

COOPERATION, DIALOGUE, DIVERGENCE

THE FUTURE UK-EU RELATIONSHIP IN FINANCIAL SERVICES

**ACROSS BORDERS**

Part of the Horizon Scanning series

25 May 2023

Regulatory dialogue between the EU and the UK is set to resume officially with the adoption by the European Commission of a draft Memorandum of Understanding (MoU) establishing a framework for structured regulatory cooperation between the parties in financial services¹. The MoU is now subject to final political endorsement by the Council of the EU. In this briefing, we consider the likely practical implications of the MoU and identify some topics that we expect to form the basis of this dialogue.

A long time coming

The UK's relationship with the EU in financial services has been a live issue since the Trade and Cooperation Agreement (TCA) was signed in 2020. Alongside the TCA, the UK and the EU published a Joint Declaration on Financial Services Regulatory Cooperation in which they committed to agreeing an MoU establishing the framework for their cooperation.²

Technical negotiations on the MoU concluded in March 2021.³ The Windsor Framework agreement,

announced on 27 February 2023, paved the way for a reset in the UK-EU relationship across a range of policy areas, including financial services, bringing the MoU back into renewed focus.⁴ In the meantime, a series of other bilateral MoUs between UK regulators and their counterparts in EU institutions and member states has facilitated continued day-to-day regulatory and supervisory cooperation in specific areas of financial regulation.⁵

What does the MoU do?

The MoU establishes the Joint UK-EU Financial Regulatory Forum which brings together the Directorate-General for Financial Stability, Financial Services and the Capital Markets Union (DG FISMA), HM Treasury, regulators, supervisors, other UK government departments, representatives from EU Member States and relevant experts, as appropriate. The Forum will, in short, “serve as a platform to facilitate structured regulatory cooperation in the area of financial services”. Meetings of the Forum are to be held at least semi-annually. The first session is expected to take place this Autumn.

¹ https://ec.europa.eu/commission/presscorner/detail/en/mex_23_2805 and <https://www.gov.uk/government/publications/uk-eu-memorandum-of-understanding-on-financial-services-cooperation/uk-eu-memorandum-of-understanding-on-financial-services-cooperation>

² 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

³ <https://www.gov.uk/government/news/technical-negotiations-concluded-on-uk-eu-memorandum-of-understanding>

⁴ See, for example, remarks by EU Commissioner McGuinness: “The Windsor Framework allowed the EU and the UK to open a new chapter in our partnership based on a spirit of mutual trust and cooperation. I am confident that our relationship and future engagement in financial services will be built on a shared commitment to preserve financial stability, market integrity, and the protection of consumers and investors” (17 May 2023).

⁵ These MoUs have enabled, for example, consultation and exchange of information for enforcement purposes, in connection with delegation arrangements or the recognition of central counterparties. There are several MoUs between the FCA and European authorities (including the European Banking Authority and the European Securities and Markets Authority, as well as EU and national competent authorities) that cover cooperation and exchange of information in the securities, investment services and asset management, insurance and pensions, and banking sectors: <https://www.fca.org.uk/news/statements/mous-european-authorities-securities-insurance-pensions-banking>

Main Takeaways

- The MoU will create an overarching formal framework for the UK and the EU to communicate on financial services matters on a regular basis.
- It will provide an opportunity for closer strategic cooperation on these matters. This might include mapping out the consequences of (further) divergence between the two regimes.
- There are no immediate implications for market access. The longer-term impact of the MoU on any potential equivalence decisions is uncertain.
- The text of the MoU underscores the importance of preserving the regulatory autonomy of both parties, though this should not ultimately hinder the development of a collaborative approach to managing cross-border risks.

The general operational objectives of the Forum include, among other things, improving transparency, reducing uncertainty and identifying potential cross-border implementation issues, such as “concerns linked to potential regulatory arbitrage by firms”. There is a commitment to consider working towards compatibility of each other’s standards (this presumably could include developing consistent regulatory approaches and reducing duplicative or divergent regulatory requirements).

The model of future cooperation is reminiscent of the existing Joint Financial Regulatory Forum between the EU and the US.⁶ The arrangements do not provide for additional market access rights or shared rules, nor are they intended to restrict the unilateral equivalence or regulatory processes of either party. They do not “create rights or

obligations under international or domestic law”. More than once, the MoU makes specific reference to the arrangements not restricting “the ability of either jurisdiction to implement regulatory, supervisory or other legal measures that it considers appropriate” (see paragraphs 3 and 10).

That is not to downplay the potential strategic value of the MoU as a mechanism for regular, structured dialogue between the parties.⁷ The MoU is to be welcomed as a positive step towards closer political and diplomatic engagement on financial services.

What might be on the agenda?

