



# Brexit: cliff-edge risks in international capital markets

By Paul Richards

## Summary

The UK is proposing to leave the EU Single Market in financial services when it leaves the EU. Cliff-edge risks will arise when passporting rights between the EU27 and the UK cease. The UK originally proposed to the EU27 that there should be mutual market access when passporting rights cease. This approach was rejected by the EU27. One alternative for firms in the UK is to make use of EU provisions for regulatory equivalence for third countries. This is currently a patchwork. If it is not possible to rely solely on regulatory equivalence, the other option is to ensure that, before passporting rights cease, firms are authorised to provide financial services in both the EU27 and in the UK. It appears that, when passporting rights cease, firms will in general be able to carry out contractual obligations already agreed between EU27 and UK entities on cross-border financial contracts. But specific cliff-edge risks will still arise when passporting rights cease. The best way of avoiding these risks is by agreement between the EU27 and the UK. Agreement is needed as soon as possible.

## Introduction

1 On 22 June, ICMA sent an open letter to senior political leaders in the EU27 and the UK on Brexit cliff-edge risks in international capital markets.<sup>1</sup> The open letter explained the concern of ICMA and its members about the risks of a cliff edge on Brexit, which would fragment international debt capital markets and damage business in the real economy and financial stability. ICMA's open letter gave examples of cliff-edge risks and argued that ways of avoiding them needed to be agreed between the EU27 and the UK as soon as possible ahead of Brexit. The Vice President of the European

Commission replied on 19 July;<sup>2</sup> and the UK City Minister replied on 6 August.<sup>3</sup> The purpose of this Quarterly Assessment is to set out possible steps that market firms can take, and help needed from the authorities in the EU27 and the UK, to avoid cliff-edge risks in international capital markets, despite the remaining uncertainty about the terms of Brexit.<sup>4</sup>

## Cliff-edge risks: background

2 Given that the UK is proposing to leave the EU Single Market in financial services when it leaves the EU, cliff-edge risks in international capital markets will arise when passporting

1. Martin Scheck, Chief Executive, ICMA: *Brexit: Cliff-Edge Risks in International Capital Markets*: Open letter to President Juncker and Prime Minister May, 22 June 2018.

2. Valdis Dombrovskis, Vice President of the European Commission: Letter to Martin Scheck, 19 July 2018.

3. John Glen, UK City Minister: Letter to Martin Scheck, 6 August 2018.

4. The paper does not consider the pros and cons of Brexit, nor the political and economic implications.

rights between the EU27<sup>5</sup> and the UK cease. Passporting rights allow firms authorised in one EU Member State to provide services in other EU Member States without requiring authorisation or supervision from the local regulator.<sup>6</sup> The European Commission explains the loss of passporting rights as follows: “Many operators, including from third countries, have established themselves in the UK and operate in the rest of the Single Market based on the passporting rights enshrined in the EU financial services legislation. These passporting rights will cease to exist after withdrawal. This means that the provision of financial services from the UK to EU27 will be regulated by the third country regimes in EU law and in the national legal frameworks of the respective Member State of the EU customers. There will be no Single Market access.”<sup>7</sup>

3 When will cliff-edge risks arise?

- Cliff-edge risks will arise most immediately if the UK leaves the EU without an agreement on Brexit on 29 March 2019.
- If there is an EU27/UK withdrawal agreement, as a result of which passporting rights continue during a transition period<sup>8</sup> after Brexit, cliff-edge risks will still arise if there is no EU27/UK trade agreement at the end of the transition period at the end of 2020, unless the transition period is extended.
- And, even if there is an EU27/UK trade agreement, there will be cliff-edge risks if the agreement does not preserve existing passporting rights.

