

The post-Brexit agreement and international capital markets

by **Paul Richards**

ICMA published an assessment on *Post-Brexit: the Way Ahead in International Capital Markets* in the ICMA Quarterly Report for the Fourth Quarter. This contribution provides an update at the end of the post-Brexit transition period on 31 December 2020:

The EU-UK Trade and Cooperation Agreement (TCA)

The TCA was agreed in principle on 24 December 2020 and ratified by the European Council and UK Parliament ahead of the 31 December deadline.¹ Financial services are not covered in any detail in the TCA. The main provisions relating to financial services include clauses under which the parties: (i) can adopt or maintain measures for prudential reasons; (ii) make their best endeavours to ensure that internationally agreed standards of regulation and supervision are implemented; and (iii) provide access to their payment and clearing systems. Post-Brexit EU-UK financial services are negotiated largely *outside* the TCA (eg through regulatory equivalence). The main advantage of the Agreement is that it should improve the climate for future EU-UK relations, including in financial services.

Passporting rights

At the end of the post-Brexit transition period on 31 December 2020, passporting rights ceased. The Single European Market became two separate markets. Under the Temporary Permissions Regime, the UK is providing EEA firms and funds previously using a passport the opportunity to continue to operate in the UK for a maximum period of three years while they seek authorisation from the UK PRA/FCA. There is no equivalent to the UK Temporary Permissions Regime at EU level, though there is a patchwork of arrangements at national level in the EU.

Regulatory equivalence

On 9 November, the British Government announced a package of equivalence decisions under which EU and EEA firms are equivalent for the purposes of regulation in the UK, together with guidance on the UK's approach to equivalence in future. The European Commission has not so far followed a similar approach for the purposes of UK firms' access to the EU market.² As at

the end of the post-Brexit transition period, the grant by the Commission of access for UK firms to the EU was strictly limited. The grant of equivalence for UK CCPs was an exception, on the grounds that it was necessary to avoid cliff-edge risks to financial stability at the end of the transition period, though the grant is limited to 18 months. (See the Box.) It remains to be seen whether the climate of cooperation from the TCA will give rise to more equivalence decisions by the Commission in future: for example, equivalence for investment firms is not due to be reviewed until mid-2021 at the earliest.

Regulatory divergence

During the post-Brexit transition period, EU regulation continued to apply in the UK, and was "onshored" by the end of the transition period. From the end of the transition period, UK financial services regulation is expected to begin to diverge from EU regulation, initially at least in a limited way. Whether the European Commission is willing to grant regulatory equivalence in future may turn on whether the Commission considers that it is sufficient for the UK and the EU to have the objective of achieving the same regulatory outcomes (eg in the case of international standards), or whether it considers that the same regulatory outcomes can be achieved only if the rules are the same.

Financial stability risks

Now that passporting rights have ceased following the end of the transition period, and where regulatory equivalence has not been provided, there are a number of outstanding cliff-edge risks affecting international capital markets. (See the Box.) Despite the risks of market volatility and disruption, both the EU and UK authorities consider that the risks to financial stability are less than they were. Given that the EU and UK have reached a TCA, there should also be scope for regulatory and supervisory cooperation to continue in future. Under the TCA, both parties are committed to establish by March 2021 an MOU framework covering exchanges of views on regulation and equivalence.



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1. The TCA is also subject to ratification by the European Parliament early in 2021.

2. When the TCA was agreed, the Commission announced that it would not make any further equivalence decisions "at this point in time".

Post-Brexit cliff-edge risks in international capital markets and steps to avoid them³

Investment services: The EU has stated that in the short to medium term it will not assess the equivalence of the UK's regulatory and supervisory regime to its own for the purposes of MiFIR Article 47, which covers investment services. This would have allowed for material cross-border access to investment services, reducing the residual risk of disruption.

Cleared OTC derivative contracts: The UK Government has legislated to ensure that UK businesses can continue to use clearing services provided by EU-based clearing houses. The EU has adopted a decision to provide equivalence to the future UK legal and supervisory framework for central counterparties (CCPs) until end-June 2022, and UK CCPs have been recognised by ESMA. This will allow UK CCPs to continue servicing EU clearing members after the end of the transition period. The Bank of England and ESMA have put in place a new cooperation agreement to support this activity.

Non-cleared OTC derivative contracts: The UK Government has legislated to ensure that EU banks can continue to perform lifecycle events on their non-cleared derivative contracts with UK businesses after the end of the transition period. The European Commission has not reciprocated in the case of UK-based banks' contracts with EU businesses. Some EU Member States have permanent national regimes which could enable lifecycle events on certain contracts to be performed.

Banking services: The UK Government has legislated to ensure that UK households and businesses can continue to be served by EU-based banks after the end of the transition period. The EU authorities have not taken similar action. As a result, major UK-based banks are transferring their EU clients to subsidiaries in the EU so that they can continue providing services to them. All material subsidiaries are now authorised, fully operational and trading.

Asset management: Cooperation agreements between the FCA, ESMA and EU NCAs have been agreed and apply from the end of the transition period. This enables EU asset managers to delegate the management of their assets to the UK. The UK Government has legislated for EU asset management firms to continue operating and marketing in the UK. And to operate in the EU, the largest

UK asset managers have completed their establishment of EU authorised management companies.

Insurance contracts: EIOPA has published recommendations to national authorities supporting recognition or facilitation of UK insurance companies' continued servicing of EU contracts at the end of the transition period.

Personal data: The UK Government has legislated to allow the free flow of personal data from the UK to the EU after the transition period. If the EU does not deem the UK's data regime adequate, companies can add standard contractual clauses into contracts in order to comply with the EU's personal data transfer rules. UK firms are generally well advanced in implementing these clauses.⁴

Access to euro payments systems: UK firms will need to maintain access to TARGET2 to make high-value euro payments. UK banks intend to access TARGET2 through their EU branches or subsidiaries or correspondent relationships with other banks. The European Payments Council has confirmed that the UK will retain SEPA access after the end of the transition period subject to its continued compliance with the established participation criteria.

Ability of EEA firms to trade on UK trading venues: The EU's Trading Obligations require EU investment firms to trade EU-listed or traded shares and some classes of OTC derivatives on EU trading venues or venues in jurisdictions deemed equivalent by the EU. The UK will also have analogous trading obligations from the end of the transition period. The EU and UK could deem each other's regulatory frameworks as equivalent for the purposes of relevant regulations, thereby mitigating risks of disruption.

Prudential requirements: UK regulators have confirmed that they will delay the application of some requirements for 15 months to end-March 2022. EU regulations will subject EU banks' and insurance companies' UK exposures to stricter capital and liquidity requirements.

Credit rating agencies: The FCA and ESMA have confirmed that their cooperation agreement will apply from the end of the transition period.

Settlement finality: Some but not all EEA countries have implemented national legislation intended to provide settlement finality protection in the event of insolvency of local firms using financial market infrastructure in non-EU countries.

3. Source: Bank of England Financial Stability Report, 11 December 2020.

4. Under the TCA, there is a time-limited "bridging mechanism" of six months pending the Commission's decision on adequacy.