opinion - Retained EU Law (Revocation & Reform) Bill 2022 [RPC-CO-5223(1)] 5.

⁸⁸ For instance the Chamber of commerce, see ‘What Is the UK’s Retained EU Law Bill and Why Is it so Controversial?’ Financial Times (17 January 2023) <https://www.ft.com/content/834ca974-440a-4c68-98eb-9fd79733fb3c>.

⁸⁹ UK Government, ‘Retained EU Law Dashboard Updated 30 January 2023’ (n 84); together with data from UK Government, ‘Retained EU Law Dashboard - Excel Sheet’ (n 85).

⁹⁰ Nicola Newson, ‘Retained EU Law (Revocation and Reform) Bill HL Bill 89 of 2022–23’ (House of Lords Library 2023) 9.

in quantitative terms, but the process of amending the UK legal framework has effectively started and will be further accelerated in 2023 (see section 3). However, the Impact Assessment emphasised that even if the financial services sector is ‘where the most unamended REUL lies, it does not directly follow that this is where the largest changes will occur’⁹¹. Therefore, this would corroborate a low to medium degree of divergence, but this can be further discussed, also from a qualitative viewpoint (see the scenarios elaborated in section 3.2). The impact assessment also indicates a future Finance Bill or subordinate tax legislation targeted on REUL for tax including VAT, excise and customs duty⁹².

In November 2022, the Regulatory Policy Committee (‘RPC’), an independent body in the UK tasked to oversee better regulation, found that the Retained EU Law (Revocation & Reform) Bill is not fit for purpose⁹³. In particular, the RPC estimates that the UK Department for Business, Energy and Industrial Strategy – which is in charge of this Bill – has not sufficiently considered the full impact of the Bill, including on small and micro businesses. Moreover, the Retained EU Law (Revocation & Reform) Bill would not be fully consistent with Better Regulation (which is a guidance framework published by the same Department)⁹⁴. The RPC pointed to the very weak cost-benefit analysis of the Bill, with no substantive analysis to support it. Regarding policy and regulatory divergence, the RPC Opinion recommends clarifying the approach of devolved administrations in the UK towards REUL in the Impact Assessment of the Bill, including the implications of regulatory divergence for businesses and the need for additional resources⁹⁵.

The UK Financial Services and Markets Bill is a separate, bespoke arrangement to deal with REUL and separate from the REUL Bill, introduced to the House of Commons in July 2022. Indeed, nearly 200 instruments in the financial services sector might be revoked, restated or replaced under this Bill⁹⁶. For instance, the provisions stemming from the EU Solvency II Directive could be repealed by the adoption of this bill. At the date of writing, the Bill is in second reading at the House of Lords⁹⁷, while the UK government priorities for financial services regulation were reiterated within the Edinburgh reforms announced in December 2022⁹⁸.

2.3.2. Plans for regulatory divergence and different approaches to regulation

a. From rules-based to principle-based approach to regulation

Regulation, while being oriented on a risk-based approach in the EU, follows another route in the UK banking and financial services sector, with a more principles-based approach or activity-based approach, leaving room for more flexibility within UK common law. This is already applicable, e.g., for investment firms’ regulation (Financial Services Act 2021)⁹⁹. Some of these trends are already observable in UK financial services regulation and policy initiatives¹⁰⁰. In its 2021 report, the Taskforce on Innovation, Growth and Regulatory Reform (TIGRR) included a proposal to restore a common law principles based approach to financial services regulation¹⁰¹. The Taskforce contrasted UK legal

⁹¹ Department for Business, Energy & Industrial Strategy, ‘Retained EU Law (Revocation and Reform) Bill 2022: Impact Assessment’ (n 83) 18.

⁹² *ibid* 15, 17.

⁹³ Regulatory Policy Committee RPC Opinion - Retained EU Law (Revocation & Reform) Bill (n 87).

⁹⁴ Department for Business, Energy & Industrial Strategy, ‘Better Regulation Framework’ (GOV.UK, 22 February 2018) <https://www.gov.uk/government/publications/better-regulation-framework>, accessed 23 November 2022.

⁹⁵ Regulatory Policy Committee RPC Opinion - Retained EU Law (Revocation & Reform) Bill (n 87) 11.

⁹⁶ Cowie (n 80) 25–26.

⁹⁷ ‘Financial Services and Markets Bill - Parliamentary Bills - UK Parliament’ (29 December 2022) <https://bills.parliament.uk/bills/3326>, accessed 3 January 2023.

⁹⁸ HM Treasury, ‘Edinburgh Reforms Hail next Chapter for UK Financial Services’ (n 15).

⁹⁹ UK Parliament, Financial Services Act 2021 2021 [2021 c. 22].

¹⁰⁰ Moloney (n 28).

¹⁰¹ TIGRR (n 33) points 158-159.

reasoning – ‘cautious, iterative and pragmatic’ – with the EU law approach that would seek ‘to impose grand, codified schemes’.¹⁰² The Taskforce authors denounced the rigidity and details of the current UK regulatory system for financial services, as inherited from the EU regulatory framework.

This principles-based approach is entrenched in the Financial Services Future Framework Review, and has manifested itself in two specific proposals put forward in this report. First, the TIGRR recommended the amendment of inherited MiFID II (Markets in Financial Instruments Directive II) position limits for greater flexibility, while protecting critical contracts (Proposal 4.1). Second, the Taskforce recommended a more discretionary and judgment-based approach to calculating CCP margins (Proposal 4.2). Moreover, several other proposals concern financial services, banking and insurance regulation as discussed below in section 3. The Financial Services and Markets Bill 2022-23 also seeks to pursue a common law principles-based approach.

b. De-regulation and Future Finance Bill

The Financial Services Future Regulatory Framework Review was launched in 2019 and has been mainly concerned with institutional issues rather than a de-regulation ambition.¹⁰³

The Impact Assessment for the REUL Bill gives some indications about the future changes in the financial services sector. Namely, the impact of the REUL Bill is limited for the REUL in financial services and insurance activities, partly due to a forthcoming Finance Bill as mentioned above. In any event, the financial services and insurance activities’ sector would not be the sector encompassing the largest changes, according to the UK Department for Business, Energy & Industrial Strategy¹⁰⁴. This would lead to the anticipation of the assimilation of large part of REUL, thus resulting in only minor amendments in the UK financial sector regulation. We provide a more granular and nuanced approach to expected changes and evolutions in different areas of the UK financial sector in the following section.

¹⁰² *ibid* point 158.

¹⁰³ Moloney (n 28) 127.

¹⁰⁴ Department for Business, Energy & Industrial Strategy, ‘Retained EU Law (Revocation and Reform) Bill 2022: Impact Assessment’ (n 83) 18.

3. BIG BANG 2.0? QUO VADIS, FINANCIAL CENTRE LONDON?

KEY FINDINGS

As the UK is struggling with identifying post-Brexit growth opportunities, there has been a strong emphasis on strengthening the financial centre London and UK, more broadly. It is a-priori not clear, however, whether such strengthening implies regulatory and supervisory loosening or tightening, with prudential authorities and politicians taking very different approaches. While there seems an openness to discuss specific rules and regulations, the emphasis of regulatory and supervisory authorities in the UK seems primarily focused on stability. This stands in contrast to statements by members of the current UK government who see regulatory loosening as a means to attract more 'customers' to the financial centre and to finance more investment in the UK. While the UK has increasingly insisted that higher barriers to serve the EU Single Market from London will simply turn the financial centre in London towards global business, there have been limited signs of such a trend.

There are several areas where the UK has already taken initiatives that could result in regulatory divergence from the EU:

- Proposals for the implementation of the final Basel III reforms (also referred to as Basel 3.1) differ between the UK and the EU, with the latter deviating from the Basel III agreements as regards proportionality.
- Both the UK and the EU are considering reforms of the Solvency II regulatory framework for insurers with the objective of fuelling more equity investment by insurers, but through different regulatory adjustments.
- The UK aims at reforming different aspect of its wholesale markets regime and capital market sector, though these reforms are considered low impact.
- The UK aims at becoming a global centre for fintech and crypto assets, through a number of regulatory and supervisory initiatives, including a financial market infrastructure sandbox, a FinTech hub at the Bank of England and encouraging the development and use of stablecoins.
- There seem to be limited concerns of an easing of the tax evasion and anti-money laundering framework in the UK, including with the UK improving the functioning of its BO register with better data/KYC, while the EU Member States' BO registers could be going backwards.
- The "Greening Finance: A Roadmap to Sustainable Investing", published in 2021 sets out that UK Green Taxonomy will adopt the EU's six environmental objectives. However, the UK government is yet to release details, but some divergence is to be expected from the EU green taxonomy.

Over six years after the Brexit referendum and almost three years after leaving the EU, discussion on the degree of general divergence of UK legislation and regulation is still ongoing in the UK, with periods of bullish push for divergence (under Liz Truss' short premiership) quickly iterating with periods of much closer collaboration between UK and EU.

We discuss three possible scenarios of divergence:

- Low divergence: there will be adjustments to some UK regulations as well as other initiatives in line with the aim of increasing the 'competitiveness' of the UK as financial centre, but there will not be major divergence, especially in areas with international standards, such as bank capital regulation.
- Medium divergence: there will be more significant divergence and fewer attempts to converge on new rules such as in the area of green finance or crypto asset developments. Divergence will be more likely and more prominent in areas where international standards are less important and where the UK has not inherited any EU regulations such as in the two areas already mentioned.
- High divergence: there would be a rather aggressive legislative and regulatory drive in the UK to diverge from EU rules. This would involve both replacing existing EU rules with new regulation and adopting divergent rules where such rules were not inherited. We expect such aggressive divergence especially in areas where UK authorities see growth opportunities and feel less constrained by international fora and cooperation initiatives, such as crypto.

In case the conflict around the Northern Ireland Protocol can be resolved to the satisfaction of both sides, there should be few if any barriers for future cooperation between UK and EU authorities on financial sector issues. Addressing the stand-off around the NIP is thus a necessary though not sufficient condition. There will certainly be competing interests (similar to what we could observe during the UK's EU membership) and no expectations of complete convergence, but an institutional framework for regulatory dialogue could be put in place.

3.1. Analysis of prospective evolutions of UK financial services regulation

As the UK is struggling with identifying post-Brexit growth opportunities, there has been a strong emphasis on strengthening the financial centre London and UK, more broadly. While this seemingly goes against the political mandate of 'levelling-up', with which the Conservative Party won the General Elections in December 2019, the longstanding reputation of London as financial centre and a thriving ecosystem of accounting, auditing, legal and other services supporting financial service provision gives a certain rationale for focusing economic policy on further strengthening London and the UK as global financial centre.

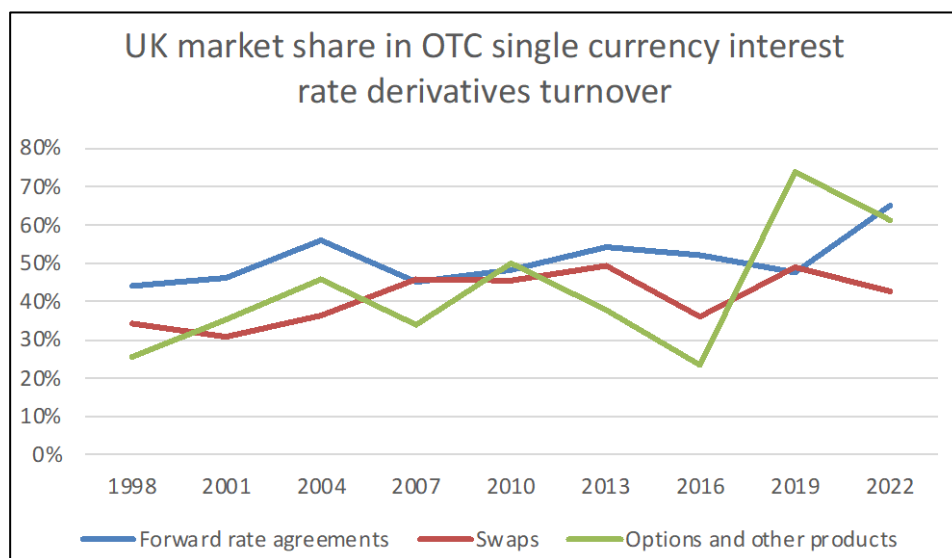
It is a-priori not clear, however, whether such strengthening implies regulatory and supervisory loosening or tightening, with prudential authorities and politicians taking very different approaches. Based on statements of Bank of England leadership over the past months and responses during our interviews, it seems clear that the Bank of England has taken the view that stability and safety is a decisive advantage of the financial centre London/UK in addition to its size. While there seems an openness to discuss specific rules and regulations, the emphasis of regulatory and supervisory authorities in the UK seems primarily focused on stability. This stands in contrast to statements by members of the current UK government who see regulatory loosening as a means to attract more 'customers' to the financial centre and to finance more investment in the UK. Specific actions taken in the past few months include removing the cap on bankers' variable remuneration (which is now also

being considered in Ireland¹⁰⁵) and cutting a tax surcharge on bank profits from 8 to 3% from April 2023, while increasing the threshold at which the tax comes into force from £25mn to £100mn, with the objective of protecting the earnings of smaller challenger banks.

While the UK has increasingly insisted that higher barriers to serve the EU Single Market from London will simply turn the financial centre in London towards global business, there have been limited signs of such a trend. Financial institutions that want to continue serving the EU Single Market have moved some operations into the EU, while some U.S. institutions have moved some operations back to the U.S. Geopolitical tensions also put pressure towards regional financial centres and away from global financial centres. Many of our interviewees do not see any additional business coming to London after Brexit from outside the EU.

While it might be too early for a final judgement and there are other confounding events, we can relate to the BIS' Triennial Central Bank Survey, with the UK market share in Over-the-counter (OTC) single currency interest rate derivatives turnover across three different product categories shown in Figure 2. While overall turnover has declined from 50.6% in 2019 to 45.5% in 2022, there are different trends across the three categories, with UK market share in swaps, options and other products falling while increasing in forward rate agreements. The increase in market share in forward rate agreements, however, comes with an overall falling volume. Independent of a falling market share, however, London still has a dominating market position in the trading of interest rate derivatives. Similarly, Berg et al. (2021) explain a decline in syndicated loan issuances in the UK after the Brexit vote primarily with a drop in domestic demand rather than loss of international business¹⁰⁶. However, their analysis stops at the end of 2018, i.e., before the exit of the UK from the Single Market. Finally, the exit of the UK from the Single Market resulted in trading of euro-denominated shares switching from London to Amsterdam. In sum, while there has been somewhat of a decline in the UK, there has not been a major exodus of financial market activity at the time of writing.

Figure 2: UK market share in different products in OTC single current interest rate derivatives



Source: BIS Triennial Central Bank Survey (2022)¹⁰⁷.

¹⁰⁵ 'Ireland to Loosen Strict Cap on Bankers' Pay and Bonuses' Financial Times (29 November 2022) <https://www.ft.com/content/f0f22aa7-5d87-4cd2-8e10-08fd872d83c6>.

¹⁰⁶ Tobias Berg and others, 'Brexit and the Contraction of Syndicated Lending' (2021) 141 Journal of Financial Economics 66.

¹⁰⁷ BIS, 'Triennial Central Bank Survey of Foreign Exchange and Over-the-Counter (OTC) Derivatives Markets in 2022' <https://www.bis.org/statistics/rpfx22.htm>, accessed 6 January 2023.