### The British Government's proposals in the White Paper

4 The EU (Withdrawal) Act, which will take EU law into UK law on Brexit, was passed by Parliament in the UK in June. Shortly after receiving Royal Assent, HM Treasury started publishing secondary legislation on the first financial services statutory instruments, including temporary permissions and recognition

regimes. These regimes are intended to enable firms currently authorised to operate in the UK to continue to be authorised for a limited period after Brexit. However, no equivalent has yet been proposed by the EU27.<sup>9</sup>

5 The British Government also published a White Paper in July.<sup>10</sup> Its main objective is to set out the British Government's proposals to remain aligned with the EU27 after Brexit on customs arrangements and EU regulations relating to goods. In addition, these proposals are intended to address the UK's commitment to avoid a hard border between Northern Ireland (in the UK) and the Irish Republic.

6 Although trade in goods is its main focus, the White Paper also covers services, including financial services. The British Government recognises that “the UK can no longer operate under the EU's passporting regime, as this is intrinsic to the Single Market of which it will no longer be a member.” It argues that “the UK and the EU will wish to maintain autonomy of decision-making and the ability to legislate for their own interests. ... The decision on whether and on what terms the UK should have access to the EU's markets will be a matter for the EU, and vice versa. However, a coordinated approach leading to compatible regulation is also essential for promoting financial stability and avoiding regulatory arbitrage.”<sup>11</sup>

7 It is not yet clear to what extent the EU27 will be prepared to accept the UK proposals in the White Paper: the main EU27 criticism so far has been that the UK proposals “cherry pick” from the four EU freedoms (people, goods, services and capital), on the grounds that the four freedoms are indivisible.<sup>12</sup> Nor is it yet clear what the response will be in the British Parliament, both if the proposals are accepted by the EU27 and in particular if the EU27 does not accept them. A framework for a future trade agreement, in the form of a political declaration, needs to be reached this year in order to give sufficient time for ratification of the EU27/UK withdrawal agreement by the British Parliament, European Parliament

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5. And the rest of the European Economic Area (EEA) which also includes Norway, Iceland and Liechtenstein. The British Government has so far ruled out remaining within the EU Single Market by joining the EEA.

6. HM Government: *Banking, Insurance and Other Financial Services if here's No Brexit Deal*, 23 August 2018.

7. European Commission: *Preparing for the Withdrawal of the UK from the EU on 30 March 2019*: Communication, 19 July 2018.

8. The British Government refers to the transition period after Brexit as an “implementation period”. The main change during the transition period after Brexit is that the UK will no longer have any say over new EU regulatory standards.

9. Bank of England Financial Policy Committee: minutes of the meeting on 19 June 2018, published on 3 July.

10. HM Government: *The Future Relationship Between the United Kingdom and the European Union*: Cm 9593, July 2018.

11. HM Government: *The Future Relationship Between the United Kingdom and the European Union*: Cm 9593, July 2018, chapter 1, paragraphs 60-61.

12. Donald Tusk, President of the European Council: “The suggested framework for economic cooperation will not work.”: Salzburg Summit, 20 September 2018.

and EU27 Member States before the deadline of 29 March 2019, when Article 50 expires. Extending Article 50 would require unanimity in the EU27 and the agreement of the UK. The British Government is currently opposed to seeking an extension, and also opposed to holding a second referendum on the outcome of its negotiations with the EU27.

### Ways of avoiding cliff-edge risks in general

8 International capital market firms have known for some time that they need to prepare for the risks of a cliff edge on Brexit. The question is: what is the best way of avoiding cliff-edge risks? The UK originally proposed to the EU27 that there should be mutual market access when passporting rights cease. This would have involved mutual recognition of each other's regulatory standards, taking into account that EU27 and UK regulatory standards will be the same at the outset. Under this approach, the EU27 and the UK would have recognised each other's regulatory standards, so long as they were consistent with equivalent regulatory outcomes, which would have been agreed in advance; and there would have been an agreed mechanism for resolving disputes. But this approach was rejected by the EU27, on the grounds that the EU27 needs to be autonomous in its decision-making.

### (i) Enhanced regulatory equivalence between the EU27 and the UK

9 In those circumstances, as there is no consensus on a way forward under mutual recognition, international capital market firms have two main options. One option for firms with operations in the UK is to make use of EU provisions on regulatory equivalence for third countries (ie countries outside the EEA). This is currently a patchwork:

- It applies to some parts of the EU regulatory framework, but not others; and, in EU regulations where it does apply, it is not always complete.<sup>13</sup> Provisions for regulatory equivalence have so far evolved piecemeal, case by case.
- It requires a judgment by the European Commission as well as a technical assessment, and it takes time to assess.
- The determination of equivalence by the Commission can be withdrawn at short notice, though this has not happened so far.