The Forum’s activities will “support an ongoing shared understanding of the relevant regulatory frameworks, particularly where measures may ... result in market fragmentation” (paragraph 11). This is expected to be of particular relevance where any fragmentation could disrupt the free flow of capital or raise financial stability concerns. The dialogue will provide the framework for discussions on existing and future areas of legislative and policy divergence. Divergence is likely to be a particularly salient topic at the present time, with the Financial Services and Markets Bill (the Bill) due to receive Royal Assent imminently. The financial services sector has been lauded by the UK government as an area where regulatory divergence between the UK and EU will yield a “Brexit dividend”. The appropriate extent—and associated benefits—of divergence are, however, widely contested and context-specific.⁸

The Bill sets up the legislative architecture to allow for a transition to a comprehensive FSMA model of regulation tailored to the UK. Among other things, it provides for the (staggered) replacement and revocation of retained EU law relating to financial services and transfers responsibility for these areas of regulation to the financial services regulators. The UK has already taken initiatives that have resulted, or will result, in divergence from the EU in

⁶ There are a few minor differences in the formulation of discussion topics and language around equivalence: https://finance.ec.europa.eu/eu-and-world/bilateral-relations/regulatory-dialogues-usa-financial-services-regulation_en

⁷ This view is underscored by comments from witnesses to the inquiry by the House of Lords European Affairs Committee on the relationship in financial services between the UK and the EU (June 2022): <https://lordslibrary.parliament.uk/uk-eu-relationship-in-financial-services/>

⁸ HM Treasury has made much of the package of ‘Edinburgh reforms’ for financial services outlined in November 2022 and heralds an ambition to build a ‘smarter’ financial services framework for the UK and deliver economic growth through regulatory reform. The announced Edinburgh reforms are, however, unlikely to lead to much immediate change. To a large degree, they restate or build on reviews or plans which are already in progress and which will take some time to realise. Many of reforms trailed do not, in any event, concern divergence from EU legacy rules. For example, the proposed reforms responding to the review on bank ring-fencing, or to adjust the Senior Managers and Certification Regime, are wholly domestic initiatives.

several areas.⁹ These include, for instance, variations in the proposed implementation of Basel 3.1 standards and the UK's reforms of different aspects of its wholesale and capital markets regimes. Most anticipated divergence is so far arising from the ongoing EU legislative agenda and UK reform geared towards establishing the UK's post-Brexit regulatory regime.

The Forum will provide an opportunity for “exchanges of views on the respective policies, rules and processes concerning deference regimes, such as equivalence”¹⁰ and “dialogue on the Participants’ autonomous decisions to adopt, suspend or withdraw equivalence relevant to one or the other side” (paragraph 11). The imminent expiry of two important decisions relating to market access for UK and EU financial services is likely to be high on the agenda. First, the UK Temporary Permissions Regime, or TPR (which allows EEA-based financial services firms to maintain their ‘passporting’ rights and enjoy access to the UK market), expires on 31 December 2023. Second, an EU equivalence decision that permits UK-based clearing houses to service EU firms expires on 30 June 2025. In December 2022, the EU published proposals designed to make EU companies clear a greater share of their derivatives trading in the EU (rather than the UK) because it sees a ‘strategic vulnerability’ in relying on a clearing market over which it has no regulatory oversight. This suggests that the equivalence decision for UK-based clearing houses is unlikely to be extended after 2025, despite the threats to market efficiency and financial stability this may entail.

It is specifically envisaged that the Forum’s work plan will take “into account the agendas of relevant international bodies including, inter alia, the G20.” The order of business conducted at other, similar fora, have tended to focus on cross border financial services developments and other “common challenges”.

ESG and sustainable finance will no doubt form a standing agenda item, with clear political intent from both parties for green investment to drive future economic growth. The Forum could look to

encourage the uptake of climate-related financial disclosures informed by initiatives such as the Task Force on Climate-Related Financial Disclosures and support the work of the International Sustainability Standards Board. Discussions may also focus on any expected divergence between the future UK Green Taxonomy and the EU Taxonomy.

We should also expect to see consideration of digital finance, potentially including initiatives to ensure greater collaboration across emerging technologies. Any such collaborative efforts will be influenced by differences in attitude towards nascent areas of financial technology, differences which are currently most pronounced in the case of cryptoassets¹¹. We note that an important aspect of the UK government’s support for the FinTech sector in recent years has been the establishment of ‘FinTech bridges’ with a number of jurisdictions around the world - and that this initiative has not to date extended to the EU.

Following recent turmoil in parts of the banking sector, the parties will also wish to examine policymaking in actual or potential threats to financial stability.

For the terms of the MoU to be meaningful and achieve their intended purpose, ongoing engagement from both political sides and the respective regulators will be required.

This briefing is part of the Slaughter and May Horizon Scanning series

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⁹ Some of these areas are noted in a report requested by the European Parliament’s Committee on Economic and Monetary Affairs on Recent trends in UK financial sector regulation and possible implications for the EU, including its approach to equivalence (February 2023): [https://www.europarl.europa.eu/RegData/etudes/STUD/2023/740067/IPOL_STU\(2023\)740067_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2023/740067/IPOL_STU(2023)740067_EN.pdf)

¹⁰ See report above for details of possible limited use of the EU equivalence regime for the UK.

¹¹ In May 2023, the House of Commons Treasury Committee strongly recommended that the Government regulates retail trading and investment activity in unbacked cryptoassets as gambling rather than as a financial service: <https://committees.parliament.uk/publications/39945/documents/194832/default/>

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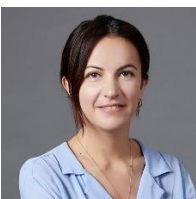
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