3.1.1. Basel III, bank supervision and the banking sector (incl. the treatment of third-country branches)

In banking regulation, the implementation of the **remaining Basel III standards** in the UK is delayed to January 2025 following a statement from the PRA, as a consequence of the Covid 19 pandemic. This matches delays in the EU in the implementation of the remaining Basel III standards.¹⁰⁸ These amendments to Banking Regulation in the EU are still discussed and negotiated with a strong reaction from the EU regulators and supervisors against deviations of the EU regulatory rules from the Basel III rules.¹⁰⁹ Specifically, EU regulators and supervisors have strongly argued against legislative proposals that would effectively reduce the increase in Tier 1 aggregate capital requirements stemming from the Basel III reform at the end of the phase-in period.¹¹⁰

The final rules for implementation in the UK were published in October 2021 in a Policy Statement by the PRA.¹¹¹ It includes the final PRA Rulebook instruments, statement of Policy as well as Supervisory Statements. But this does not cover the remaining part of Basel III. A Consultation Paper on implementation of the remaining Basel III banking standards was announced for Q4 2022, known as Basel 3.1¹¹² and was published on 30 November 2022¹¹³. The focus is on a (1) 'revised set of Standardised Approaches across all risk areas to introduce more granular requirements that better reflect the risk of firms' exposures and make them a more credible alternative to using Internal Models; (2) changes to the Internal Model (IM) approaches available to firms, including removing IM approaches entirely in some areas and where Internal Rating Based (IRB) approaches remain available reducing the available flexibility in modelling and (3) forcing firms using the IM approaches to apply the same revised Standardised Approaches in output floor calculation of 72.5% as those used by firms using the revised Standardised Approaches. The PRA considers these proposals as being in line with the international standards and draws specific attention to the legislative proposal in the EU, which, 'if adopted, these deviations would likely make the EU an international outlier, particularly in its approach to the implementation of the output floor.' The consultation closes on 31 March 2023 and the PRA expects the implementation of these changes by 1 January 2025. Given these different proposals for completing the Basel III implementation by UK authorities and European Commission, there will most likely be divergence between the two regulatory jurisdictions, with the EU deviating from the Basel III accord towards looser capital requirements.

There are two specific areas where divergence has already been happening, one of them related to Basel III and the other to supervisory requirements in cross-border banking.

¹⁰⁸ 'EU Could Fall Foul of Global Banking Rules, Regulators Warn' Reuters (4 November 2022) <https://www.reuters.com/markets/europe/eu-could-fall-foul-global-banking-rules-regulators-warn-2022-11-04/>, accessed 29 November 2022.

¹⁰⁹ Andrea Enria, Luis de Guindos and Jose Campa, 'Strong Rules, Strong Banks: Let's Stick to Our Commitments' (ECB Blog, 4 November 2022) <https://www.ecb.europa.eu/press/blog/date/2022/html/ecb.blog221104~34240c3770.en.html>, accessed 29 November 2022.

¹¹⁰ Among others, the ECB has raised concerns on the significant transitional arrangements leading to lower risk weights for the output floor than those envisaged in the Basel standards in (i) residential real estate exposures with low historical losses, (ii) exposures to unrated corporates, and (iii) the calibration of counterparty credit risk related to derivative exposures. Regarding the credit risk framework, the ECB points to several new deviations from Basel III standards, especially as regards (i) specialised lending exposures, (ii) equity exposures, (iii) retail exposures and (iv) the methodology for collateral valuation for exposures secured by immovable property. Further, the ECB also notes a divergence in the calibration of capital requirements for market risk from the Basel III standards. See Opinion of the European Central Bank of 24 March 2022 on a proposal for amendments to Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (CON/2022/11) 2022.

¹¹¹ PRA, PS22/21 - Implementation of Basel standards: Final rules 2021 [Policy Statement 22/21].

¹¹² HM Treasury and others, 'Regulatory Initiatives Grid - May 2022' (2022) 5th edition 4.

¹¹³ 'The PRA Consults on Proposals for Implementation of the Basel 3.1 Standards' (30 November 2022) <https://www.bankofengland.co.uk/news/2022/november/pr-consults-on-proposals-for-the-implementation-of-the-basel-3-1-standards>, accessed 3 January 2023; PRA, 'Implementation of the Basel 3.1 Standards' (2022) CP16/22 Consultation Paper <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/november/implementation-of-the-basel-3-1-standards>, accessed 3 January 2023.

First, in the context of the General Prior Permission (GPP) deduction regime, the EBA Regulatory Technical Standards (RTS) on own funds (OF) and eligible liabilities requires deduction to occur at the moment authorisation is granted, whereas the UK PRA updated in September 2022 its capital rulebook¹¹⁴ providing that, in case of GPP, the deduction would be deducted from own funds when the actual transaction is expected to take place with “sufficient certainty” regarding the transaction (i.e. no upfront deduction via the GPP, only when the actual reduction in OF is about to occur). In addition, the EU issuers need to submit their application for regulatory approval for reducing own funds and eligible liabilities 4 months before the actual reduction or redemption. This regulatory difference favours UK issuers that have more flexibility to implement liability management due to a less stringent/rigid timeframe for OF application and calls exercises, and therefore to optimise the management of their own funds, compared to EU issuers.

Second, the treatment of third-country branches (TCBs) should change in the EU after the latest Banking Package proposed by the Commission (October 2021) and the Council agreed its position in November 2022 before starting the negotiations with the European Parliament.¹¹⁵ 15 Third Country Branches from the UK located in the EU (as counted by the European Banking Authority (EBA) at the end of December 2020)¹¹⁶ will become subject to an authorisation procedure, minimum regulatory prudential requirements and reporting obligations if they wish to conduct banking activities in the EU, with prudential supervision of the ‘Brexit banks’ by the ECB Single Supervisory Mechanism (SSM) in the banking union for class 1 TCBs, in existing or newly established colleges of supervisors. But it should be noted that the relocation in the EU Single Market has taken less the form of branches than the establishment of subsidiaries, which are in the euro area subject to SSM banking supervision (e.g., a recent speech by Andrea Enria, the ECB Supervisory Board Chair¹¹⁷).

On the other side, some SSM Banks with physical presence in the UK are concerned that their entities are being asked by the UK-PRA for group-level data that have already been shared with the SSM. The UK-PRA is requesting this information under the Supervisory Statement SS5/21 “International banks: The PRA’s approach to branch and subsidiary supervision” (from July 2021), which is applicable to all PRA authorised banks that are headquartered outside of the UK or are part of a group based outside of the UK. In Chapter 4 (*Information, co-operation, and controls to be effectively supervised*), it sets the information which is expected to be sent by the subsidiaries/branches located in the UK. Given the fact that these data are extremely sensitive and strategic, SSM banks consider that UK-PRA’s information requests exceed/breach the scope defined in the MoU established between the SSM and the UK-PRA.

There are two other relevant initiatives to report in terms of potential forthcoming regulatory divergence concerning banking, credit and lending.¹¹⁸ First, regarding the Interest rate risk in the

¹¹⁴ PRA, ‘Definition of Capital: Updates to PRA Rules and Supervisory Expectations’ (2022) PS8/22 | CP2/22 Policy Statement | Consultation Paper <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/february/definition-of-capital-updates>, accessed 3 January 2023.

¹¹⁵ Council of the EU, ‘Implementation of Basel III - General Approach / COREPER - Interinstitutional File: 2021/0341 (COD)’ <https://www.consilium.europa.eu/media/59969/st13773-en22.pdf>, accessed 31 January 2023.

¹¹⁶ EBA, ‘Report to the European Parliament, the Council and the Commission on the Treatment of Incoming Third Country Branches under the National Law of Member States, in Accordance with Article 21b(10) of Directive 2013/36/EU’ (European Banking Authority 2021) EBA/REP/2021/20 https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2021/1015664/Report%20on%20third%20country%20branches.pdf, accessed 1 May 2022.

¹¹⁷ Andrea Enria, ‘The Desks Mapping Review – Integrating Brexit Banks into European Banking Supervision’ (ECB Banking Supervision, 19 May 2022) <https://www.bankingsupervision.europa.eu/press/blog/2022/html/ssm.blog220519~3081950bac.en.html> accessed 1 June 2022; for a more recent study, see Pier Mario Lupinu, ‘From Branches to Subsidiaries: Post-Brexit Enforcement of Subsidiarisation in the European Union’ in Lukas Böffel and Jonas Schürger (eds), *Digitalisation, Sustainability, and the Banking and Capital Markets Union: Thoughts on Current Issues of EU Financial Regulation* (Springer International Publishing 2023) https://doi.org/10.1007/978-3-031-17077-5_14, accessed 3 January 2023.

¹¹⁸ HM Treasury and others (n 112) 49.

banking book (IRRBB), the Capital Requirements Directive (CRDV) introduced Basel III's enhanced Pillar 2 approach to the management and control of IRRBB. The PRA intends to implement the Basel IRRBB standards through a combination of PRA rules and supervisory expectations. Second, regarding the update of the UK's prudential regime for credit institutions (incorporating elements of the Capital Requirements Regulation – CRR II) with the BoE/HMT/PRA in charge, there might be further regulatory divergence from the EU Single Rulebook. The EU is implementing a number of Basel 3 standards, and other prudential regulations, via CRR II. The UK intends to update the prudential regime for UK credit institutions and ensure the Financial Policy Committee's powers are aligned with this.

3.1.2. Solvency II and the insurance sector

Regulatory reforms in the insurance sector, specifically related to Solvency II, have been often seen as an early Brexit dividend. Policymakers' hope has been that a loosening of insurers' capital regulation can result in significant additional private funding for infrastructure investment and favouring an insurance sector competitive at the global level¹¹⁹. This involves a cut on the risk margin, an extra capital buffer that companies must hold, by 65 per cent for life insurers and 30 per cent for general insurers¹²⁰. At the same time, it was decided against tightening the rules regarding the so-called matching adjustment (which allows insurers to recognise as capital money they will earn over time from assets that match their future cash flows), which offers a capital benefit to life insurers that invest in assets that match their long-term liabilities. The PRA had pushed for such a tightening but was overruled by the government. It is expected to pass through Parliament in 2023, while in the meantime a consultation has been opened by the BoE on the streamlining of reporting and disclosure requirements for insurers until May 2023¹²¹. Industry estimates expect the proposed reduction in the risk margin to add about three to four percentage points to its solvency ratio, possibly freeing up some £100bn, according to the Association of British Insurers.

It is important to note that similar discussions are ongoing in the EU about a reform to Solvency II, but have not resulted in a conclusion yet. Specifically, the Commission's legislative proposal includes several propositions to increase EU insurers' investment in equity. First, the Commission proposes to widen the upper and lower bounds of the symmetric adjustment of the maximum standard equity capital charge to thus mitigate the impact of sharp changes on the stock market of the insurance companies' capital requirements and thus reduce the procyclicality of insurers' equity investment. However, according to De Groen and Oliinnyk (2022)¹²² the proposal is likely to have only limited impact on the capital requirements, as it will only affect the capital requirements in extreme market conditions. The impact on equity investments is therefore also expected to be limited. Second, the Commission proposes to redefine the scope of equity investments that are considered long term - expanding the criteria for long-term equity investment would increase the scope of equity investment that is considered long term. The changes are likely to increase the equity investments through an effective reduction of the capital charges. Using a simplified model based on conservative asset allocation, US

¹¹⁹ Treasury Committee, 'The Solvency II Directive and Its Impact on the UK Insurance Industry' (House of Commons 2017) Third Report of Session 2017–19 HC 324 <<https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/324/32402.htm>> accessed 3 August 2022 points 26-27.

¹²⁰ HM Treasury, 'Review of Solvency II: Consultation' (2022) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1071899/20220328_Review_of_Solvency_II_Consultation.pdf, accessed 30 November 2022.

¹²¹ Bank of England, 'CP14/22 - Review of Solvency II: Reporting Phase 2' (2022) <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/november/review-solvency-ii-reporting-phase-2>, accessed 30 November 2022.

¹²² Willem Pieter de Groen and Innq Oliinnyk, 'Solvency II Prudential Treatment of Equity Exposures' (2022) PE 733.974 Study for the Committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg [https://www.europarl.europa.eu/RegData/etudes/STUD/2022/733974/IPOL_STU\(2022\)733974_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2022/733974/IPOL_STU(2022)733974_EN.pdf), accessed 6 January 2023.

investment manager Neurberger Berman finds that a typical EU life insurance company could see their solvency ratios increase by 21 percentage points, while for a typical non-life insurer this figure would be 51 percentage points (Neurberger Berman, 2021 as quoted by De Groen and Oliinyk, 2022)¹²³.

In sum, proposed changes for the insurance prudential framework in both EU and UK aim at encouraging broader equity investment by insurers, but using different tools, which will lead to divergence between the two regulatory jurisdictions.

3.1.3. UK wholesale markets regime and capital markets sector

In its 'New Chapter for Financial Services' strategy, the UK Treasury consulted about its wholesale markets regime¹²⁴. Several proposals were made to change UK capital markets regulation, which will diverge from the MiFID/MiFIR regimes (including with a power to repeal retained EU Law, see section 2.3.1 above). The Wholesale Markets Review includes several initiatives, with implementation via regulatory action or legislation. Among these are two initiatives related to the equity market: HMT's reviews of the UK prospectus regime and secondary capital raising markets (newly released in May 2022). UK Listing Review regulation is divided into two initiatives: 'UK Prospectus Regime Review Outcome' and 'Secondary Capital Raising Review Report', listed hereinafter.

The full list of nine initiatives, aimed at improving the effectiveness of regulation and reducing the burden on firms whilst maintaining the highest standards of regulation and market efficiency, is as follows (Regulatory initiatives grid from May 2022):

- Changes to the European Market Infrastructure Regulation (EMIR) Derivatives Clearing Obligation;
- Accessing and using wholesale data;
- Primary Market Effectiveness – UK Listings Review response;
- Review of the Securitisation Regulation;
- Secondary Capital Raising Review led by Mark Austin;
- UK prospectus regime review outcome;
- HMT Consultation on power to block listings on national security grounds;
- EMIR REFIT; and
- Financial Markets Infrastructure (FMI) Sandbox.

All of these nine initiatives are considered low impact and are at different stages of implementation¹²⁵. In the EU, legislative proposals to amend MiFID and MiFIR could be adopted in 2023, so that there will be both active and passive regulatory divergence between the EU and the UK. The exact degree of divergence can only be assessed once reforms on both side of the Channel have been spelt out.

3.1.4. A new approach to FinTech and Digital Finance

Both the UK government and regulatory authorities have taken a very positive attitude towards FinTech and crypto assets. The new Prime Minister Rishi Sunak is often described as a champion of

¹²³ *ibid.*

¹²⁴ HM Treasury, 'Wholesale Markets Review Consultation Response' (n 35).

¹²⁵ See over 30 reforms in HM Treasury, 'Financial Services' (n 12).

FinTech, a reputation dating back to his time as Chancellor of the Exchequer¹²⁶. In October 2018, a joint Treasury-FCA-Bank of England Cryptoassets Taskforce published a report that set out the UK's policy and regulatory approach to cryptoassets and distributed ledger technology (DLT) establishing its assessment of the risks and benefits of the sector, as well as a broad roadmap for regulation in the UK¹²⁷. This was followed by the FCA's Final Guidance published in 2019, which established that cryptoasset firms aiming to do business in the UK would require authorisation according to the specific design of a given token¹²⁸. These UK initiatives are parallel to several legislative initiatives in the EU, including the Markets in Crypto-Assets (MiCA) Regulation that has been recently adopted and the Digital Operational Resilience Act (DORA).

a. Regulatory sandboxes and innovation hubs

The FCA established a regulatory sandbox for fintech in 2016, giving firms the opportunity to find out whether a business model is attractive to consumers, or how a particular technology works in the market, conducted on a small scale, for a limited duration, with a limited number of consumers¹²⁹. The Bank of England established a Fintech Hub in March 2018 to ensure a coordinated approach towards fintech within the institution¹³⁰.

