POST-BREXIT PROSPECTS

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The future of financial services in the UK

The global financial sector is experiencing a period of rapid change. The Covid-19 pandemic has transformed the behaviour of individuals, organisations and economies. The balance between protectionism and free trade is being tested in many major economies, and the European banking sector is under increasing pressure while the US and Asian markets grow. There are also unprecedented challenges and opportunities on the horizon, as the urgency of the climate crisis increases and technology diversifies our financial markets, pushing the boundaries of how our financial institutions operate.

This direction of travel will have unknown consequences on the shape of Europe's future financial landscape. In the face of this uncertainty, the UK continues to advocate for a global financial system that is built on open and competitive markets, which preserves financial stability and market integrity and protects both citizens and investors. In November, the Chancellor outlined the Government's plans to ensure that the UK moves forward as an open, attractive and well-regulated market, that continues to lead the world in pioneering new technologies and shifting finance towards a net zero future.

Central to our strategy is maintaining a predictable and transparent environment for business, backed by high-quality, proportionate regulation. Our key aim of the Future Regulatory Framework Review is to achieve an agile, coherent, and democratically accountable approach to financial services regulation. In parallel, we are undertaking a series of policy reviews to ensure regulation effectively addresses the risks arising in the UK's financial system and enhances its competitiveness.

To take just one example, we have announced that we are going to consult on wider capital markets reforms to build on the UK's reputation as a hub for high quality capital markets underpinned by high standards of regulation and market efficiency. We do not plan to significantly overhaul the current regime but rather enhance the effectiveness of our regulation.

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Innovation-friendly regulation is also a key component of the UK's sector, to promote the adoption of safe, cutting-edge technologies in financial services, and the growth of the fintech sector itself. We are considering the recommendations of Ron Khalifa's FinTech Review and have announced the introduction of a new unsponsored points-based route and visa process for UK 'scale ups', that will allow us to attract talent from overseas.

We're pursuing an ambitious agenda in Green Finance, committing to make Task-Force for Climate Related Financial Disclosures fully mandatory across the economy by 2025; implement a green taxonomy; launch our first green gilt; and offer a green retail savings product. Our G7 and COP26 presidencies come at a critical time for us to champion sustainable financial flows and work collaboratively with partners. This is a key area where the UK and EU share ambitions to drive global change.

Maintaining openness is also integral to strengthening our international relationships and has always been a cornerstone of our financial services policy. To foster further collaboration with partners, we are developing ambitious trade and regulatory relationships with several jurisdictions. The proposed UK-Switzerland Mutual Recognition Agreement is a truly exciting opportunity to develop our tool kit for appropriately managing cross-border financial services business between advanced financial centres. I would like to think that a successful agreement might set a new international standard for openness and the benefits that brings when underpinned by global standards and close cooperation.

At the time of writing, we're working towards a Memorandum of Understanding on regulatory cooperation with the EU. Providing certainty and stability for the industry remains at the forefront of our minds, and I'd like to thank the sector and the regulators for their extensive preparation for the end of the Transition Period.

Constructive engagement between industry and the authorities will be essential for the UK/ European financial sector to thrive, pioneering solutions to global challenges and tackling novel challenges as they arise. The UK will continue to build on its vision for financial services in the coming months, to strengthen the role it plays in global financial markets – now and in the future.

JOHN BERRIGAN

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Nearly 4 months after Brexit: where do we stand and what way forward for the EU and UK?

The Trade and Cooperation Agreement (TCA) between the EU and the UK covers financial services in the same way that financial services are generally covered in the EU's other free trade agreements with third (non-EU) countries. The TCA provides for limited market access commitments for cross-border provision of financial services and preserves the sovereignty and regulatory autonomy of the EU (and the UK), in line with the Commission's mandate.

A regime change took place in financial services on 1 January 2021. UK firms have lost their passporting rights and are now treated as third-country firms for the provision of financial services in the EU. Market fragmentation is an unfortunate, but inevitable consequence of the UK decision to leave the EU and the Single Market. Nevertheless, the transition in financial services has gone smoothly. Market participants were prepared. While there have been some necessary adaptions, there has been no volatility or disruption.