- The assessment of regulatory equivalence is based on measuring outcomes, but outcomes are not straightforward to measure, as in the case of mutual recognition.
- Unlike mutual recognition, regulatory equivalence would be determined unilaterally by the EU27 and the UK in their respective markets, not jointly by both the EU27 and the UK.<sup>14</sup>

10 Given London's role as a global financial centre, it is also important to note that many of its markets and products are different from the EU27. The British Government's view is that these differences mean that rule-taking - in the sense of an open-ended commitment to adopt rules without having any say in making them - will not work in the UK financial services sector.<sup>15</sup> There is also a risk that new EU27 rules - which will be made without any direct influence from the UK - will not take sufficient account of their impact on market firms in the UK.

11 In its White Paper, the British Government accepts that the EU27's equivalence regimes for third countries currently "provide limited access for some of its third country partners to some areas of EU financial services markets"; and states that "the existing autonomous frameworks for equivalence would need to be expanded, to reflect the fact that equivalence as it exists today is not sufficient in scope for the breadth of the interconnectedness of UK-EU financial services provision". It "proposes that there should be reciprocal recognition of equivalence [between the EU27 and the UK] under all existing third country regimes, taking effect at the end of the implementation [ie transition] period".<sup>16</sup>

12 There is a case for enhancing regulatory equivalence between the EU27 and the UK as far as possible, since "the UK and the EU start from a position of identical rules and entwined supervisory frameworks". In that sense, the EU27 and UK are super-equivalent. No other third country has identical rules to the EU27, as the UK will have when Brexit takes place. There are in any case limits on the extent to which regulatory standards in wholesale markets in the EU27 and the UK can in practice diverge significantly, given the framework of global standards within which they operate under the G20 through the Financial Stability Board. And if regulatory standards in the UK were to diverge from regulatory standards in the EU27 after Brexit, then there would be an opportunity for an assessment to be made about

13. For example, services not covered include: wholesale lending and deposit-taking in CRD; some areas of investment firm activity in MiFID; and wholesale insurance within Solvency II: HM Government: *Framework for the UK-EU Partnership: Financial Services*, 25 July 2018.

14. See also Chancellor of the Exchequer: "Our financial regulatory frameworks are in effect identical. It is inconceivable that the mutual benefits of this relationship could be preserved by an "off-shelf" model, such as the EU's existing equivalence framework for third country financial services relationships.": *An Alternative Approach for Britain's Financial Services*: FT, 13 July 2018.

15. HM Government: *Framework for the UK-EU Partnership: Financial Services*, 25 July 2018.

16. HM Government: *The Future Relationship Between the United Kingdom and the European Union*: Cm 9593, July 2018, chapter 1, paragraphs 62, 65 and 66.

whether regulatory equivalence should continue to apply, as with any other third country. But despite this, it is not yet clear whether and to what extent there will in practice be scope during the EU27/UK negotiations to enhance the arrangements for regulatory equivalence between the EU27 and the UK as a third country; and, if EU or UK regulations need to change, it will take time to implement the EU or UK legislation required.

### **(ii) Authorisation to operate in both the EU27 and the UK**

13 Regulatory equivalence is useful for international capital market firms, but it is not likely to be a complete solution; and it will not be a complete solution if it is limited in scope to the regulatory equivalence available to other third countries at the moment. If it is not possible to rely solely on regulatory equivalence, the other option for international capital market firms is to ensure that, before passporting rights cease, they are authorised to provide financial services in both the EU27 and in the UK, even though this is likely to involve higher costs for them (eg in terms of extra capital and liquidity) and for their business customers than at present. Most large international capital market firms either have authorised operations in the EU27 and the UK already or are seeking authorisation to do so, as long lead-times are involved. But those which have not yet done so need to consider this option carefully, given the long lead-times involved and the shortage of time available. Market firms are likely to be in a better position to avoid cliff-edge risks after passporting rights cease if they are authorised to operate in both the EU27 and in the UK.