The FMI Sandbox – to be run by the Bank of England and the FCA – has the objective to allow financial market infrastructure providers and other relevant parties to test and adopt new technologies and practices (including distributed ledger technology) by temporarily disapplying or modifying certain UK financial services regulation for specific purposes. According to an official communication, the initial focus will be exploring the application of DLT by firms who want to set up DLT securities settlement systems integrated with trading platforms. The FMI sandbox should be implemented in 2023¹³¹.

The UK Government identified digital finance as a key area of post-Brexit growth in the Kalifa review of UK FinTech¹³², which is covered in international agreements too (see section 2.2 on DTA for Singapore and Ukraine). In regulatory terms, the UK is following the lead of the EU (digital finance and retail payments package, September 2020), which also aims to foster regulatory sandboxes and innovation hubs in the EU.

b. Private issuance of digital coins/money: e.g. crypto assets and stablecoins

As announced by the then Treasury Minister responsible for the City, John Glen, earlier in 2022, the UK is “open for crypto businesses.” There are several legislative initiatives, contained in the Financial Services and Markets Bill, including to bring certain stablecoins into the payments framework, with the aim of creating the conditions for stablecoin issuers and service providers to operate and grow in the UK, and to remove disincentives for UK fund managers to include cryptoassets in their portfolios. In particular, the UK will enable certain stablecoins and financial market infrastructure sandboxes under the new crypto asset regulatory framework¹³³. Beyond these specific plans, there seems also a clear

¹²⁶ HM Treasury, ‘Government Sets out Plan to Make UK a Global Cryptoasset Technology Hub’ (GOV.UK, 4 April 2022) <https://www.gov.uk/government/news/government-sets-out-plan-to-make-uk-a-global-cryptoasset-technology-hub>, accessed 8 August 2022.

¹²⁷ HM Treasury, Financial Conduct Authority and Bank of England, ‘Cryptoassets Taskforce: Final Report’ (2018).

¹²⁸ Financial Conduct Authority, ‘Guidance on Cryptoassets Feedback and Final Guidance to CP 19/3’ (2019) Policy Statement PS19/22 <https://www.fca.org.uk/publication/policy/ps19-22.pdf>, accessed 30 November 2022.

¹²⁹ Financial Conduct Authority, ‘Regulatory Sandbox’ (1 March 2022) <https://www.fca.org.uk/firms/innovation/regulatory-sandbox>, accessed 31 January 2023; and see for concrete examples, Financial Conduct Authority, ‘Regulatory Sandbox Accepted Firms (Last Update 16 December 2022)’ (FCA, 8 March 2022) <https://www.fca.org.uk/firms/innovation/regulatory-sandbox/accepted-firms>, accessed 31 January 2023.

¹³⁰ Bank of England, ‘Fintech’ (11 October 2022) <https://www.bankofengland.co.uk/research/fintech>, accessed 31 January 2023.

¹³¹ HM Treasury, ‘Financial Services’ (n 12).

¹³² Ron Kalifa OBE, ‘Kalifa Review of UK Fintech’ (HM Treasury 2021).

¹³³ HM Treasury, ‘Government Sets out Plan to Make UK a Global Cryptoasset Technology Hub’ (n 126).

intention by the UK government to engage directly with the crypto-industry, for example in the form of *CryptoSprints* which brings together regulators and industry and are organised by the FCA¹³⁴.

As digital finance and crypto are areas where there is not retained EU legislation from the UK's viewpoint, except in the areas of payment services and electronic money, significant divergence can be expected over the coming years. Given the emphasis by the UK government on digital finance and crypto assets as a growth area for the financial centre UK, and given recent failures and fragility in the crypto space, this is certainly an area where divergence, uneven level playing fields and regulatory arbitrage should be carefully watched.

3.1.5. Tax evasion, tax avoidance, and money laundering

a. Risk-based approach and onshored AML/CFT rules into UK Law

Article 186 of the TCA provides that both “parties shall make their *best endeavours* to ensure that internationally agreed *standards* in the financial services sector for regulation and supervision, for the fight against money laundering and terrorist financing and for the fight against tax evasion and avoidance, are implemented and applied in their territory” (emphasis added). This provision focuses on international standards and would ensure a priori a certain degree of remaining convergence between the two regulatory and supervisory frameworks.

AML/CFT rules are primarily driven by global standard setters. And while there are attempts within the EU to centralise some of the regulatory and supervisory tasks in this area (including with the establishment of an AML Agency), this is primarily still national responsibility. In the UK, the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 amended the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.

We observe in general no leniency or push back of AML rules, despite the concerns expressed following the Panama papers’ scandal¹³⁵. There has been a proposal to reduce AML burdens for new Open banking and FinTech Services (TIGRR, proposal 5.3), but this is more broadly explained by the objective to support innovation, including the development of sandboxes (see section above). All of the interviewees agreed that there is little risk that the UK will lower AML/CFT rules and standards. What potentially raises higher risks is the difficult access to data in transaction monitoring from EU. Though some interviewees also pointed to the reputation of London as ‘laundromat’ for money from doubtful origin.

In 2020, the UK Government proposed a reform of Companies house to clamp down on fraud and ensure confidence in transactions¹³⁶. The policy paper on Corporate transparency and register reform highlighted the need to reform Companies House to be the custodian of more reliable, accurate data and enable an increased flow of data processed¹³⁷.

Companies House is a public beneficial ownership (BO) register in place since 2016, more advanced than in the EU, even if there are controversies as to the quality of the data reported. This criticism

¹³⁴ The aim of regulators is to “increase our understanding of emerging cryptoasset market practices and to seek views from the industry on what an appropriate regulatory regime might look like.” see Financial Conduct Authority, ‘CryptoSprint Outputs’ (FCA, 11 May 2022) <https://www.fca.org.uk/firms/cryptoassets/cryptosprint>, accessed 31 January 2023.

¹³⁵ European Parliament, ‘Resolution on the Pandora Papers: Implications for the Efforts to Combat Money Laundering, Tax Evasion and Tax Avoidance’ [https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2021/2922\(RSP\)](https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2021/2922(RSP)), accessed 31 January 2023.

¹³⁶ UK Government, ‘Reforms to Companies House to Clamp down on Fraud and Give Businesses Greater Confidence in Transactions’ (GOV.UK, 18 September 2020) <https://www.gov.uk/government/news/reforms-to-companies-house-to-clamp-down-on-fraud-and-give-businesses-greater-confidence-in-transactions>, accessed 24 November 2022.

¹³⁷ Department for Business, Energy & Industrial Strategy, ‘Corporate Transparency and Register Reform’ (GOV.UK, 28 February 2022) 12 <https://www.gov.uk/government/publications/corporate-transparency-and-register-reform>, accessed 24 November 2022.

prompted the need for reforms to improve Know Your Customer (KYC) processes and data. The changes suggested take place within evolutions triggered by geopolitical events including the war in Ukraine (see the Economic Crime Bill). The Economic Crime (Transparency and Enforcement) 2022 Act (adopted 18 March 2022) created a Register of Overseas Entities as tool against foreign criminals using UK property to launder money and reformed and strengthened the UK's Unexplained Wealth Order regime.

It must be said that the UK first mover advantage in BO register (and current improvement) contrasts sharply with the yet-to-be-effective BO registers in the EU Member States¹³⁸. This is also at risk considering a recent preliminary ruling of the Court of Justice in which there was a trade-off between the transparency of BO and the preservation of fundamental rights, including the right to privacy and protection of personal data (Judgment of the Court in Joined Cases C-37/20 *Luxembourg Business Registers* and C-601/20 *Sovim*)¹³⁹. The effect could be significant: the UK improving the functioning of its BO register with better data/KYC, while the EU Member States' BO registers could be going backwards as Luxembourg and the Netherlands closed theirs, right after the publication of the preliminary ruling¹⁴⁰.

In addition, the Economic Crime and Corporate Transparency Bill¹⁴¹ published as an initiative in September 2022 will further reform the Companies House by introducing identity verification for all new and existing registered company directors and broaden the powers of the registrar; tighten registration requirements for limited partnerships, increasing transparency requirements and requiring them to maintain a connection to the UK. Moreover, it will provide additional powers to law enforcement authorities to seize and recover cryptoassets which are the proceeds of crime or associated with illicit activity. The Bill is in its second reading at the House of Lords as of January 2023.

b. UK Government's approach towards tax evasion, tax avoidance and other forms of non-compliance

The UK has significantly strengthened its tax enforcement regime in the past years, including with the introduction on "unexplained wealth" orders that law enforcement agencies can adopt with a reversal of the burden of proof. The current fiscal stance ('Austerity 2.0') points rather to a further strengthening of the UK government approach towards tax avoidance (in breach of the spirit of the law) and tax evasion (in breach of the letter of the law)¹⁴². There is also a willingness to overcome financial secrecy with further transparency so as to reduce tax avoidance in Crown Dependencies and Overseas Territories (e.g. details of offshore financial accounts)¹⁴³. From the EU stance, as of December 2022, the UK Crown Dependencies are not part of the list of third countries considered as non-cooperative tax

¹³⁸ See AMLDVI proposal and Christy Ann Petit, 'Chapter 16. Anti-Money Laundering' in Miroslava Scholten and Leander Stahler (eds), *Research Handbook on EU Law Enforcement* (Edward Elgar Publishing 2023).

¹³⁹ Maxime Lassalle, 'Op-Ed: "Who Cares about Financial Privacy?: The Court of Justice in WM, Sovim SA v Luxembourg Business Registers, (C-37/20 and C-601/20)"' (EU Law Live, 16 December 2022) <https://eulawlive.com/op-ed-who-cares-about-financial-privacy-the-court-of-justice-in-wm-sovim-sa-v-luxembourg-business-registers-c-37-20-and-c-601-20-by-maxime-lassalle/>, accessed 31 January 2023.

¹⁴⁰ 'European Countries Begin Taking down Public Company Registers after Ruling' *Financial Times* (23 November 2022) <https://www.ft.com/content/e4b31a4e-a79d-40f7-8a19-c1e451a95c4b?desktop=true&segmentId=d8d3e364-5197-20eb-17cf-2437841d178a#myft:notification:instant-email:content>, accessed 24 November 2022.

¹⁴¹ UK Government, 'Factsheet: Economic Crime and Corporate Transparency Bill Overarching' [2023] GOV.UK <https://www.gov.uk/government/publications/economic-crime-and-corporate-transparency-bill-2022-factsheets/fact-sheet-economic-crime-and-corporate-transparency-bill-overarching>, accessed 31 January 2023.

¹⁴² Anthony Seely, 'Tax Avoidance and Tax Evasion' (House of Commons Library 2021) Commons Library Research Briefing 7948 <https://researchbriefings.files.parliament.uk/documents/CBP-7948/CBP-7948.pdf>, accessed 1 February 2023.

¹⁴³ Crown Dependencies are Jersey, Guernsey, and the Isle of Man], and Overseas Territories, including for instance the Cayman Islands, the British Virgin Islands, and Bermuda. See 'Tax Avoidance and Evasion - Debated on Tuesday 25 February 2020' (House of Commons 2020) 672, <https://hansard.parliament.uk/commons/2020-02-25/debates/7545B0D1-1D14-4296-843C-5CCB67A61A97/TaxAvoidanceAndEvasion>, accessed 31 January 2023.

jurisdictions nor in the list of high-risk third countries presenting strategic deficiencies in AML / CFT regimes.

Yet, in the UK, the estimated data points at around £10 billion lost due to tax fraud on an annual basis¹⁴⁴ while the data related to tax evasion remains uncertain¹⁴⁵. Actually, the estimates of tax evasion by UK residents are expected to be published in 2023 by HM Revenue & Customs that plans to calculate “a new standalone offshore tax gap”¹⁴⁶. In a report published in January 2023, the Committee of Public Account of the House of Commons considered that the UK government misses “the opportunity to recover billions in lost revenue by not resourcing compliance”¹⁴⁷.

The main challenge, also confirmed by some of the interviewees, is the limited institutional capacity (also affected by spending cuts and inflationary pressures)¹⁴⁸ and the limited international exchange of information after Brexit. This calls for stronger international cooperation, insofar as tax evasion becomes “much more complex, more sophisticated, more international and more digitally enabled” with the support of professional enablers¹⁴⁹. The other challenge concerns the timeline of the implementation of the public register in the Crown Dependencies and Oversea Territories by 2023¹⁵⁰. Once again, the above judgment of the Court of Justice of the EU (Joined Cases C-37/20 *Luxembourg Business Registers* and C-601/20 *Sovim*) may have adverse effects on the Crown Dependencies’ approach to access to BO registers,¹⁵¹ potentially using this judicial development.

Since January 2020, crypto-asset firms operating in the UK have been subject to the Money Laundering Regulations, and there was a recent consultation on implementing the Financial Action Task Force’s Travel Rule for transfers of crypto-assets. The UK is also playing a leading role in negotiations on the new OECD Crypto-asset Tax Reporting Framework¹⁵². Thom Townsend, executive director of Open Ownership, takes a rather positive view: “The UK’s corporate transparency regime, if new legislation passes to give Companies House the power to effectively verify the data it holds, could well be ahead of the EU”¹⁵³.

In summary, notwithstanding the politicians’ will to ease some regulatory burdens and have a more flexible principles-based regulation, with negative repercussion for AML and the fight against tax fraud and tax evasion, the changes in practice may be minimal. Furthermore, the independence of regulators

¹⁴⁴ ‘HMRC Heightens Focus on Professional Enablers of Tax Fraud, Says Top Official’ Financial Times (12 January 2023) <https://www.ft.com/content/2f89d48e-872c-46e0-96ba-4bb7c6bd8cc1>.

¹⁴⁵ ‘UK Admits It Has No Idea How Much Tax Is Being Evaded through Offshore Assets’ Financial Times (29 May 2022) <https://www.ft.com/content/a14162d0-0f65-4c63-842e-e0778516d03a>.

¹⁴⁶ ‘HMRC to Publish Estimates of UK Offshore Tax Evasion’ Financial Times (15 July 2022) <https://www.ft.com/content/00e7a52d-d85e-467c-b287-5d592b37035c>.

¹⁴⁷ House of Commons - Committee of Public Accounts, ‘HMRC Performance in 2021–22’ (House of Commons 2023) Thirty-Third Report of Session 2022–23 HC 686 <https://committees.parliament.uk/publications/33390/documents/182713/default/>.

¹⁴⁸ ‘UK Tax Agency Failing to Collect Billions in Revenue, MPs Warn’ Financial Times (11 January 2023) <https://www.ft.com/content/1e1f14d1-96a4-49f6-8e4a-aa55552123eb>.

¹⁴⁹ ‘HMRC Heightens Focus on Professional Enablers of Tax Fraud, Says Top Official’ (n 144).

¹⁵⁰ Crown Dependencies are Jersey, Guernsey, and the Isle of Man], and Overseas Territories, including for instance the Cayman Islands, the British Virgin Islands, and Bermuda. See ‘Tax Avoidance and Evasion - Debated on Tuesday 25 February 2020’ (n 143); ‘Progress against Dirty Money with Pledge from UK Crown Dependencies’ (Global Witness, 19 June 2019) <https://en/press-releases/progress-against-dirty-money-pledge-uk-crown-dependencies/>, accessed 31 January 2023.

¹⁵¹ States of Guernsey, ‘Statement of the Three Crown Dependencies Concerning Access to Registers of Beneficial Ownership of Companies’ (22 December 2022) <https://www.gov.gg/article/194495/Statement-of-the-three-Crown-Dependencies-concerning-access-to-Registers-of-beneficial-ownership-of-companies>, accessed 31 January 2023.

¹⁵² OECD, ‘Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard’ (OECD 2022) <https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf>.