The Agreement last December brought to an end a four-year period of preparations and negotiations. However, for financial services, 2021 is the start of a new, complex period. The EU-UK relationship in financial services will have to be developed over time. While Brexit is unfortunately a fragmenting event, we will strive for close cooperation with the UK. As set out in the Joint Declaration on Financial Services Regulatory Cooperation, annexed to the TCA, our aim is to establish a durable and stable relationship between the EU and the UK. Our bilateral relationship with the UK will be based on voluntary regulatory cooperation outside of the TCA structures.

The purpose of a regulatory cooperation framework will not be to restore market access rights that the UK has lost, nor to constrain the EU's unilateral equivalence or regulatory process. Equivalence is an area which we will discuss with the UK – progressively, taking into account the UK's regulatory intentions, on a case-by-case basis. The EU is an open financial jurisdiction. We use equivalence as a tool to manage interactions with third countries, including the UK. Our third-country regimes allow EU consumers and investors to benefit from the services provided by third-country firms, whilst ensuring adequate risk management.

I remain hopeful that, over time, through cooperation and trust, we will manage to build a stable and balanced relationship.

When it comes to UK equivalence decisions, the EU, just as we do with all third countries, must consider our own interests. Given the close links between the EU and UK financial systems, our risk-based and proportional approach needs to be particularly thorough in order to capture, across all sectors, all potential risks for financial stability, market integrity risk, investor protection and the level playing field. It is clear that there cannot be equivalence and wide divergence.

Over time, there is scope for a broad and deep relationship with the UK in financial services. There are many areas of common interest in regulatory developments, such as risks to financial stability, digital finance, or new issues like green finance where the UK will play an important role with its presidency of the COP26. I would also anticipate close cooperation with the UK at international level in the FSB and other standard setting bodies.

The past four months has marked the beginning of a new phase in the trade of financial services between the EU and the UK. Given the level of interconnectedness between the two jurisdictions, it is essential that we get the basis for our new relationship right from the outset. I remain hopeful that, over time, through cooperation and trust, we will manage to build a stable and balanced relationship with the UK in the area of financial services.

Let's not forget that London will remain a very important global financial centre on our doorstep, and although a third country, the UK will remain one of our main partners in the area of financial services. It will be important for the EU to strategically manage the significant level of interconnectedness between the two jurisdictions so as to maximise the benefits of our new relationship while, at the same time, avoiding any element of dependency that would translate into reduced autonomy for the EU.

VERENA ROSS

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European Securities and
Markets Authority (ESMA)

EU-UK regulatory and supervisory relations in a post-Brexit world

The end of the UK's transition from the EU on 1 January 2021 marked the beginning of a new era in the relations between the EU and UK financial sectors, both for firms and for the authorities overseeing those sectors. The good news was that the transition period ended without any notable disruption. Since then, the EU and UK have turned their attention to establishing a framework for structured regulatory cooperation, which will be the foundation for a strong, balanced and fruitful future relationship.

Separate to this, the EU and UK begun the process of assessing the equivalence of each other's rules and supervisory arrangements in early 2020. On the EU's side, the Commission (with the technical assistance of ESMA and other EU bodies) undertook a comprehensive assessment of 28 areas of EU law where the most relevant equivalence provisions exist. With the end of the transition period approaching in late 2020, in the interest of mitigating potential risks to financial stability, time-limited equivalence was granted by the Commission for UK Central Counterparties (CCPs) and UK Central Securities Depositories. For all other areas, the assessment remains ongoing.

Any future equivalence decisions will be unilateral and in the interest of the EU, just like the equivalence decisions adopted by the UK towards the EU in November 2020.

The EU is an open financial jurisdiction and ESMA is a strong proponent of the use of deference in financial services, as a means to reduce market fragmentation and limit cross-border divergences. Unfortunately, Brexit is by its nature a market fragmenting event and with the UK signaling its intention to diverge from EU rules, the task for the Commission on equivalence becomes more complicated. Equivalence normally works by fostering coherence between EU rules and the corresponding framework in a third country. In this case, with one jurisdiction likely to increasingly diverge from the other, it makes sense for the EU to also be forward-looking in its assessments.