14 On behalf of the EU27, the European Central Bank (ECB), the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) have all drawn attention to the need for market firms to be authorised in the EU27 in order to be able to operate there after passporting rights between the EU27 and the UK cease:

- The ECB and national supervisors “expect banks to continue to prepare for all possible contingencies, including a no-deal scenario leading to a hard Brexit with no transition. Banks are responsible for ensuring that all authorisations required for them to carry out their activities as envisaged are in place in a timely manner.”<sup>17</sup>

- The EBA has asked national competent authorities to ensure that financial institutions take practical steps now to prepare for the possibility of UK withdrawal from the EU with no ratified withdrawal agreement in place, and no transition period between 29 March 2019 and the end of 2020.<sup>18</sup>
- The ESMA has reiterated its own concerns on the timely submission of applications for authorisation to operate in the EU27; and encouraged UK-based regulated entities to prepare for the possibility that the UK and the EU27 will fail to agree on a withdrawal agreement, with the result that there is no transition period.<sup>19</sup>

15 The ECB has also provided guidance to banks on relocating to the euro area:

- The ECB is completely neutral regarding the choice of location within the euro area and ensures consistent supervision throughout the euro area.
- It usually takes six months for a decision to be made regarding a licence application once the application is complete.
- Banks in the euro area need to be capable of managing all material risks potentially affecting them independently and at the local level, and they should have control over the balance sheet and all exposures.
- Sufficient staff need to be located in the supervised entity to run operations, including both risk management and the front office.
- With specific reference to “back-to-back booking models”, the ECB and national supervisors would expect that part of the risk generated by all material product lines should be managed and controlled locally. Transitional arrangements may be allowed on a case-by-case basis.<sup>20</sup>

16 The British Government has recognised that many financial services firms which currently passport from the UK into the EEA are taking steps to ensure that they can continue to operate after Brexit, for example by establishing a new subsidiary authorised in the EU27. This would allow the UK firm to offer new services after Brexit through its EEA subsidiary; and, in some cases, existing contracts could be transferred to the new entity.<sup>21</sup>

17. ECB: *Relocating to the Euro Area*: updated on 2 August 2018.

18. EBA Opinion, 25 June 2018.

19. ESMA *Reminds UK-Based Regulated Entities about Timely Submission of Authorisation Applications*, 12 July 2018.

20. ECB: *Relocating to the Euro Area*: updated to 2 August 2018.

21. HM Government: *Banking, Insurance and Other Financial Services if There's No Brexit Deal*, 23 August 2018.

## Specific cliff-edge risks

17 Apart from cliff-edge risks in general when passporting rights cease, there are a number of specific cliff-edge risks in international capital markets involving the EU27 and the UK. It appears that, on Brexit, firms will in general be able to carry out contractual obligations already agreed between UK and EU27 entities on cross-border financial contracts.<sup>22</sup> But when passporting rights cease, market firms may no longer be able fully to service some outstanding contracts across EU27/UK borders.<sup>23</sup> There are also a number of other specific cliff-edge risks which arise when passporting rights cease. For example, specific cliff-edge risks include:

- the risk that it may not be possible for EU27 and UK parties to continue to perform some existing cross-border insurance contracts by paying claims to, or receiving premiums from, policyholders in the other jurisdiction;
- the risk that EU27 and UK parties may no longer have the necessary permissions to service over-the-counter (OTC) derivative contracts with parties in the other jurisdiction;<sup>24</sup>
- the risk that central counterparties (CCPs) may no longer be recognised across borders with the result that EU27 and UK CCPs may find that they are in breach of regulation by providing clearing services in the other jurisdiction, requiring abrupt close-out of positions;<sup>25</sup>
- the risk that the holding and sharing by the EU27 and UK of each other's data may be in breach of national law, with the result that barriers to the cross-border flow of personal data disrupt the provision of financial services;
- the risk that liabilities already issued under UK law may be considered in the EU27 like any other liability governed by the law of a third country, with the effect that they no longer count towards the minimum capital requirement for own funds and eligible liabilities (MREL);
- the risk that, under MiFID II/MiFIR, data thresholds set for the EU as a whole may no longer be relevant;

- the risk that automatic recognition of resolution actions under the Bank Recovery and Resolution Directive across the EU may no longer apply between the EU27 and the UK; and
- the risk that delegation of fund management across borders between the EU27 and the UK may be restricted or suspended if there is no agreement on third country cooperation.