¹⁵³ ‘European Countries Begin Taking down Public Company Registers after Ruling’ (n 140).

is embedded in the culture in the UK (see section 2.1.2) and for several of these issues, the UK is indeed part of global cooperation, which can be the adequate forum for standards setting.

3.1.6. Net zero and greening the financial system

Sustainable finance is a multi-sector component and coined under Environmental, Social and Governance (ESG) as per the UK Regulatory Initiatives Grid.¹⁵⁴

The UK government has stated the objective to be the ‘world’s first net zero-aligned financial centre’¹⁵⁵. This includes:

- Mandatory disclosure of transition plans. The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022¹⁵⁶ requires the largest UK-registered companies and financial institutions to disclose climate-related financial information on a mandatory basis in their strategic report from April 2022. In April, the UK Transition Plan Taskforce (TPT) was launched by HM Treasury to “develop the gold standard for private sector climate transition plans in the UK.”¹⁵⁷ In November 2022, it published a consultation paper including a new disclosure framework¹⁵⁸, the idea being that over 1,300 of the largest UK-registered companies and financial institutions will be required to disclose climate related financial information on a mandatory basis in line with TCFD recommendations, with first disclosures made in 2023; and
- A green financing programme was launched in 2021, with two inaugural green gilt issuances, raising a total of £16.1 billion and the world’s first retail Green Savings Bonds, raising a total of £0.3 billion. However, proceeds from these bond issues are not ringfenced, but the intention is to spend an amount equivalent to the cash raisings on eligible green expenditures.¹⁵⁹

The Chancellor of the Exchequer Jeremy Hunt announced an updated Green Finance Strategy to be published in early 2023, and a forthcoming consultation to bring ESG ratings providers within a regulatory ambit¹⁶⁰.

a. UK taxonomy vs EU taxonomy

The “Greening Finance: A Roadmap to Sustainable Investing”¹⁶¹, published in 2021 sets out that UK Green Taxonomy will adopt the EU’s six environmental objectives, including climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. However, the UK government is yet to release details, but some divergence is to be expected from the EU taxonomy.

¹⁵⁴ HM Treasury and others (n 112).

¹⁵⁵ HM Government (n 11) 49.

¹⁵⁶ The Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 [No. 31].

¹⁵⁷ TPT, ‘UK Transition Plan Taskforce Launches New “Gold Standard” for Best Practice Climate Transition Plans by Private Sector Firms’ (Transition Taskforce, 8 November 2022) <https://transitiontaskforce.net/uk-transition-plan-taskforce-launches-new-gold-standard-for-best-practice-climate-transition-plans-by-private-sector-firms/>, accessed 31 January 2023.

¹⁵⁸ TPT, ‘The Transition Plan Taskforce Disclosure Framework - Consultation Paper’ <https://transitiontaskforce.net/wp-content/uploads/2022/11/TPT-Disclosure-Framework.pdf>, accessed 31 January 2023.

¹⁵⁹ HM Treasury and UK Debt Management Office, ‘UK Green Financing – Allocation Report’ (2022) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1106352/11138-HHG-HMT-UK_Green_Financing_Allocation_Report_Accessible_2.pdf.

¹⁶⁰ HM Treasury, ‘Financial Services’ (n 12).

¹⁶¹ HM Treasury, ‘Greening Finance: A Roadmap to Sustainable Investing’ (2021) <https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing>, accessed 31 January 2023.

b. Global fora cooperation and remaining convergence

The UK government participates in several global fora. Specifically, the Bank of England is a member of the NGFS, a global network of central banks and supervisors with the objective to 'exchange experiences, share best practices, contribute to the development of environment and climate risk management in the financial sector, and to mobilize mainstream finance to support the transition toward a sustainable economy.' One of the four workstreams ('Monetary Policy') is chaired by a Bank of England staff member. Through its membership of the Bank for International Settlements (BIS) and the Financial Stability Board (FSB/Basel Committee), international organisations that have increasingly focused on climate change and green finance, authorities from the UK and from the EU are also cooperating and it is to be expected that some of this cooperation will result in convergence or – at a minimum – to limited divergence in this area.

The leading financial institutions in the UK are part of the Glasgow Financial Alliance for Net-Zero, launched in April 2021 by UN Special Envoy on Climate Action and Finance Mark Carney and the COP26 presidency, which aims at supporting the transition to a net-zero economy.

3.2. Scenarios about the future developments of UK financial regulatory framework

In the following, we develop different scenarios of the potential evolutions of financial services sub-areas in the short to medium term: Over six years after the Brexit referendum and almost three years after leaving the EU, discussion on the degree of general divergence of UK legislation and regulation is still ongoing in the UK, with periods of bullish push for divergence (under Liz Truss' short premiership) quickly iterating with periods of much closer collaboration between UK and EU (including the 'Swiss' model that showcases closer trade interactions, see section 2.2.1). Making predictions on future divergence in the financial sector, therefore, seems rather pointless. Rather, we focus on different possible scenarios on the basis of the recent and prospective evolutions observed in UK financial services regulation (sections 2 and 3.1).

There is also a clear tug of war between the political imperative of strengthening the competitiveness of the UK financial centre and the regulatory objective of financial stability, as already discussed above. There was a plan to introduce the power of government to overrule regulatory authorities in the Financial Services and Markets Bill, but this provision has been dropped since November 2022. The political imperative is also reflected in providing the regulatory authorities with additional objectives, including international competitiveness. On the other hand, this has led to push-back from regulatory authorities. Ultimately, as pointed out by one of our interviewees, a focus on international competitiveness might introduce a bias towards large incumbent players.

As already discussed in section 2.1.1, divergence of the UK can happen actively or passively: i.e., actively, with UK changing existing rules or adopting new rules that are different from what the EU is adopting, and negatively, with the EU changing existing rules that have been retained so far under UK law and the UK not adjusting their rules accordingly. Unlike in the case of the Single Market (including Iceland, Liechtenstein and Norway as part of the European Economic Area, EEA) where dynamic adjustment is taking place, i.e., adjustment of national rules implementing EU rules, divergence between the EU and the UK is all but to be expected in the next few years. The question is thus not whether but how much divergence we will see, beyond the sunset date which might be adopted in the REUL Bill (see section 2.3.1).

The main challenges are, if such divergence simply reflects differences in financial market structures and regulatory/supervisory tools and instruments as well as with a principles-based approach, or a

more fundamental shift towards a less regulated financial system that focuses on growth and 'competitiveness' of the sector and less on its stability. It is important to stress, however, that not all observers, and none of our interviewees, see necessarily a contradiction between growth/competitiveness and stability, even though economic research has shown that rapid growth of the financial sector can result in financial fragility and crisis.

3.2.1. Low, medium and high divergence

Low divergence: Under this scenario, there will be adjustments to regulations such as Solvency II as well as other initiatives in line with increasing the 'competitiveness' of the UK as financial centre. However, there will not be major divergence, especially in areas with international standards, such as bank capital regulation. There might be informal consultations between UK and EU regulatory and possibly legislative authorities to converge on rules in new areas such as crypto and the decentralised financial system more generally. Even under the politically most positive developments (as described below in 3.2.2), however, there will be divergence between the UK and EU, also as EU Law is significantly amended with the UK not following it (in other words, passive divergence).

Regulatory cooperation, however, will allow for such divergence not to turn into beggar-thy-neighbour policies. Apart from resolving the political conflict around the Northern Ireland Protocol (NIP), a reconfirmation of the stability focus of the prudential policies and regulation in the UK is necessary in our opinion. In terms of specific segments of the financial system, we would expect least divergence in areas where international standards play an important role, such as capital and liquidity regulation of banks. Interestingly, it seems that the EU is diverging more from the initial global standards than the UK (see discussion above in 3.1). Similarly, given the early initiative that EU authorities have taken with the green taxonomy and the joint participation in many global fora and other cooperation initiatives, we would also expect the UK to follow the lead in this area, as already discussed above, even though there might be a certain degree of divergence. It is important to stress that many of the legislative initiatives in sustainable finance in the UK are still in the early stages and one has to look beyond political headlines to details once they are spelled out.

Medium divergence: Under this scenario, there will be more significant divergence and fewer attempts to converge on new rules such as in the area of green finance or crypto asset developments. Divergence will be more likely and more prominent in areas where international standards are less important and where the UK has not inherited any EU regulations such as in the two areas already mentioned, green finance and crypto. While supervisory cooperation between EU and UK authorities might continue (and will be necessary in areas of regulatory equivalence), regulatory cooperation even if formalised will be less strong and there will not necessarily be any voluntary attempt by UK authorities to follow adjustments and changes in EU regulation and supervision. On the other hand, both the UK and the EU are members of global regulatory bodies across different segments of the financial system (FSB, Basel Committee) and this will effectively be a constraint on too much positive or negative divergence.

High divergence: Under this final scenario, there would be a rather aggressive legislative and regulatory drive in the UK to diverge from EU rules. This would involve both replacing existing EU rules with new regulation and adopting divergent rules where such rules were not inherited, such as in green finance and crypto/digital finance more broadly. It can also include not following changes in EU legislation to thus mark differences between the two regulatory jurisdictions. We would expect such aggressive divergence especially in areas where UK authorities see growth opportunities and they feel less constrained by international fora and cooperation initiatives. Crypto is certainly an area where one could envision such aggressive divergence. Such high divergence, however, seems more likely under

an institutional architecture in the UK where the independence of regulatory authorities has been significantly weakened (though not necessarily in a formal, i.e., legislative manner) and growth/competitiveness objectives are clearly prioritised over stability concerns.

As we will discuss in section 3.2.2, which of the three scenarios will develop depends very much on how the overall political relationship between the EU and the UK will develop over the next years, with the Northern Ireland Protocol being the major hurdle in this relationship.

3.2.2. Disentangling the Northern Ireland Protocol situation to unblock/reactivate UK-EU regulatory cooperation

Resolving the dispute between the UK and the EU on the implementation of the Northern Ireland Protocol (NIP) seems key to rebuild trust and unblock UK-EU regulatory cooperation across a number of policy areas including the financial sector. Resolving this dispute requires political leadership from the UK Prime Minister taking office in October 2022, Rishi Sunak, and bringing on board both the European Research Group (ERG) of hardcore Brexiters in the British Parliament and Northern Ireland's Unionists, not an easy feat. While immediate conflicts can be avoided by delaying the legislative process of the NIP Bill (which would override and breach the NIP and the Withdrawal Agreement), cooperation between UK and EU authorities on trade data provision from the UK to the EU, and not taking unilateral steps, the resolution of the 'stand-off' cannot be delayed forever. Namely, the Northern Ireland Executive has not been established since the 2022 May elections and new elections to the Legislative Assembly will have to be called in spring 2023, which raise the political temperature in the region. The upcoming 25th anniversary of the Good Friday Agreement in 2023 increases both internal and external (especially from the US) pressures. Finally, in case of increasing divergence in goods standards between the UK and the EU, there will be increasing pressure from the EU on properly monitoring trade between Great Britain and Northern Ireland.

In case the conflict around the Northern Ireland Protocol can be resolved to the satisfaction of both sides, there should be few if any barriers for future cooperation between UK and EU authorities on financial sector issues. Addressing the stand-off around the NIP is thus a necessary though not sufficient condition. At the end of November 2022, the Council Presidency and the European Parliament actually reached a provisional agreement on a Regulation on 'autonomous measures' potentially taken as a retaliation and that would allow the EU to ensure 'timely and effective exercise of its rights in enforcing and implementing' the Withdrawal Agreement and the TCA¹⁶². At the same time, not long after, the European Commission Vice President Maroš Šefčovič stressed the 'window of opportunity for a positive outcome'¹⁶³ in the context of the extension of practical arrangements for veterinary medicines until December 2025. This positive 'mood music' has been echoed by Leo Varadkar, the Taoiseach in Ireland, who stressed the increased trust and flexibility between the UK and the EU – notwithstanding remaining differences¹⁶⁴. There will certainly be competing interests (similar to what we could observe during the UK's EU membership) and no expectations of complete convergence, but an institutional framework for regulatory dialogue could be put in place.

¹⁶² Council of the EU, 'EU-UK Relations: Council Presidency and European Parliament Reach Provisional Agreement on a Regulation on Autonomous Measures' (30 November 2022) <https://www.consilium.europa.eu/en/press/press-releases/2022/11/30/eu-uk-relations-council-presidency-and-european-parliament-reach-provisional-agreement-on-a-regulation-on-autonomous-measures/>, accessed 5 January 2023.

¹⁶³ 'Statement by Vice-President Maroš Šefčovič' (European Commission, 19 December 2022) https://ec.europa.eu/commission/presscorner/detail/en/statement_22_7831, accessed 5 January 2023.

¹⁶⁴ "Much Better Mood Music" in EU-UK Relations than at Any Period since Brexit Referendum - Taoiseach' (n 22).

Before the resolution of this conflict, it is difficult to see any progress happening in terms of regulatory cooperation. Similar, if the conflict around the NIP escalates again, it is hard to envision any progress towards trade partnership of the UK with third countries such as the US.

4. OPTIONS FOR THE EU FACING UK REGULATORY AND POLICY DIVERGENCE

KEY FINDINGS

We analyse the possible implications of the regulatory developments in UK financial services regulation (as discussed in sections 2 and 3 above) for the EU approach to equivalence. The UK is a third country and therefore subject to the existing provisions in EU financial services and banking regulation that may provide for equivalence with third country regimes. Equivalence may give access to the EU market and foster cross-border activities. Indeed, the negotiations between the EU and the UK led to the assumption that activities or sectors not covered by the TCA may be settled through equivalence. With such an approach, equivalence is limited in its scope with a focus on specific activities. In the EU, this is a sectoral approach and the equivalence applicable to the UK in the financial services area has been minimal since its departure from the EU, with only one equivalence for UK Central Clearing Counterparties.

The EU equivalence regime is part of the EU acquis. A number of EU legal acts provide for specific rules that may grant third country equivalence, not all activated in practice. These provisions exist in specific sectors in EU financial services: banking, insurance and reinsurance, retail markets and wholesale financial markets. These are the sectors covered by equivalence in the EU Single Rulebook (albeit with some limitations). Equivalence objectives resemble to some extent the regulatory and supervisory objectives discussed before, i.e. investor protection, market stability, and market efficiency/integrity.

The EU's approach to equivalence is restrictive towards the UK financial services' sector. Actually, the EU treatment of UK CCPs equivalence may become even more stringent than it used to be, following the European Commission legislative package for further developing the Capital Markets Union (with one act in the area of clearing) in December 2022. To be sure, this initiative aims at developing EU infrastructures for ensuring an internal EU clearing capacity. In the meantime, an extension of CCPs equivalence to third-countries worldwide demonstrates the EU effort to redirect clearing beyond the UK while the EU works on building its own infrastructures. This trend corresponds to a will to diversify and move away from a heavy reliance on specific third-country CCPs including the UK CCPs. This is fully in line with the EU's commitment to integrated financial markets and international standards.

Overall, EU's approach to equivalence have the following features: discretionary, dynamic, contingent, and relying on reciprocity. These features stem from the ongoing adaptation of equivalence regimes, which justifies unilateral changes by the European Commission. It leads to uncertainty, which is a policy and legal issue that is at odds with the preferences of the industry participants for legal certainty and predictability. However, the practice shows some prior engagement with third countries, which may partly alleviate the issues raised by a unilateral equivalence withdrawal. One of the challenges, shared by both the UK and the EU, is to safeguard their regulatory autonomy, which might be in tension with seeking reciprocity in equivalence.

Against this backdrop, this section elaborates on the types of equivalence and potential scenarios for future equivalence granted to the UK. The EU may adopt different types of equivalence: (i) scope-limited and time-bound equivalence; (ii) scope-limited, also called partial equivalence, (iii) conditional equivalence, and (iv) provisional equivalence.