> **...the most important thing from ESMA's perspective is that cooperation and information sharing between EU and UK regulators remains open and constructive.**

The EU's equivalence model, which focuses on achieving the same outcomes, remains the tool which the Commission will use to determine equivalence for the UK. It should be noted however that there are heightened level-playing field concerns and increased systemic risks due to natural and historic interconnectedness of the UK and EU economies and financial markets. The European Supervisory Authorities, with their new equivalence monitoring powers, will assist the Commission through technical advice and monitoring of ongoing compliance by third countries with the conditions of equivalence decisions.

In addition, the EU's third-country supervision model has been enhanced in recent years. The most notable enhancement, which was first used in the context of the 2020 time-limited equivalence decision for the UK, was to the EMIR regime for third country CCPs. ESMA must now tier and recognise applicant CCPs and, depending on the tiering decisions, they may be subject to additional requirements and to ESMA's direct supervision. These additional safeguards ensure that any risk which is imported into the EU via third-country entities can be appropriately managed, in particular when it comes to third-country entities that may be systemically important in the EU.

Aside from the ongoing question of equivalence, the most important thing from ESMA's perspective is that cooperation and information sharing between EU and UK regulators remains open and constructive. In 2019 ESMA concluded two cooperation agreements with the UK Financial Conduct Authority (FCA), which have ensured that ESMA, the FCA and EU securities markets authorities can cooperate effectively on supervisory and enforcement matters, and exchange information to allow all authorities to discharge their duties regarding investor protection, orderly markets and financial stability.

Similarly, we intend to continue our cooperation with the UK at international level in the work of standard setting bodies like IOSCO.

STÉPHANE BOUJNAH

Chief Executive Officer and Chairman of the Managing Board, Euronext Paris

Following Brexit, a strong and multipolar capital market is rising in the EU

In the first weeks of 2021, there has been a massive shift of trading in European shares from London to Amsterdam. This trend is likely to continue in other areas because of the quality of European financial centres and increased uncertainty stemming from Brexit. It is my strongly held conviction that the EU must now act as a strong and competitive finance maker, not merely as an open territory of finance takers. Brexit has been a clarification moment and a wake-up call for the EU.

But the EU will not strengthen its capital market without strong European financial institutions and market infrastructures. We must stop the unilateral disarmament of the European financial system to the sole benefit of non-European players. Building a fertile and innovative ecosystem in the EU will be critical. In this context, the work on delivering Capital Markets Union to build a powerful integrated European financial system and ensure the financing of the recovery from the Covid-19 crisis assumes its full importance and significance.

Euronext believes a competitiveness test should be introduced within the new CMU to assess the impact of any new proposals on EU competitiveness as compared to major third country jurisdictions. This is obviously important in respect of the UK, but also the US. The EU must remain attentive to significant policy and regulatory changes in those countries and adjust when necessary. Alongside impacting on any consideration of possible equivalence measures, the EU must also ensure that its rule-making processes are agile enough to be able to adjust the European rulebook to respond promptly where necessary.

The recent evolution of Euronext into a stronger pan-European financial markets infrastructure is a key enabler to build the backbone of the CMU. With the Italian capital market expected to join Euronext, investors and issuers will be able to benefit from the largest capital and liquidity pool of the internal market, across eight countries in Europe. This transformational project for Euronext will also contribute to the objective of better funding the recovery of the EU economy, with a positive impact in terms of efficiency as well as market and product availability. At the same time, this evolution strengthens Euronext's federal model, closing the gaps between the different financing needs and ecosystems at European, national and local levels.

It is my strongly held conviction that the EU must act as a strong and competitive finance maker, not merely as an open territory of finance takers.

This capability is very much needed to build an effective CMU to deliver integrated capital markets across the EU to the benefit of European companies, investors and the real economy, whilst nurturing and developing the often diverse ecosystems on which these markets depend. The Euronext markets reflect this reality. On the one hand, our markets benefit from a significant presence of global investors in European listed companies, boosting access to growth for European companies, thanks to our single order book and our single liquidity pool. On the other hand, retail investor participation is increasing, often with a local outlook. Both these dynamics should be enhanced by CMU. Ultimately, an efficient combination of the global, European, national and local market participants is required.

An effective CMU will be essential for the recovery of the EU economies because the economic transition initiated by massive injection of debt programs must be coupled with an efficient injection of equity to fund risky projects and innovation.