### The European Commissioner's reply to ICMA's open letter<sup>26</sup>

In the reply on 19 July from the European Commission to ICMA's open letter about cliff-edge risks in international capital markets on Brexit, the European Commissioner says that he has "at this stage the impression that most of those risks can be addressed through timely adaptation by the industry".

"On insurance and OTC derivative contracts, I would note that while every type of contract needs to be looked at separately, at this juncture, there does not appear to be an issue of a general nature linked to contract continuity as even after Brexit the performance of existing obligations can generally continue to take place. Of course, when the parties to the contract decide to create new rights and obligations by, for instance, concluding new contracts or amending contracts, an authorisation may be required under Union or national law.

As regards possible cliff-edge risks related to non-recognition of EU27 and UK CCPs, the EU has in this area the tools necessary to deal with different scenarios. In this context, the Commission proposal to amend EMIR is important, as it would make relevant

22. Financial Markets Law Committee (FMLC): "The FMLC is in agreement with the European Commission's Communication of July 2018 and considers it unlikely that Brexit will give rise to issues of contractual continuity in a general sense and so far as it is a matter of English law and jurisdiction." *UK Withdrawal from the EU: Issues of Legal Uncertainty Arising in the Context of Robustness of Financial Contracts*: August 2018.

23. See, for example, ISDA and AFME: *Contractual Continuity in OTC Derivatives: Challenges with Transfers*: "The loss of EU financial passporting rights after Brexit will have implications for cross-border OTC derivatives contracts between UK and EU27 firms and their EU27 and UK clients and counterparties respectively where those firms currently rely on an EU passport to trade cross-border in the EU27 or the UK.": July 2018.

24. Scott O'Malia, Chief Executive, ISDA: "Many other critical actions that take place during the life of a derivatives trade will be disrupted. These so-called lifecycle events include material amendments to contractual terms, the rolling over of trades and trade compression. These occur on a daily basis and are vital to the efficient functioning of the derivatives market. In fact, some - like trade compression - are important risk management techniques required by EU regulation: Letter to the FT, 4 July 2018. See also Bank of England Financial Policy Committee Statement from its policy meeting, 3 October 2018.

25. Steven Maijoor, Chair of ESMA: "The current legislative framework of EMIR does not allow ESMA to recognise CCPs based in the UK as third country CCPs as long as it is an EU Member State.": Athens, 3 October 2018. See also Bank of England Statement, 3 October 2018.

26. Extract from the letter of Valdis Dombrovskis, Vice President of the European Commission to Martin Scheck, ICMA, 19 July 2018.



changes to the EU's third country framework. We hope it will be rapidly agreed by the Union legislator.<sup>27</sup>

You also mention the issue of cross-border data flows. As you certainly know data controllers have a series of instruments available to ensure legal data transfers to third countries, even in the absence of continuation of the current situation or an adequacy decision. The Commission has highlighted the various tools that are available to data controllers in a notice to stakeholders of early January 2018.

With regard to the resolution dimension you mention both the eligibility of MREL and the recognition of resolution actions under BRRD. As on the other issues, the UK's withdrawal from the EU will have an impact on the legal situation which resolution authorities need to take into account in their work to ensure banks can be effectively resolved without impact on financial stability. The Single Resolution Board has issued guidance on these issues, to allow credit institutions to prepare in the best possible manner for the new situation.