On the same logic as for regulatory developments, we propose scenarios for the future development of EU equivalence:

- no equivalence (once the current CCPs' equivalence lapses and without any extension),
- no additional equivalence (should the CCPs equivalence be further extended beyond June 2025),
- a bundle of equivalence,
- a furnished and unlimited equivalence regime (that we consider unlikely).

Despite its versatile nature, the granting of equivalence sets and frames (temporarily) a higher degree of integration between the EU and the third countries benefiting from it by favouring cross-border activities and market access (to some extent).

But, the equivalence regime is not without its limits. The exclusion of equivalence from some EU regulatory areas and the inadequacy of third countries' regulatory regime raise challenges. Indeed, equivalence is not always 'fit for every purpose', with issues arising when third countries do not have any, or have less effective regulatory and supervisory frameworks than the EU.

Considering the limits of the equivalence regimes in EU financial services and banking regulation, equivalence is only one route available among others to build a functional and efficient connection between the EU and the UK in this area. Other forms of more stable and encompassing regulatory alignments can and should be considered. To be sure, alternatives to equivalence exist, for instance, cooperation frameworks, regulatory forums, and trade agreements (discussed in section 2).

The study elaborates on the potential EU cross-border regulatory interactions with third countries in section 4.1. Moreover, the study examines the EU's current approach to equivalence decisions, including the equivalence granted to the UK and the recent tightening of equivalence observed in some legislative proposals put forward by the European Commission in section 4.2. It also considers, on the basis of reciprocity, the equivalence granted by the UK itself¹⁶⁵. Section 4.3 discusses options for an EU-UK equivalence regime which safeguards financial stability and guarantees a level playing field. These objectives, namely financial stability vs competition, could be in tension. A dilemma between financial stability and competition in financial regulation played out after the Global Financial Crisis (but before the Brexit referendum) as observed in the EU's equivalence regime developed with third countries¹⁶⁶. In essence, equivalence can be granted only in scenarios where there is low or no regulatory divergence of UK financial services regulation with the EU regulatory framework. Building upon scenarios drawn under section 3.2, this gives already a sense of the limited options available in the financial services area.

¹⁶⁵ HM Treasury, 'Equivalence Decisions for the EEA States' [2020] Policy paper <https://www.gov.uk/government/publications/hm-treasury-equivalence-decisions-for-the-eea-states-9-november-2020/hm-treasury-equivalence-decisions-for-the-eea-states-9-november-2020>, accessed 4 August 2022.

¹⁶⁶ Lucia Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in the European Union' (2015) 38 *West European Politics* 167.

4.1. EU cross-border regulatory interactions with third countries

Cross-border activities between the EU and third countries are regulated with different degrees of alignment (at statutory/regulatory level) and regulatory cooperation across jurisdictions. Regulatory interactions take place within different political and legal systems, as in this case the EU and the UK as third country, keeping in mind the importance of global fora and international cooperation in the financial services area (see in particular sections 3.1.1. and 3.1.7 above).

Alternative regulatory approaches to the activation of equivalence regimes for third country can include:¹⁶⁷

- remaining national treatment;
- granting exemptions (which may go through equivalence decisions too);
- passporting (with some underlying agreements, e.g. a common market area as formerly the EU Single Market for the UK, or the Asia Region Funds Passport initiative); and
- international agreements (e.g.: EU-Switzerland Non-Life Insurance Agreement and the recently concluded EU-US Covered Agreement on Insurance and Re-insurance).

Furthermore, alternative routes within the EU legal order may exist for granting third country firms market access, either to the EU Single Market or Member States' markets (see Table 6). These routes require the establishment of new legal entities either as subsidiaries in the Single Market, which can access the EU Single Market then, or third country branches authorised in EU Member States. The supervisory and regulatory framework of third country branches is under legislative review following the 2021 Banking Regulation Package from the European Commission, which could lead to re-authorisation of already established branches by the competent ESAs following amendments to Title VI of the CRD.

¹⁶⁷ European Commission, 'Commission Staff Working Document on EU Equivalence Decisions in Financial Services Policy: An Assessment' (European Commission 2017) SWD(2017) 102 final 6 https://finance.ec.europa.eu/system/files/2017-02/eu-equivalence-decisions-assessment-27022017_en.pdf, accessed 21 November 2022.

Table 6: “Routes” to access EU/Member States market

	Access to the whole EU market		Access to Member States’ market (national)	
	Equivalence	Legal entity	Third country branch (TCB)	National Regime
Banking (lending, deposit taking)	No	Need to access the EU market	Possible authorisation required	Not specified in EU legislation
Investment services	Yes	Needed in the absence of equivalence to access the EU market	Possible authorisation required	Not specified in EU legislation (but no TCB more favourable treatment)
Alternative Investment Fund	Yes		Possible authorisation required	Marketing possible (national and EU Laws)
Market Infrastructure (EMIR)	Yes ESMA recognition (CCPs and Trade repositories)		Not specified in EU legislation	Not specified in EU legislation
Credit Rating Agencies	Yes ESMA certification		Not specified in EU legislation	Not specified in EU legislation
Central Securities Depositories	Yes ESMA recognition		Possible, specific CSDR requirements	Possible
Trade Repositories	Yes ESMA recognition		Not specified in EU legislation	Not specified in EU legislation
Financial Benchmarks	Yes ESMA register / Member State recognition		Not specified in EU legislation	Not specified in EU legislation

Source: Adapted from EGOV Briefing (2019)¹⁶⁸.

¹⁶⁸ J Deslandes, C Dias and M Magnus, ‘Third Country Equivalence in EU Banking and Financial Regulation’ (2019) PE 614.495 EGOV In-depth analysis.

4.2. EU equivalence regime

During the UK's EU membership, UK financial services firms used to be able to access the EU market simply on the basis of an authorisation from the UK competent authorities, BoE, PRA and FCA, allowing them to avoid duplications of authorisation and supervisory-regulatory requirements, for instance reporting requirements. Since Brexit, the EU financial services 'passport' is no longer accessible¹⁶⁹ and UK firms must be authorised in each EU Member State to provide services in jurisdiction where they intend to operate. Two routes have been open and used: establishment in the EU's single market and the EU equivalence regime, i.e., the potential decision by the European Commission that the UK regulatory/supervisory framework is equivalent to those of the EU in some financial services sectors (so far granted only for clearing services, as we will see).

During the negotiations of the TCA, the UK suggested a bespoke regime in financial services to guarantee its regulatory autonomy. Indeed, in case of ongoing alignment between the two jurisdictions to maintain equivalence, regulatory autonomy is at least partly lost¹⁷⁰. This bespoke regime would have focused on regulatory outcomes, in line with the rationale of a principles-based approach (see section 2.3). Such an approach differs from what is currently applicable, even at a minimal level, with equivalence of detailed rules among legal orders. Theresa May stressed at that time the need for a 'collaborative, objective framework that is reciprocal, mutually agreed, and permanent'¹⁷¹. However, this suggestion did not make it into the final agreement due to firm opposition of the EU.

EU-UK relationships in financial services can be shaped by (functional) regulatory cooperation and equivalence granted by each party, within the current and upcoming regulatory reforms in the UK and in the EU. We consider the adoption of an equivalence regime as a potential effective solution¹⁷² even though it cannot be the only element in the respective strategies setting and framing the UK-EU relationships in financial services¹⁷³. Alternatives or additions to an equivalence regime include a regulatory forum (also used by the EU and US and the UK and Japan as examined above) and the still to be signed MoU as basis for broader cooperation. To be sure, the idea of a UK-EU regulatory forum was proposed during the TCA negotiations. Once the MoU is signed and operational, the Joint UK-EU Financial Regulatory Forum should be established¹⁷⁴ with the explicit commitment 'to preserve financial stability, market integrity, and the protection of investors and consumers'¹⁷⁵. This forum might materialise rather sooner than later considering the rather positive political developments on both sides of the Irish sea at the end of 2022 and the beginning of 2023 (see section 3.2.2). Furthermore, the

¹⁶⁹ See earlier studies, e.g. Henning Berger and Nikolai Badenhoop, 'Financial Services and Brexit: Navigating Towards Future Market Access' (2018) 19 *European Business Organization Law Review* 679; Olha Cherednychenko, 'The UK's Potential Withdrawal from the EU and Single Market Access under EU Financial Services Legislation' (2017) IP/A/ECON/2016-13 In-depth analysis, European Parliament Economic Governance Support Unit; Christos V Gortsos, 'Potential Concepts for the Future EU-UK Relationship in Financial Services' (2017) IP/A/ECON/2016-20 In-depth analysis, European Parliament Economic Governance Support Unit.

¹⁷⁰ Moloney (n 28) 115, 126.

¹⁷¹ Theresa May, 'PM Speech on Our Future Economic Partnership with the European Union' (GOV.UK, 2 March 2018) <https://www.gov.uk/government/speeches/pm-speech-on-our-future-economic-partnership-with-the-european-union>, accessed 25 November 2022.

¹⁷² Eddy Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (2018) 4 *Journal of Financial Regulation* 209; Francisco Pennesi, *Equivalence in Financial Services - A Legal and Policy Analysis* (Palgrave Macmillan Cham 2022) <https://link.springer.com/book/10.1007/978-3-030-99269-9>, accessed 30 May 2022.

¹⁷³ See the opinion towards a fragmented UK strategy, Emil Năstegard, 'Equivalence Decisions in the EU and UK Financial Services Sectors Post-Brexit' (2022) 33 *European Business Law Review* 463, 473.

¹⁷⁴ HM Treasury, 'Technical Negotiations Concluded on UK – EU Memorandum of Understanding' (n 16).

¹⁷⁵ 'Joint Declaration on Financial Services Regulatory Cooperation between the European Union and the United Kingdom' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/948105/EU-UK_Declarations_24.12.2020.pdf, accessed 27 January 2023.

UK and the EU could activate some ‘ad hoc’ cooperation via political and diplomatic channels¹⁷⁶, to compensate, temporarily, for such ineffective regulatory cooperation in the financial services area.

Based on the stocktaking and different scenarios presented above (section 3.2.1), there are opportunities and risks for the EU to grant equivalence to the UK in the financial services sub-areas (as examined in section 3.1: the sectors of banking, insurance, wholesale markets and capital markets, FinTech and Digital Finance, green finance, and risks for AML and tax evasion). On the one hand, allowing equivalence and thus provision of financial services by UK based firms in the Single Market can have positive repercussions for market efficiency and competition. On the other hand, there are clear stability concerns, including concerns on data exchange, supervisory cooperation and cooperation during crisis situations. EU’s strategic autonomy would call for removing any EU dependence on the UK financial services sector as the UK will most likely not step in for the EU, should financial stability risks occur¹⁷⁷.

One specific challenge for European authorities is the treatment of clearing houses in London. On the one hand, there is the intention to build more clearing capacity within the EU, in particular with the legislative proposals from the European Commission in December 2022, on the other hand, there are financial stability concerns on having a large part of transactions be cleared outside the EU. Supervisory cooperation is therefore critical, but equivalence decisions are not exclusively driven by technical criteria but also by (legal/political) risks stemming from a scenario where such an equivalence would be withdrawn.

After outlining the EU’s current approach to equivalence, we discuss the two equivalence decisions that have existed since the UK withdrawal from the EU (for clearing and Central Securities Depositories). Possible equivalence options will emerge, based on some existing equivalence regimes with other third countries, and the UK equivalence regime. The scenarios will follow in section 4.3.

4.2.1. EU’s current approach to equivalence

Equivalence is determined by the European Commission, which assesses whether third countries’ rules have an ‘equivalent’ effect to EU rules. Equivalence has three distinctive features: at the **substantive level, in its enforcement, and in its reciprocity**¹⁷⁸. The first substantive level corresponds to the substance of the rules. The second feature of enforcement relies in particular on the supervisory and regulatory framework. The third examines to what extent the third country’s legal framework provides for reciprocal treatment (in the rules and, in the case of market access, in the access granted to EU firms). The European Commission publishes a list of the equivalence decisions taken (updated in October 2022)¹⁷⁹.

The EU equivalence policy has three objectives as stated in the European Commission’s 2019 policy document¹⁸⁰:

¹⁷⁶ European Affairs Committee (n 19) points 131-134.

¹⁷⁷ Andromachi Georgosouli and Rosa Maria Lastra, ‘Evidence to the European Affairs Committee on the UK-EU Relationship in Financial Services - EAC/21-22/128’ <https://committees.parliament.uk/writtenevidence/108489/html/>, accessed 5 January 2023.

¹⁷⁸ John Armour, ‘Brexit and Financial Services’ (2017) 33 Oxford Review of Economic Policy 554.

¹⁷⁹ European Commission, ‘Overview Table - Equivalence/Adequacy Decisions Taken by the European Commission’ https://finance.ec.europa.eu/document/download/013005aa-8040-4b1e-b518-bc76b5bb9ba7_en?filename=overview-table-equivalence-decisions_en.pdf, accessed 21 November 2022.

¹⁸⁰ European Commission, Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Equivalence in the Area of Financial Services 2019 [COM(2019) 349 final].

- to safeguard financial stability and investor protection, while reaping the benefits from open and globally integrated financial markets;
- to promote regulatory convergence (with international standards); and
- to guarantee supervisory cooperation with third countries.

It is important to note that equivalence decisions may grant access to third-country firms in the EU Single Market, e.g. investment firms with MiFID II, but the purposes of equivalence are primarily geared towards prudential regulation and to reduce or eliminate compliance overlaps¹⁸¹. The latter benefits cross-border activities and the functioning of the EU Single Market in financial services. The European Commission bases its decisions on the principle of proportionality and a risk-based assessment to grant equivalence,¹⁸² but there is some degree of unilateralism and discretion. Decisions related to equivalence for financial services are ‘unilateral decisions of the EU and are not subject to negotiation’ as stressed in an explainer of what the TCA covers and, indeed, does not include within its scope¹⁸³. Therefore, the EU’s current approach to equivalence is not only **discretionary in essence to activate or revoke such equivalence**, but also **contingent, limited in scope (sometimes in time) and requiring reciprocity** (see section 4.3.3). Equivalence decisions may also include conditions or limitations.

In EU Law, equivalence is pre-determined in the Single Rulebook, in particular as provided by level 1 Acts in the Single Rulebook and sector legislation in the European System for Financial Supervision (ESFS), e.g. in the CRR, MiFID II, and MiFIR. Box 1 lists the legal acts that have provisions for existing/applicable equivalence with third countries. Indeed, some equivalence regimes have not yet been activated, e.g. in the case of Alternative Investment Funds (AIF), and of investment services provided for professional clients¹⁸⁴ (left outside this list), even if they are provided under EU secondary legislation.

Moreover, the following acts have a specific regime with provisions existing for equivalence: namely, Alternative Investment Fund Managers Directive (AIFMD) for professional investors, clearing services with the equivalence regime reviewed by EMIR 2.2¹⁸⁵, and investment services for professional clients. While clearing services are covered by some equivalence decisions granted to third countries and still applicable to the UK (see sections 4.2.2 and 4.3.2), the equivalence provisions for AIFMD and investments services for professional clients have not yet been activated. They would matter for the UK as these are key services/actors in its financial services sector. It would lead to grant access to the EU internal market to AIF or investments services firms (provided to professional clients) without requiring the establishment of legal entities or branches. Under AIFMD, third country firms would need a legal representative¹⁸⁶. But, it is unlikely that the EU would grant such equivalence to the UK anytime soon (see section 4.3.3).

¹⁸¹ European Commission, ‘Commission Staff Working Document on EU Equivalence Decisions in Financial Services Policy: An Assessment’ (n 167) 5–6.

¹⁸² *ibid* 10.