Beyond factoring in the consequences of Brexit, the CMU will also have to enable green finance, contribute to the strengthening of the role of the euro and adapt to the lasting impacts on markets of the recent massive central bank interventions and fiscal stimulus measures.

It is now time for European financial market infrastructures to meet the challenges of building strong integrated financial centres distributed across Europe. Through the expected inclusion of the Borsa Italiana Group into its successful federal model, Euronext will continue to prove that building European capital markets is the core of its project.

PATRICK THOMSON

Chief Executive Officer, EMEA,
J.P. Morgan Asset Management

Putting customers first means cooperation over competition

The UK's departure from the EU remains a source of political tension. It also comes with an economic price for business large and small. On a personal note, I have a French mother and a British father. I served for five years in the British armed forces and my first J.P. Morgan project was based in Paris, so I have been lucky to work in both the UK and EU and understand the myriad opportunities for growth. But political or personal, we cannot afford to dwell on what has come to pass. COVID-19 and other challenges facing the EU and UK collectively – the region of Europe – are too significant and too urgent. Equally, there are huge opportunities to be gained by working together, especially when it comes to supporting a thriving investment culture in Europe and promoting the sustainability agenda. Intense and constructive cooperation must be our North Star moving forward.

Debating about financial market access has been constant over the past few years. The reason is obvious: the UK hosts a large amount of our region's capital markets. And the EU has a strategic interest in housing financial markets more in line with its geopolitical weight. This view is understandable and rational, but, importantly, this is not a zero-sum game.

In the political heat, it has, at times, seemed like the impact on clients has been secondary to which jurisdiction will 'win' more business. This is regrettable. Ultimately the success or failure of the EU and the UK should be judged on the impact on clients and the economy, rather than the relative size of financial sectors. We need to continue putting customers and the economy at the heart of everything we do.

Recent years have seen increased geopolitical tensions. Logically, the EU wants to look after its strategic interests in a more uncertain geopolitical landscape. However, as a global firm with an almost-200-year history in Europe, we are concerned when we hear concepts like 'strategic autonomy' and 'financial sovereignty' voiced as tenets for policy. The openness of financial markets has long been a source of their strength. Due to its nature as a supranational organisation, the EU has a natural knack for cross-border financial services. My sector, investment management, is a perfect example of this.

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EU lawmakers' vision to create a pan-EU fund product, UCITS, in the early 1980s, remains commendable. Forty years later, UCITS have become an international gold standard, marketed in Europe, Asia and Latin America. J.P. Morgan Asset Management Europe, established in Luxembourg in 1988, was an early adopter of UCITS. Today we have branches in Austria, France, Germany, Italy, Netherlands, Spain, Sweden, and a subsidiary in Switzerland, 330 staff and nearly €390 billion in AUM. We distribute across thirty-six countries worldwide. Our European funds are sold in, for example, Croatia, Korea, Poland and Peru. We are just one of many firms enthusiastically embracing the global success story that is UCITS, and increasingly AIFs. The European funds market is almost €19 trillion.

And yet recently, we have faced a debate about the global supply chains of European funds. Third country delegation, a key pillar of the global success of UCITS has come under constant supervisory and regulatory scrutiny since 2016. Delegation allows global investors in UCITS funds access to the benefits of talent and expertise across the globe with robust investor protection.

Some policymakers have asserted that third country delegation presents supervisory risk. We have not seen evidence of any inefficiencies or risks in this model, nor have these policymakers raised any concrete or specific issues. Customers recognise the delegation model as a good one; a model that has enhanced the attractiveness and competitiveness of Europe. Why tamper with this model now or, needlessly, put investors' trust in UCITS into question?

Investors will be better served by investing time and energy into the many positive areas that will, collectively, drive our economies forward. The UK has left the EU, but it has not turned its back on the sustainability agenda. The UK has doubled down on helping make finance flows consistent with a pathway to net-zero. Whether we are promoting corporate governance toward a carbon-free future, or fine-tuning climate-related financial reporting, getting the balance between consistency and flexibility is key. So is striving for global consistency.