Finally, on the issue of delegation of portfolio management, the Commission's proposal for the review of the ESAs simply contributes to supervisory convergence, which is of the utmost importance for CMU and will help your members to do business in the EU. Our proposal does not change the substantive rules applicable to delegation. We are proposing to promote transparency among supervisors within the ESAs on certain delegation arrangements, in particular cases where firms engage in very substantial outsourcing with the objective of being active in the EU only by way of letter-box entities. In this context, it is clear that supervisors will take into account the particular situation in the asset management sector - where many firms have recourse to outsourcing not to avoid EU supervision but to provide EU clients with the highest quality of service."

## Ways of avoiding specific cliff-edge risks

18 If these specific cliff-edge risks cannot be avoided, the resulting fragmentation in the functioning of international capital markets, and associated market uncertainty, will damage growth in the real economy and damage financial stability. This appears to be common ground between the EU27 and the UK. However, there are different views between the EU27 and the UK about how to avoid them.

### (i) Private sector approach

19 The European Commission and the EBA have both emphasised the role of the private sector in avoiding cliff-edge risks:

- In his reply to ICMA's open letter, the European Commissioner says that he has "at this stage the impression that most of those risks can be addressed through timely adaptation by the industry".<sup>28</sup> (See box.)
- The EBA has given its opinion that financial institutions should take adequate steps to mitigate the impact of Brexit without relying on possible public sector solutions that may not be proposed and/or agreed in time. This involves not only ensuring that they have the correct regulatory permissions and associated management capacity in place in time, but also addressing any impact on rights and obligations of their existing contracts, in particular derivative contracts.<sup>29</sup>

### (ii) Public sector approach

20 By contrast, the Bank of England Financial Policy Committee argues that "it would be difficult, ahead of March 2019, for financial companies on their own to mitigate fully the risks of disruption to households and businesses."<sup>30</sup> This is because it is not feasible for international capital market firms to address all the potential cross-border contractual issues - including the associated requirements for repapering - that arise when passporting rights cease through private sector negotiation alone, given the shortage of time available.<sup>31</sup>

27. See also Steven Maijoor, Chair of ESMA: "In my view, we need to ensure continued access to UK CCPs for EU clearing members and trading venues. I would support a swift conclusion of the EMIR 2.2 legislative file, complemented by a transitional provision allowing for the continued access to UK-based CCPs.": Athens, 3 October 2018.

28. Extract from the letter of Valdis Dombrovskis, Vice President of the European Commission to Martin Scheck, 19 July 2018.

29. EBA: "While the political agreement on a transition period is welcome, it will not be given legal effect until there is a ratified withdrawal agreement in place. This is not guaranteed, and in any event, it will only come at the end of the Article 50 process.": Opinion, 25 June 2018.

30. Bank of England Financial Policy Committee minutes: Minutes of the meeting on 19 June 2018, published on 3 July.

31. Scott O'Malia, Chief Executive of ISDA: "The problem is not the notional figure but the substantial number of contracts that would have to be transferred and the number of counterparties that would individually have to agree to the transfer in a short period of time. A transfer of this scale has never before been attempted and is operationally unlikely without regulatory and legislative support from the EU and the UK.": Letter to the FT, 4 July 2018.

21 The UK is introducing a Temporary Permissions Regime, which will allow EEA firms and funds using a UK passport to continue to operate for a limited period after Brexit without needing to apply for authorisation at this stage. The UK has also made a commitment to legislate, if necessary, to ensure that contractual obligations (such as under insurance contracts) between EEA firms and UK-based customers that are not covered by the Temporary Permissions Regime can continue to be met.<sup>32</sup> And the UK is proposing Temporary Recognition Regimes for CCPs, central securities depositories, credit rating agencies, trade repositories, data reporting service providers, systems currently under the Settlement Finality Directive and depositories for authorised funds.<sup>33</sup>

### (iii) A joint approach?

22 Although the UK has proposed a Temporary Permissions Regime, there is currently no reciprocal Temporary Permissions Regime proposed by the EU27.<sup>34</sup> Many specific cliff-edge risks cannot be fully resolved by unilateral action by the EU27 or the UK.<sup>35</sup> They can only be fully resolved by agreement between the EU27 and the UK.<sup>36</sup> It is therefore encouraging that, on 27 April this year, the European Central Bank and the Bank of England announced the formation of a working group reporting to the European Commission and HM Treasury on risk management in response to Brexit.<sup>37</sup> The European Central Bank and Bank of England will also be able to invite other relevant authorities, such as the FCA, where their expertise is required.<sup>38</sup> But if it takes too long to work out the scale of the problem, there may be insufficient time left to resolve it. Regular communication from the European Central Bank and Bank of England jointly in the run-up to Brexit would help reduce market uncertainty.