¹⁸³ European Commission, ‘EU-UK TCA: A New Relationship, with Big Changes’ 2 https://ec.europa.eu/info/sites/default/files/brexit_files/info_site/6_pager_final.pdf, accessed 25 November 2022.

¹⁸⁴ Deslandes, Dias and Magnus (n 168) 5.

¹⁸⁵ Regulation (EU) 2019/2099 of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs 2019 (OJ L).

¹⁸⁶ Article 37 (3) AIFMD provides that ‘A non-EU AIFM intending to obtain prior authorisation as referred to in paragraph 1 shall have a legal representative established in its Member State of reference’.

Box 1: List of EU legal acts providing for third countries equivalence regimes

- Accounting Directive
- Audit Directive
- Benchmarks Regulation
- Capital Requirements Regulation (CRR)
- Central Securities Depositories Regulation (CSDR)
- Credit Rating Agencies Regulation
- EMIR II
- Market Abuse Regulation (MAR)
- Markets in Financial Instruments Directive (MiFID II)
- Markets in Financial Instruments Regulation (MiFIR)
- Prospectus Directive
- Solvency II Directive
- Transparency Directive

Source: European Commission, [Equivalence of non-EU financial frameworks](#) (2022).

Most often, equivalence provisions require a technical assessment or an opinion from the ESAs. Such technical assessment inform the adoption of the equivalence decisions by the European Commission. This split between the agencies of the ESFS and the European Commission is explained by the exercise of the discretionary power by the latter. The European Commission adopts level 2 legal acts in the Single Rulebook¹⁸⁷ (see Figure 3) in the form of an implementing act or a delegated act (as determined in EU secondary law). It activates or revokes equivalence regimes discretionarily.¹⁸⁸

It must be noted that the 2019 ESAs Review reinforced the monitoring of equivalence (granted to third countries) by the three ESAs in their respective area of competences, i.e. in banking, insurance/pension and financial markets¹⁸⁹. In particular, the ESAs monitor the third countries' regulatory and supervisory developments as well as the enforcement, and market developments¹⁹⁰ (see section 4.3.2. with an example of withdrawal of Indian CCPs recognition, following a negative assessment by ESMA).

¹⁸⁷ For its application in the Banking Union, see Christy Ann Petit, 'Differentiated Governance in the Banking Union: Single Mechanisms, Joint Teams, and Opting-Ins' (2022) 2022 7 European Papers - A Journal on Law and Integration 889, 891, 893.

¹⁸⁸ Deslandes, Dias and Magnus (n 168).

¹⁸⁹ Article 33 Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds 2019 (OJ L).

¹⁹⁰ Article 33(3) *ibid.*

Figure 3: Acts in the three-level Single Rulebook

<i>Single Rulebook</i>	Level 1: EU directives and regulations
	Level 2: delegated and implementing acts, and technical standards
	Level 3: guidelines and recommendations, Q&As

Source: Authors' own elaboration.

The European Commission publishes the list of equivalence decisions, which is regularly updated¹⁹¹. However, modifications to applicable equivalence are neither highlighted nor explained. The European Commission should do so in a separate document to improve transparency and traceability of the evolution in the equivalence of non-EU financial frameworks overtime, with a more dynamic representation.

4.2.2. Unique equivalence granted towards UK Central Clearing Counterparties and former Central Securities Depositories-related equivalence

In terms of principle, part of the regulatory framework in force in the UK is deemed (*temporarily*) equivalent to those of the EU. In practice, one equivalence expired for Central Securities Depositories (CSDs) and one equivalence has been extended for UK-based CCPs, which is a very thin recognition of equivalence between the EU and the UK in the field of financial services. Only for a short period have UK CCPs and CSDs been able to clear and settle euro-denominated derivatives/securities. Moreover, on 7 December 2022, the European Commission published a proposal in the area of clearing, which is part of a comprehensive package to further develop CMU, and seems to be tightening its approach to grant equivalence in the area of clearing (see section 4.2.3).

First, one temporary equivalence was granted for CSDs for the settlement of (mainly Irish) securities but, this equivalence was only applicable until 30 June 2021¹⁹². The objective of this temporary equivalence was to ensure the migration of Irish corporate securities and exchange-traded funds from the UK's securities settlement system operated by Euroclear UK and Ireland (CREST - Certificateless Registry for Electronic Share Transfer) to Euroclear Bank, a CSD in Belgium.

Second, the UK regulatory and supervisory framework applicable to UK-based CCPs has been considered equivalent in accordance with the European Market Infrastructure Regulation No 648/2012 (EMIR Regulation). In other words, the UK legal and supervisory arrangements applicable to CCPs already established and authorised in the UK on 31 December 2020 are considered equivalent to EMIR requirements (as per Article 1 of the equivalence decision). Central clearing is considered to play a key role in increasing market transparency, mitigating credit risks, and reducing contagion should one of the participants in the CCP default.

This equivalence has been granted to UK CCPs for a limited time, with a number of extensions made between 2018 and 2022 to safeguard financial stability. The European Commission granted equivalence for the use of UK clearing houses for euro-denominated derivatives transactions for a limited period of time in December 2018 at a time when there was risk of a no deal Brexit, namely until

¹⁹¹ European Commission, 'Overview Table - Equivalence/Adequacy Decisions Taken by the European Commission' (n 179).

¹⁹² Commission Implementing Decision (EU) 2020/1766 of 25 November 2020 determining, for a limited period of time, that the regulatory framework applicable to central securities depositories of the United Kingdom of Great Britain and Northern Ireland is equivalent in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council 2020 (OJ L).

30 March 2020¹⁹³. This equivalence decision was renewed twice, in April 2019 and in December 2019¹⁹⁴, following the UK request for an extension under Article 50 TEU. Initially applicable until the end of June 2021¹⁹⁵, equivalence runs now until 30 June 2025¹⁹⁶, following the February 2022 extension.

This remaining unique equivalence is **time-limited, despite several extensions**, and exhibits the **essence of EU equivalence, i.e. temporary regulatory alignment** (see further analysis in section 4.3). The last extension aimed to avoid a ‘cliff-edge’ scenario, as stated by Commissioner McGuinness in November 2021, and to ensure financial stability in the short term. As stated in the equivalence decision itself, the market for central clearing is highly concentrated (in particular, for OTC derivatives, at the end of December 2020, 90% of euro-denominated OTC interest rate derivatives were cleared in one single UK CCP, SwapClear, which is a clearing service of LCH Ltd¹⁹⁷). In contrast, there is limited participation in the EU CCPs, which leads to a greater liquidity at UK CCPs¹⁹⁸. In practice, ESMA has recognised three UK CCPs: ICE Clear Europe Ltd, LCH Ltd (both Tier 2 CCPs) and LME Clear Ltd (Tier 1 CCP), the first two being of a systemic nature¹⁹⁹. Following the last extension of the European Commission equivalence decision, ESMA extended its recognition decisions for these three CCPs²⁰⁰.

The EU affirmed its objective to develop its clearing capacity thanks to the CCP equivalence extension²⁰¹ (see also section 4.2.3) and to find measures to reduce the markets participants’ exposures to systemic UK CCPs. This also led to an upgrading of equivalence decisions granted to additional third countries’ CCPs in 2022 (section 4.3.2).

¹⁹³ Commission Implementing Decision (EU) 2018/2031 of 19 December 2018 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council 2018 (OJ L).

¹⁹⁴ Commission Implementing Decision (EU) 2019/544 of 3 April 2019 amending Implementing Decision (EU) 2018/2031 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council 2019 (OJ L); Commission Implementing Decision (EU) 2019/2211 of 19 December 2019 amending Implementing Decision (EU) 2018/2031 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council 2019 (OJ L).

¹⁹⁵ Commission Implementing Decision (EU) 2020/1766 of 25 November 2020 determining, for a limited period of time, that the regulatory framework applicable to central securities depositories of the United Kingdom of Great Britain and Northern Ireland is equivalent in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council.

¹⁹⁶ Commission Implementing Decision (EU) 2022/174 of 8 February 2022 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council 2022 (OJ L).

¹⁹⁷ European Commission, Commission Staff Working Document Impact Assessment Report Accompanying the Documents Proposal for a Regulation of the European Parliament and of the Council Amending Regulations (eu) No 648/2012, (EU) No 575/2013 and (eu) 2017/1131 as Regards Measures to Mitigate Excessive Exposures to Third-Country Central Counterparties and Improve the Efficiency of Union Clearing Markets and Proposal for a Directive of the European Parliament and of the Council Amending Directives 2009/65/EU, 2013/36/EU and (EU) 2019/2034 as Regards the Treatment of Concentration Risk Towards Central Counterparties and the Counterparty Risk on Centrally Cleared Derivative Transactions 2022 [SWD(2022) 697 final] 112.

¹⁹⁸ *ibid* 18, 112.

¹⁹⁹ ESMA, ‘List of Third-Country Central Counterparties Recognised to Offer Services and Activities in the Union ESMA70-152-348’ https://www.esma.europa.eu/sites/default/files/library/third-country_ccps_recognised_under_emir.pdf, accessed 29 November 2022.

²⁰⁰ Recognition decisions initially adopted on 25 September 2020 ESMA Press release, ‘ESMA Extends UK CCPs’ Recognition Decisions’ (25 March 2022) <https://www.esma.europa.eu/press-news/esma-news/esma-extends-uk-ccps%E2%80%99-recognition-decisions>, accessed 29 December 2022.

²⁰¹ See Recital 20: The equivalence decision expiry to June 2025 should give ‘enough time for the development of the clearing capacity of Union CCPs, exploring ways to enhance liquidity in those CCPs and to expand the range of clearing solutions on offer from Union infrastructures’ Implementing Decision (EU) 2022/174.

4.2.3. European Commission Proposals: a tightening of equivalence recognition for clearing provided by third countries

An EU central clearing capacity would allow to disconnect from third countries' CCPs but would require the development of EU infrastructures within the Single Market. While it is easy to envision a stable equilibrium with most of transactions being cleared in the euro area, a transition process is characterised by a number of significant risks related to the migration of actors from the UK to the EU and cliff-edge effects. It might be hard to envision a replication of the necessary infrastructure within a few years. As we have seen, the objective to reduce significantly EU clearing members' exposures to UK CCPs is expressly stated in the temporary equivalence decision²⁰².

And while the EU can take 'unilateral' steps to force clearance of euro-denominated securities into the Single Market (with Japan having taken similar actions some time ago) interviewees pointed to the economic costs of such a step. In the transition period and until capacity and size are developed in EU internal clearing, there might be higher costs for market clearing in the EU and ultimately, this will increase the costs of financial service provision in the EU Single Market. Many of our interviewees also pointed to the difficulty of market players willing to give up on scale economies achieved in London and move to a new market place even if all the necessary infrastructure is in place.

The development of EU internal clearing capacity is at the core of new EU legislative proposals. The main policy objectives of the proposals adopted by the European Commission in December 2022 are (i) to ensure the attractiveness of EU clearing (with an expansion of the products and incentivising EU market participants), (ii) to guarantee safe and resilient clearing system by strengthening the EU supervisory framework for CCPs, and (iii) to reduce excessive exposures of EU market participants to CCPs in third countries, in other words, to disconnect from these external CCPs. The third objective would lead to change in the medium term the CCPs equivalence granted so far to third countries (see below section 4.3.2.), and represent a tightening of equivalence in this specific area of the financial sector.

In putting forward this new legislative package, the European Commission has confirmed the **temporary character of the regulatory alignment with the UK**: 'it is assumed that equivalence for the UK remains until it expires on 30 June 2025: as such, it is assumed that the regulatory framework of the UK will remain aligned with EMIR until 2025'²⁰³. This shows how equivalence is intrinsically a temporary mechanism. Furthermore, the option of a permanent equivalence for UK CCPs has been discarded due to its inconsistency with financial stability concerns and the EMIR legal framework²⁰⁴.

4.3. Options for an EU-UK equivalence regime

The options for an EU-UK equivalence regime are based on the analysis of the EU's approach to equivalence granted to other third countries, including in the area of CCPs. Several legal and policy issues will be considered, including reciprocity with the current status of UK equivalence, before discussing the potential scenarios for granting equivalence to the UK. Considering the observations of the state of play of UK financial services regulation, the ongoing developments and potential regulatory divergence scenarios developed in section 3, we take the view that equivalence will be for the few, not for the many, in the financial services sector.

²⁰² Recitals 7, 8 and 20 *ibid*.

²⁰³ European Commission Commission Staff Working Document Impact Assessment Report (n 197) 23.

²⁰⁴ See Annex 6 *ibid* 32, 114.

4.3.1. Third countries' equivalence: overview of objectives in equivalence

Equivalence regimes are based on EU Law secondary legislation, i.e. specific legal acts in EU Financial and Banking Regulation (Single Rulebook level 1, see above 4.2.1). In other words, the provisions found in equivalence decisions are 'tailored'²⁰⁵ to the needs of such legal acts and must be applied and interpreted in the light of the objectives stated in this EU secondary legislation, themselves based on EU primary sources.

It is pointless to state each and every objective from such legal acts considering their number. However, the **objectives of contributing to the establishment and functioning of the internal market, market integrity, investor protection and safeguarding financial stability** are common to these acts. Legal acts provide for rules that may grant third country equivalence; however, this is an option as such rules have not been all activated, as we have seen in section 4.2.1. These provisions exist in specific sectors in EU financial services as introduced above: banking, insurance and reinsurance, retail markets, and wholesale financial markets, including Prospectuses, Credit ratings, Derivatives (albeit with some limitations for some of these for the concerns discussed under section 4.1). At the level of the ESAs, their monitoring responsibilities in equivalence focus on the implications for financial stability, market integrity, investor protection and the functioning of the internal market²⁰⁶.

4.3.2. CCPs equivalence granted by the European Commission to third countries other than the UK

The diversity and increasing number of equivalence for recognised third-country CCPs reflects the EU's commitment to both integrated financial markets and international standards²⁰⁷. There is a willingness to diversify and move away from a heavy reliance on specific third-country CCPs, including in the UK. Overall, there are 56 CCPs authorised or recognised under the EMIR framework for clearing worldwide, according to data combined from ESMA's list of EU CCPs and third-country CCPs, and the impact assessment from the European Commission in the area of clearing (EMIR review)²⁰⁸.

We provide some data on equivalence adopted for recognised third-country CCPs. The Commission reviewed its equivalence to US CCPs so that CCPs registered with the US Securities and Exchange Commission (SEC) can provide central clearing services in the EU Single Market²⁰⁹. In June 2022, it also granted equivalence for CCPs in Chile, China, Malaysia, Indonesia and Israel, and amended existing equivalence decisions for South Africa and India²¹⁰. Equivalence was granted in September 2022 to

²⁰⁵ European Commission, 'Commission Staff Working Document on EU Equivalence Decisions in Financial Services Policy: An Assessment' (n 167) 7.

²⁰⁶ Article 33(3) Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds.

²⁰⁷ European Commission Commission Staff Working Document Impact Assessment Report (n 197) 112.

²⁰⁸ ESMA, 'ESMA List of Third Country CCPs' (n 199); ESMA, 'List of Central Counterparties Authorised to Offer Services and Activities in the Union' https://www.esma.europa.eu/sites/default/files/library/ccps_authorised_under_emir.pdf, accessed 5 January 2023; European Commission Commission Staff Working Document Impact Assessment Report (n 197) 112.

²⁰⁹ European Commission, 'Commission Adopts Equivalence Decisions for US Exchanges' (4 April 2022) https://ec.europa.eu/commission/presscorner/detail/en/IP_22_2263, accessed 2 May 2022.

²¹⁰ European Commission, 'Implementing and Delegated Acts' (June 2022) https://ec.europa.eu/info/law/derivatives-emir-regulation-eu-no-648-2012/amending-and-supplementary-acts/implementing-and-delegated-acts_en, accessed 21 July 2022.