The EU is charting new courses and leading the way with the ESG agenda. The US, with a new administration, is starting to engage. The UK has a leadership role to play, alongside the EU, in fostering global partnerships especially with the US. In my view, the UK is showing genuine eagerness to be a world leader, not least with its ambitious net zero targets and its role in co-hosting COP26.

But the sustainability agenda is just one of many examples where the UK and EU can thrive together, putting differences aside. Together, we can support financial technology and lead policy on cyber resilience. Together, we can tackle issues related to gender, sexual orientation and ethnic diversity and promote a more diverse and inclusive financial services sector. Last but not least, together, we can support the development of the Capital Markets Union, especially through increasing the level of retail participation in Europe's capital markets, supporting greater financial literacy, pension initiatives and helping more Europeans make the jump from saver to investor. In other words, how can we better help European individuals and families achieve their life goals through investing, while channelling more money into companies, transport networks, hospitals, schools and housing?

We need concerted cooperation to achieve the best outcomes for investors and our economies. The agreed Memorandum of Understanding between the EU and the UK gives us hope. It formalises a technical dialogue, helps to park the politics and fosters trust. But this is just a starting point and frankly, the minimum we would expect between partners. There is an opportunity here to make the next chapter a positive and constructive one. As we write this next chapter, let us never lose sight of the end-users of financial services – businesses, investors, savers. They must be prioritised. The notion that 'cooperation is a higher moral principle than competition' feels particularly pertinent here. Constructive cooperation must be our North Star moving forward.

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After Brexit - Looking towards closer regulatory cooperation

Now that the UK has left the EU, the financial services sector is looking ahead at what the future might hold. The UK is now a "third country" under the EU financial services regime, and UK banks have lost important access rights to the EU markets, in particular, the ability to freely "passport" financial services across EU member states. As a result, UK banks must now carefully navigate the regulatory framework in each EU member state in which they look to do business.

Looking ahead, it is possible to see that, notwithstanding Brexit, there may in the future be a return to close EU and UK regulatory alignment. It seems possible that the benefits of free market access which have been enjoyed by both the EU and the UK – making both the EU and the UK attractive international centres of business – may continue through bilateral "equivalence" arrangements.

Close regulatory cooperation will ensure the continued attractiveness of UK and EU financial markets.

"Equivalence", however, depends on regulation achieving outcomes which are comparable between the EU and the UK, and it is up to the EU and the UK to agree equivalence in key areas. Although developments towards equivalence have so far taken place at a measured pace, it is hoped that an agreement on financial services will be reached between the EU and the UK in due course. In many areas, in particular, derivatives and securities business, there is otherwise the risk of fragmented markets which are inefficient and costly to navigate. Equivalence would not only benefit UK businesses, who would be able to easily access EU markets, but also European consumers and corporates needing liquidity.

Equivalence – although very important for financial services – is clearly only part of the picture. Regulatory cooperation in the purest sense means countries working together to determine the appropriate direction of regulatory policy, all the while being able to react appropriately to real-world events. This will create a positive environment for international business.

As a basic matter, it is hoped that the EU and the UK will continue to be "open" rather than "protective" financial services markets. Being "open to business" has made London, Frankfurt, and other European financial services hubs global centres of financial excellence. It is hoped that even outside of areas of regulation which are deemed "equivalent", the EU and the UK will be able to work closely together to formulate regulatory objectives which ensure broadly similar standards. Close co-operation going forward on the green agenda, for example, is a high priority.

While there are clear benefits to equivalence in being able to enjoy free market access across borders, this will always be subject to the possibility of equivalence being withdrawn by either the EU or the UK at short notice. Businesses, of course, need time to react effectively. Where equivalence is taken away, there may not be an easy solution to ensuring that businesses are protected from the adverse impacts of sudden regulatory change; in particular, where they have structured their business based on equivalence decisions.

Regulatory cooperation should therefore not just be an area-by-area assessment, but should be an exercise at the highest level of regulatory policy in financial services; closer cooperation will, hopefully, reduce the risk of the EU and the UK taking a radically different path from each other. Equivalence should, therefore, be easier to maintain. Where rules are broadly aligned, they are easier to understand, and they provide a more comprehensible basis for structuring international business.

The ultimate aim in close regulatory cooperation – across the full spectrum of financial services – is to create an environment which ensures the continued attractiveness of the UK and EU financial markets for international business.