Taiwan and Columbia²¹¹. Equivalence has been previously granted to the following third countries' CCPs: Australia, Brazil, Canada, China, Dubai, Honk Kong, *India*, Japan, Mexico, New Zealand, Singapore, *South Africa*, South Korea, Switzerland, and United Arab Emirates (prior to 2022, emphasis added to indicate the above third countries for which equivalence was amended).

Table 7: Upgrade of equivalence regimes for third countries' CCPs (apart from the UK)

	Already granted between 2014 and 2021 (alphabetical order)	Newly granted in 2022	Amended
List of countries	Australia, Brazil, Canada, Dubai, Honk Kong, India, Japan, Mexico, New Zealand, Singapore, South Africa, Republic of Korea, Switzerland, and United Arab Emirates	Equivalence granted for CCPs in Chile, China, Malaysia, Indonesia and Israel (June), to Taiwan and Columbia (September)	US, South Africa and India

Source: Authors' own elaboration (as of December 2022).

This extension of CCPs equivalence to other jurisdictions demonstrates the effort to redirect clearing beyond the UK – which has three CCPs recognised as we have seen above – while the EU works on building its own infrastructures with internal capacity. ESMA is responsible for recognising third countries' CCPs which intend to offer services and activities in the EU.

4.3.3. Legal and policy issues in equivalence

This section discusses, with a critical approach, legal and policy issues in the equivalence regime by examining its main features, some of its limits, and do so with a particular focus on reciprocity.

Governance and uncertainty

A number of issues relate to the mode of adoption/governance and uncertainty, as equivalence decisions are subject not only to unilateral changes but are also inherently dynamic. The EU equivalence regime is described as an 'arcane and technical' equivalence regime²¹². Moloney (2021) considered this procedure complex and slow²¹³, with involvement of the relevant ESA before the adoption of the equivalence decision by the Commission. This involves legislative measures and administrative rules, i.e. a combination of level 1, level 2 and level 3 measures integrated in the EU Single Rulebook (as discussed above).

The uncertainty created by the EU's equivalence regime stems from the discretionary power of the European Commission in its assessment of the third country supervisory and/or regulatory regime. Indeed, this assessment is dynamic and follows the developments in the rules, the supervisory architecture and the enforcement in third countries, whereby equivalence can be unilaterally withdrawn at any time. The reasons for withdrawal may well depend upon broader circumstances,

²¹¹ Commission Implementing Decision (EU) 2022/1684 of 28 September 2022 on the equivalence of the regulatory framework for central counterparties in Taiwan to regulation (EU) No 648/2012 of the European Parliament and of the Council as regards Futures Clearing Houses under the supervision of the Financial Supervisory Commission and Commission Implementing Decision (EU) 2022/1683 of 28 September 2022 on the equivalence of the regulatory framework for central counterparties in Colombia to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council.

²¹² Moloney (n 28) 117.

²¹³ *ibid.*

including the political context. All these circumstances create issues for businesses and the industry participants in terms of legal certainty and predictability.

However, recent practice has shown some prior engagement with the third countries, with the issues being discussed, and leading to the withdrawal of equivalence being expected. Therefore, it is a contained unilateralism, ensuring some degree of predictability. For instance, such withdrawal by the EU took place for Credit Rating Agencies from a number of countries in 2019²¹⁴, which now benefit only from the ESMA endorsement regime (and not equivalence as their regulatory framework is not considered equivalent to the Credit Rating Agencies (CRA) Regulation as amended in 2013). In October 2022, ESMA decided to withdraw its recognition decisions for six CCPs in India (with deferral to April 2023)²¹⁵. The issues concern the absence of cooperation arrangements that should have been concluded between ESMA and counterparts in India, in breach of EMIR requirements. In contrast, the UK equivalence towards these Indian CCPs differs: three CCPs are still considered equivalent, whereas, from July 2023, three others CCPs will no longer be able to provide clearing services in the UK (as of January 2023)²¹⁶.

The dynamic character of equivalence also takes into account changing EU policy priorities. It is also intrinsically linked to changes that are made in the third countries' political/legal systems. It is the responsibility of the Commission to monitor them with the support of the ESAs, and that may lead eventually to a response in form of amending equivalence or revoking it. Moreover, the European Commission takes into consideration, in particular at the international level, the existence of international sanctions, the fight against money laundering and terrorist financing, and tax good governance, with the objective to ensure consistent EU external action²¹⁷.

Limits of equivalence

There are two limits: the exclusion of equivalence from some regulatory areas and the inadequacy of third countries' regulatory regime. On the one hand, some areas in financial services and banking regulation do not provide for third country equivalence regimes (e.g. in the banking area with lending and deposit taking excluded), or were not yet activated as discussed above. On the other hand, equivalence is not always 'fit for every purpose', with issues arising when third countries do not have any, or have less effective regulatory and supervisory frameworks than the EU. In particular, the European Commission outlined in its assessment of EU equivalence decisions in financial services that equivalence may be unfit if regulatory outcomes of the third country regimes are 'markedly different'²¹⁸.

Reciprocity

From the EU perspective, reciprocity considers the third country's treatment of EU's regulatory and supervisory framework, as well as the presence of EU market participants in this third country²¹⁹. The equivalence decision may itself include such reciprocity as a condition, e.g., for investment firms under MiFIR (not yet activated). In other words, the recognition of investment firms authorised under the UK

²¹⁴ Argentina, Australia, Brazil, Canada and Singapore lost their equivalence in summer 2019.

²¹⁵ 'ESMA to Withdraw the Recognition Decisions of Six Indian CCPs' <https://www.esma.europa.eu/press-news/esma-news/esma-withdraw-recognition-decisions-six-indian-ccps>,> accessed 29 November 2022.

²¹⁶ Bank of England, 'List of Third-Country CCPs That Are Taken to Be Eligible for Temporary Deemed Recognition in the UK by Virtue of the Temporary Recognition Regime Established by the Central Counterparties (Amendments, Etc., and Transitional Provision) (EU Exit) Regulations 2018 as Amended'.

²¹⁷ European Commission Communication in the Area of Financial Services (n 180).

²¹⁸ European Commission, 'Commission Staff Working Document on EU Equivalence Decisions in Financial Services Policy: An Assessment' (n 167) 7.

²¹⁹ European Commission Communication in the Area of Financial Services (n 180).

framework should benefit from an effective equivalent system of the UK towards the EU. Only after securing such system, would the European Commission equivalence decision give access to the EU Single Market. Indeed, the reciprocity dimension implies that the UK regime would give access to the UK market to EU investment firms²²⁰. Moreover, the Commission also discusses (where appropriate) the prudential treatment that the third country grants to EU market participants, in parallel to the decision made for the equivalence decision for that third country.

However, when reciprocity exists, this does not guarantee (a lasting) equivalence. For instance, in the area of CSDs, the equivalence granted to UK CSD expired in June 2021, regardless of the UK recognition of EEA CSDs. Indeed, the UK had granted equivalence to EEA CSDs as part of a wider package of UK equivalence from November 2020²²¹. In this regard, the UK considers itself having a 'more generous approach' to the granting equivalence than the EU's²²² which essentially reflects a difference of approach in the EU and UK equivalence policy,²²³ and an asymmetry.

In the area of CCPs, discussed above, the UK follows a temporary recognition regime (TTR) for non-UK CCPs (where the TTR is the UK approach to grant 'passporting' rights to EEA financial services). This is a temporary equivalence that will last until 31 December 2023 (extendable). The list of third country CCPs eligible for temporary deemed recognition by the UK is published by the BoE²²⁴. Actually, the UK approach to equivalence is represented in an excel table (as of January 2021, and referring to retained EU law for financial services and banking areas, see section 2.3.2)²²⁵. These equivalence decisions are still part of UK 'onshored' equivalence. The European Commission has considered that the BoE has 'wide discretionary powers' in withdrawing temporary recognition and points at legal certainty being at risk²²⁶. However, these characteristics are precisely shared with the EU's equivalence regime too, as we have just seen. One of the challenges, shared by both the UK and the EU, is to safeguard their regulatory autonomy,²²⁷ the other side of the coin of reciprocity.

4.3.4. Scenarios for granting (or not) equivalence to the UK

We elaborate different scenarios as to **possible future equivalence** to ensure, from the EU's perspective, a level playing field, fair competition, financial stability, market integrity, and protection of the consumer, to which we may add strategic autonomy considering the global dimension of the equivalence regime that considers the EU external action. The general status of the UK-EU relationship as discussed under section 3.2.2 with the NIP plays a significant role.

The EU may adopt different types of equivalence: (i) scope-limited and time-bound equivalence; (ii) scope-limited, also called partial equivalence, (iii) conditional equivalence, and (iv) provisional equivalence. An alternative option is to maintain the status quo and grant no further equivalence beyond the UK CCPs' equivalence which is effective until June 2025.

²²⁰ Recitals 41 and 44 MiFIR as amended Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 2022.

²²¹ HM Treasury, 'Equivalence Decisions for the EEA States' (n 165).

²²² See points 68-69 European Affairs Committee (n 19).

²²³ See also Nätstega⁹rd (n 173).

²²⁴ Bank of England, 'List of Third-Country CCPs That Are Taken to Be Eligible for Temporary Deemed Recognition in the UK by Virtue of the Temporary Recognition Regime' <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/financial-market-infrastructure-supervision/list-of-third-country-ccps.pdf?la=en&hash=8C96A829A5F570A235A4944912AFA278A8728399>.

²²⁵ HM Treasury, 'Table of UK Equivalence Decisions' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/952320/Table_of_UK_Equivalence_Decisions_Jan_2021.xlsx.

²²⁶ Recital 12 Implementing Decision (EU) 2022/174.

²²⁷ James and Quaglia (n 28).

Box 2: Typology of equivalence

The EU equivalence regime and general policy approach to equivalence can be summarised with the following types of equivalence:

- Scope-limited and time-bound equivalence
- Scope-limited, partial equivalence (e.g. scope of supervisory framework)
- Conditional equivalence
- Provisional or time-bound equivalence

Source: Authors' own elaboration.

Considering the features of equivalence, we consider that the essence of EU equivalence today will most likely remain, namely a **temporary regulatory alignment which serves specific objectives in the EU financial services sector** (determined under EU secondary and primary law). One important characteristic remains the dynamic character, which looks at the state of play of the regulatory/supervisory framework of the counterpart. This is a crucial element of cross-border regulatory alignment, which requires continuous close cooperation at technical, administrative and political level. Should the EU and the UK (or other third countries) be willing to cooperate more closely, there are alternatives, which can effectively complement or even replace an equivalence regime (see section 4.1. above).

Against this backdrop, the scenarios can range from granting: (i) no equivalence (once the current CCPs' equivalence lapses and without any extension), (ii) no additional equivalence (should the CCPs equivalence be further extended), to (iii) a bundle of equivalence (following the types of equivalence listed above). However, considering the scenarios of regulatory divergence developed under section 3, the 'higher' option of (iv) a furnished and unlimited equivalence regime remains unlikely. We develop some features of potential equivalence next to each scenario hereinafter.

No equivalence further adopted would correspond to a status quo with the unique equivalence lapsing in June 2025, and being not renewed or extended. This scenario would reflect broader misalignment between the two UK-EU regulatory and political systems, and correspond to the current expectations on the UK side²²⁸.

Unique temporary equivalence further extended (within a time limit) regarding clearing services in accordance with the equivalence regime under EMIR 2.2. This could stem from the unpreparedness of the industry and/or the supervisory and regulatory framework for clearing in the EU single market. Moreover, this could be part of a diversification strategy, in which the other third countries CCPs' equivalence are insufficient to provide clearing services in the EU Single Market.

Multiple partial equivalence (temporary, in scope, and with conditions) would correspond to a set of equivalence regimes activated for the UK. Considering the features outlined above, this would require not only reciprocity, but also a functional and continuous regulatory dialogue beside, including supervisory cooperation among competent authorities. Moreover, the granting of equivalence may not be seen as important as it was during the negotiations, because not having equivalence is not seen as a 'matter of fundamental concern' by the financial sector participants²²⁹. This shift in their approach

²²⁸ No further EU equivalence decisions are expected, as shared by several witnesses in front of the UK Parliament, European Affairs Committee (n 19) points 85-86.

²²⁹ See points 102 *ibid*.

might be explained by a number of reasons, including some pragmatic and psychologic reasons. At the pragmatic level, the participants got used to this state of affair that is now lasting. At the psychological level, they may have moved away from fearing changes and preferring the status quo (which can correspond to equivalence of regulatory frameworks) to adapting to a new situation in which regulatory divergence is accepted, and finding ways to tackle this concretely (in the UK and/or with relocation within the EU Single Market). At the same time, stakeholders are well aware that equivalence is part of the MoU (for now only negotiated at technical level) and features among the tasks of the upcoming Joint UK-EU Financial Regulatory Forum, once set up and running. Regardless of this shift in mood, some elements of multiple partial equivalence within the financial sector could correspond, for instance, to AIFMD for professional investors, and investment services for professional clients. This equals the activation of unexploited equivalence rules under AIFMD and MIFIR (as represented in Table 8 below). Furthermore, such multiple partial equivalence could be envisaged for trading venues, and reinsurance under Solvency II²³⁰. Partial equivalence could also include conditional equivalence.

In this overview of potential scenarios for EU equivalence regimes for the UK financial sector, it is considered unrealistic to expect an **unlimited and full equivalence regime** for two main reasons: the rationale behind UK financial services regulation developments differs significantly from the EU's approach (see section 2), and as discussed, the EU equivalence regime is intrinsically limited in its scope and has tended towards a temporary regulatory alignment so far. The expected further deepening of UK-EU regulatory divergence (from low to high divergence scenarios as under section 3.2) also corroborates the undesirability of a permanent equivalence regime, an option that has been expressly discarded in the impact assessment attached to the EMIR review for clearing²³¹.

However, it must be said that **supervisory cooperation may stem from the future EU-UK equivalence framework**. Beyond the adoption of the draft MoU and the creation of a Joint UK-EU Regulatory Forum that will facilitate high-level dialogue on financial services regulation (discussed under section 4.2, the future equivalence decisions might comprise the adoption of additional supervisory cooperation frameworks to consolidate and maintain trustworthy and functional channels among UK-EU authorities. As stated in the European Commission Communication from 2019, some equivalence framework has already encouraged the adoption of supervisory cooperation arrangements as part of 'mutually accommodating outcomes with third countries'²³². The 2019 Communication explicitly envisages the status of EU-Third country 'bilateral cooperation/mutual trust' as a determinant in the conditions of the broader regulatory environment²³³ for participants that are active in the EU Single Market.

EU supervision of UK firms under (potential) equivalence regimes

The below table examines the potential equivalence regimes that could lead to EU supervision of UK firms, should equivalence be granted. A discussion follows regarding the supervisory cooperation arrangements that are sometimes included into the EU equivalence decisions themselves, and what this implies for the UK. Table 8 is constructed on the basis of financial services legislation provision and the observation of the EU equivalence practices. It shows how UK firms could be supervised in the EU if equivalence were granted for these cases, on the basis of prior work realised in an EGOV briefing that provides detailed information on authorisation and supervisory responsibilities.²³⁴

²³⁰ See points 93 *ibid*.

²³¹ See Annex 6 European Commission Commission Staff Working Document Impact Assessment Report (n 197) 115.

²³² European Commission Communication in the Area of Financial Services (n 180).

²³³ *ibid*.

²³⁴ Deslandes, Dias and Magnus (n 168) 6–7.

Table 8: Models of EU supervision of UK firms under potential equivalence

Models	Access and authorisation/ registration	Additional requirements	EU equivalence regime	UK status (end of 2022)
1 – Investment services (MIFIR)	Registration does not extend to an additional authorisation (registration can be withdrawn)	Reporting to ESMA	Not yet activated	N.A.
2 – AIFMD	Double-lock system with equivalence decision and NCA authorisation (dual level)	Legal representative in the EU	Not yet activated	N.A.
3 – Clearing (EMIR 2.2)	Equivalence decision and ESMA: authorisation and registration of TC CCPs (EU level)	Dual supervision ESMA and third country competent authority for Tier 2 CCPs Location policy	Granted to a number of third countries, see section 4.3.2	Granted until June 2025
4 – Core banking activities	N.A.	N.A.	N.A.	N.A.

Source: Adapted from EGOV Briefing (2019)²³⁵.

Considering the limits of the equivalence regimes in EU financial services and banking regulation, equivalence is only one route available among others to build a functional and efficient connection between the EU and the UK in this area. Other forms of more stable and encompassing regulatory alignments can and should be considered (see section 4.1.).

²³⁵ Deslandes, Dias and Magnus (n 168).

5. CONCLUSIONS

This study has assessed the current state of regulatory reforms in the UK financial services sector and possible divergence with the EU regulatory framework as well as the options for future EU-UK cooperation. The UK has embarked on a legislative and regulatory path to further strengthen its financial centre including through regulatory divergence from the EU and an emphasis on growth and competitiveness, although the push for some divergence stems often more from the government than from regulators.

In several recent *bilateral* trade agreements with third countries, the UK has included financial services chapters, although they focus primarily on regulatory cooperation and non-discriminatory treatment. The MRA concluded with Switzerland aims at reducing non-tariff barriers in conformity assessment and relies indeed on the mutual recognition principle, but it does not include financial services in its scope. The UK FTAs with respectively Australia and New Zealand are presented as a new generation of trade agreements, even more so in the case of the Digital Economy Agreement concluded with Singapore and the Digital Trade Agreement concluded with Ukraine. The innovative aspects of these recent trade deals relate to the inclusion of digital and sustainable finance provisions. However, some of them could be only 'best endeavour' commitments. These developments may well be used to showcase the UK diplomatic and political strategy of strengthening its global presence, without leading to significant developments in the digital/sustainable finance area. Their effective implementation will have to be assessed in the medium term. Overall, divergence would be at a rather low level if we consider that most of the FTAs and MTAs concluded by the UK with third countries are considered to be 'modelled' on the former EU trade agreements. However, the post-Brexit UK global strategy together with the emphasis on growth and competitiveness, internally, still makes the UK stand out on the surface.

While divergence so far has not been as strong between the UK and EU legal orders, we expect that it will increase over the coming years, especially in areas where no inherited regulatory framework exists, including in crypto and green finance.

As the UK is struggling with identifying post-Brexit growth opportunities, there has been a strong emphasis on strengthening the financial centre London and UK, more broadly, as the Edinburgh reforms' announcement proved in December 2022. It is a priori not clear, however, whether such strengthening implies regulatory and supervisory loosening or tightening, with prudential/business conduct authorities and politicians taking very different approaches. While there seems an openness to discuss specific rules and regulations, the emphasis of regulatory and supervisory authorities in the UK seems primarily focused on preserving the stability of the financial system. This stands in contrast to statements by members of the current UK government who see regulatory loosening as a means to attract more 'customers' to the financial centre and to finance more investment in the UK. Hence, since the Future Regulatory Framework Review announcement, the UK government has argued for attributing secondary objectives for growth and competitiveness within the mandates of UK supervisory and regulatory authorities, i.e. in order to enhance the international competitiveness of the UK financial services sector. While the UK has increasingly insisted that higher barriers to serve the EU Single Market from London will simply turn the financial centre in London towards global business, there have been limited signs of such a trend.

Notwithstanding limited divergence so far, there are already indications for divergence across different segments of the financial system in the near future: Given different proposals for completing the Basel III implementation by UK authorities and European Commission, there will most likely be divergence between the two jurisdictions, with the EU deviating from the Basel III accord towards looser capital requirements in order to apply the proportionality principle for some smaller entities. The proposed

changes for the insurance prudential framework in both EU and UK aim at encouraging broader equity investment by insurers, but using different tools, which will lead to divergence between the two jurisdictions. Given the emphasis by the UK government on digital finance and crypto assets as a growth area for the financial centre UK, and given recent failures and fragility in the crypto space, this is certainly an area where divergence, uneven level playing fields and regulatory arbitrage should be carefully watched. The “Greening Finance: A Roadmap to Sustainable Investing”²³⁶, published in 2021 sets out that UK Green Taxonomy will adopt the EU’s six environmental objectives. However, the UK government is yet to release details, but some divergence is to be expected from the EU green taxonomy.

Notwithstanding the politicians’ will to ease some regulatory burdens and have a more flexible principles-based regulation, with negative repercussion for AML and the fight against tax evasion, the changes in practice may be minimal. It is more, the UK has been improving the functioning and transparency of its BO register with better data/KYC, while the EU Member States’ BO registers might be going backwards after a recent judgment of the Court of Justice of the EU in cases *WM, Sovim SA v Luxembourg Business Registers* (C-37/20 and C-601/20) which favoured financial data protection over transparency.

In this study, we discussed three scenarios of divergence:

- Low divergence: there will be adjustments to some UK regulations as well as other initiatives in line with the aim of increasing the ‘competitiveness’ of the UK as financial centre, but there will not be major divergence, especially in areas with international standards, such as bank capital regulation;
- Medium divergence: there will be more significant divergence and fewer attempts to converge on new rules such as in the area of green finance or crypto asset developments. Divergence will be more likely and more prominent in areas where international standards are less important and where the UK has not inherited any EU regulations such as in the two areas already mentioned; and
- High divergence: there would be a rather aggressive legislative and regulatory drive in the UK to diverge from EU rules. This would involve both replacing existing EU rules with new regulation and adopting divergent rules where such rules were not inherited. We expect such aggressive divergence especially in areas where UK authorities see growth opportunities and feel less constrained by international fora and cooperation initiatives, such as crypto.

In case the conflict around the Northern Ireland Protocol can be resolved to the satisfaction of both sides, there should be few if any barriers for future cooperation between UK and EU authorities on financial sector issues. This would then facilitate not only regulatory cooperation among the two legal orders but also enhance the supervisory and institutional cooperation among the UK and EU authorities. Addressing the stand-off around the NIP is thus a necessary though not sufficient condition. There will certainly be competing interests (similar to what we could observe during the UK’s EU membership) and no expectations of complete convergence, but an institutional framework for regulatory dialogue could be put in place (as for instance, the future Joint UK-EU Financial Regulatory Forum).

The EU Single Market in financial services has certainly suffered a loss with the UK exit. The scale, scope and network economies enjoyed by the London financial centre benefitted all of the EU Single Market. While it might be possible to replicate some of these gains within the EU Single Market, it is not clear

²³⁶ HM Treasury, ‘Greening Finance’ (n 161).

to which extent and on which timeline, as seen in the effort to build internal infrastructures for central clearing and the corresponding supervisory architecture. The primary objective of the EU authorities is to protect the financial market in the EU, its participants and its customers from financial stability risks, while at the same time deepening, integrating and diversifying financial markets in the EU further.

For the EU, it is important to find the right balance between the benefits of access to the London financial centre (as mentioned above) and the financial stability risks, stemming from regulatory divergence and more limited supervisory cooperation. The equivalence framework seems the right approach, though we see this as for the few rather than the many, as only a very limited number of financial services segments will be granted equivalence.

Elaborating on the scales proposed in the study, some sub-areas of UK financial services regulation will follow the 'lift and shift' approach (minimal adaptation of retained EU Law) while other areas will follow an approach that significantly reshapes UK Regulation²³⁷ (as expected in digital and sustainable finance). This spans across the low to high regulatory divergence scenarios elaborated in the study. There are two alternatives, which constitute extreme options, in no change, or, total change of the UK regulatory framework that departs from EU Law in financial services and banking. On the one hand, the absence of changes would correspond to a low divergence scenario (considering some passive divergence). However, we consider this unrealistic considering the UK government strategy for financial services. On the other hand, total change would correspond to the high regulatory divergence scenario. Nevertheless, very specific areas might still converge thanks to international cooperation at global level (e.g. international fora favouring standards, e.g. recommendations for AML from FATF, principles and standards from the Basel committee for Banking Supervision and the Financial Stability Board for Banking Supervision, among others). This corresponds to minimal adaptation as each jurisdiction still implements with national specificities in its legal order, and in light of strategic objectives, with the UK clearly stressing competitiveness growth across the board. The tightening of tax enforcement regime in the UK and its Crown Dependencies will need to be monitored in 2023 as they seek further transparency of offshore financial accounts and to resolve the 'offshore tax gap'.²³⁸ Considering UK significant loss in tax fraud and not yet reliable data about tax evasion, including via its Crown Dependencies, the UK Government is pressured to build up institutional capacity to ensure compliance and adequate reporting of data²³⁹. Such Issues also call for stronger international cooperation in tax matters.

Changes in EU Law to address potential deviations and grant equivalence (in a feedback loop from the UK regulatory divergence) should consider their impact on higher principles, i.e. competition, financial stability, market integrity and consumers' protection. EU financial services regulation have some equivalence regimes that have not yet been activated, despite their importance in the financial services sector (e.g. AIFMD and MiFIR).

The EU's approach to equivalence is restrictive towards the UK financial services' sector. Actually, the EU treatment of UK CCPs equivalence may become even more stringent than it used to be, following the European Commission legislative package for further developing the Capital Markets Union (with one act in the area of clearing) in December 2022. To be sure, this initiative aims at developing EU infrastructures for ensuring an internal EU clearing capacity. In the meantime, an extension of CCPs equivalence to third-countries worldwide demonstrates the EU effort to redirect clearing beyond the UK while the EU works on building its own infrastructures. This trend corresponds to a will to diversify

²³⁷ Treasury Committee, 'Future Parliamentary Scrutiny of Financial Services Regulations' (n 30) point 10.

²³⁸ 'HMRC to Publish Estimates of UK Offshore Tax Evasion' (n 146).

²³⁹ House of Commons - Committee of Public Accounts (n 147).

and move away from a heavy reliance on specific third-country CCPs including the UK CCPs. This is fully in line with the EU's commitment to integrated financial markets and international standards.

Overall, EU's approach to equivalence have the following features: discretionary, dynamic, contingent, and relying on reciprocity. These features stem from the ongoing adaptation of equivalence regimes, which justifies unilateral changes by the European Commission. It leads to uncertainty, which is a policy and legal issue that is at odds with the preferences of the industry participants for legal certainty and predictability. However, the practice shows some prior engagement with third countries, which may partly alleviate the issues raised by a unilateral equivalence withdrawal. One of the challenges, shared by both the UK and the EU, is to safeguard their regulatory autonomy, which might be in tension with seeking reciprocity in equivalence.

Against this backdrop, the types of equivalence and potential scenarios for future equivalence granted to the UK are suggested in this study as follows. First, the EU may adopt different types of equivalence: (i) scope-limited and time-bound equivalence; (ii) scope-limited, also called partial equivalence, (iii) conditional equivalence, and (iv) provisional equivalence. Second, the scenarios for the future development of EU equivalence may lead to:

- no equivalence (once the current CCPs' equivalence lapses and without any extension);
- no additional equivalence (should the CCPs equivalence be further extended beyond June 2025);
- a bundle of equivalence; and
- a furnished and unlimited equivalence regime (that we consider unlikely).

But, the EU equivalence regime is not without its limits. The exclusion of equivalence from some EU regulatory areas and the inadequacy of third countries' regulatory regime raise challenges. Indeed, equivalence is not always 'fit for every purpose', with issues arising when third countries do not have any, or have less effective regulatory and supervisory frameworks than the EU. Considering the limits of the equivalence regimes in EU financial services and banking regulation, equivalence is only one route available among others to build a functional and efficient connection between the EU and the UK in this area.

There are several legal and policy issues when considering amending EU Law, not in the granular details of EU financial services and banking regulation but at the level of principles. Both sides look for regulatory autonomy, which might be difficult to conciliate in the current political environment. The EU Single Rulebook for financial and banking regulation, despite the UK contributions for most of its components before leaving the EU, could be in tension with a more flexible and principles-based regulatory approach that will increasingly characterise the UK. Furthermore, if the EU is sometimes gold plating and over-implementing some international standards (with the exception of Basel III with proportionality), the UK regulatory approach might be very diverse. In this regard, the UK government's drive for competitiveness and to establish Global Britain may well confront itself with the EU's open strategic autonomy developed across EU policies' sectors.

Most importantly, even though financial sector regulation is a technical area, any further cooperation and the degree of divergence will be determined by politics and the broader relationship between the EU and UK. Unless the conflict over the Northern Ireland Protocol has been resolved, any further cooperation is doubtful. As in other areas of cooperation (e.g., research), financial sector cooperation is thus held hostage to the unwillingness of UK authorities to implement an international treaty. Similarly, the current wave of regulatory reforms and possibly divergence in the UK is driven by the current government and there might be a very different approach after the next General Elections.

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ANNEX

Acknowledgments

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All errors remain the authors' responsibility.

Interviews held in October-November 2022

Names	Affiliation	Date of interviews
Eva Micheler	London School of Economics	27 Oct 2022
Nicolas Veron	Bruegel and Peterson Institute	28 Oct 2022
Jean-Jacques van Helten	formerly Bank of Montreal and Non-executive director	28 Oct 2022
Richard Fenner	Director, Government Relations (formerly head of public affairs at TheCityUK) Euroclear UK & Ireland	2 Nov 2022
Ignazio Angeloni	Former Supervisory Board member at the ECB/SSM	2 Nov 2022
Joe Heavey	Senior Officer at Governance and External Affairs Department (ESMA)	4 Nov 2022
Maria Ana Barata	Policy adviser, European Banking Federation	4 Nov 2022
N.A.	Staff member of Euronext	4 Nov 2022
N.A.	High-level official in the UK industry and public sector (as well as Bank Board member)	4 Nov 2022
Anouk Gauthier	General Counsel, Euroclear Belgium, France and the Netherlands	9 Nov 2022
EU Commission Official	DG FISMA	11 Nov 2022

Source: Authors' own elaboration

N.A. corresponds to anonymity granted to the interviewees, as per their request. The study does not include any quotes.

Methodology

The interviews aimed at gathering insiders' information and further qualitative evidence on points non-documented in published resources and reporting (e.g. unclear timeline, contentious points in the negotiations, interests of the industry, expected consequences for different stakeholders). They helped identify in practice where divergence may occur and the preparedness of stakeholders.

11 semi-structured interviews were held, of 45-minute duration. The **target groups** for the interview were: members from the financial services industry (including CCPs), (current or former) regulators and legislators, academics, think tank members in the UK and selected EU jurisdictions. Interviews were conducted online on zoom.

The interviews were semi-structured to leave the space for additional points that are not covered by the questions. The objective was to gather qualitative information, including from stakeholders who have insiders' knowledge. The general aim of the interviews was to corroborate or rebut (some of) the hypotheses. The outcomes of the interviews have been analysed together with the primary sources and most up-to-date documentation released by UK and EU public authorities.

The questionnaire was articulated around the following parts: starting with the evolutions of UK financial services regulation and continuing to discuss some potential risks created by Brexit in the area of tax evasion and money laundering, and finally discussing the impact of these evolutions on the EU, including its equivalence regime.

Brexit poses unique challenges for policymakers in the EU as the most important financial centre in Europe is now outside its regulatory framework. We expect significant divergence over the medium- to long-term, given recent legislative and regulatory initiatives in the UK, but also developments of the regulatory framework in the EU. However, there seem to be limited concerns of an easing of the tax evasion and Anti-Money Laundering framework in the UK. We expect a limited use of the EU equivalence regime for the UK.

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