23 The best way to address cliff-edge risks is through a joint

statement by the EU27 and the UK in, or in a side letter alongside, the withdrawal agreement. This should include provision for continuity of cross-border financial contracts between the EU27 and the UK by “grandfathering” all such financial contracts outstanding at the point at which passporting ceases.<sup>39</sup> Something similar was done when several EU national currencies were replaced by the euro on 1 January 1999. If it is not possible to use the withdrawal agreement, a separate agreement is needed between the EU27 and the UK, or alternatively the EU27 could make a commitment to provide its own Temporary Permissions Regime, as the UK has already done: the sooner the better; and the sooner there is a joint statement of intent by the EU27 and the UK, the better, given the shortage of time available.

### Supervisory cooperation to avoid systemic risks in future

24 In the White Paper, the British Government has also proposed that the EU27 and the UK should commit to an overall supervisory framework which supports:

- extensive supervisory cooperation in relation to firms which pose a systemic risk or provide significant cross-border services on the basis of equivalence; and appropriate reciprocal participation in supervisory colleges;
- regulatory dialogue under which the UK and the EU should be able to understand and comment on each other’s proposals at an early stage, while respecting the autonomy of each side’s legislative process and decision-making; and
- transparency processes to ensure that the relationship is stable, reliable and enduring, with some of the processes treaty-based.<sup>40</sup>

32. Some cross-border contracts have been transferred by large insurance companies from the UK to the EU27: FT, 27 August 2018.

33. HM Government: *Banking, Insurance and Other Financial Services if There’s No Brexit Deal*, 23 August 2018.

34. See also: HM Government: *Banking, Insurance and Other Financial Services if There’s No Brexit Deal*, 23 August 2018.

35. For example: “In the absence of EU action, EEA clients will no longer be able to use the services of UK-based investment banks, and UK-based investment banks may be unable to service existing cross-border contracts.”: HM Government: *Banking, Insurance and Other Financial Services if There’s No Brexit Deal*, 23 August 2018.

36. Bank of England Financial Policy Committee: “The biggest remaining risks of disruption were where action was needed by both UK and EU authorities, such as ensuring the continuity of existing derivative contracts. As yet the EU had not indicated a solution analogous to a temporary permissions regime.”: Minutes of the meeting on 19 June 2018, published on 3 July.

37. Chancellor of the Exchequer: “Working with the European Commission, we have set up a Technical Working Group between the Bank of England and the European Central Bank which is working to manage transition risk and provide further reassurances to our financial services firms.”: Mansion House speech, 21 June 2018.

38. HM Government: *Banking, Insurance and Other Financial Services If There’s No Brexit Deal*, 23 August 2018.

39. See, for example, ISDA and AFME, *op. cit.*: “The withdrawal agreement should contain appropriate provisions both facilitating contract transfers or novations to EU entities and allowing firms to continue to service legacy contracts after the end of the transition period at least to the extent such transfers or novations cannot be effected within an appropriate amount of time. However, there should also be coordinated backstop arrangements that apply if a withdrawal agreement is not concluded.”: July 2018.

40. HM Government: *The Future Relationship Between the United Kingdom and the European Union*: Cm 9593, July 2018, chapter 1, paragraphs 69 and 70.

25 Supervisory cooperation between the EU27 and the UK needs to continue after Brexit, including the securities markets as well as banking. This would be consistent with the global initiative to manage cross-border challenges to financial stability (eg by sharing information and working together), and to set strong global standards to make the financial system safer, simpler and fairer. The Governor of the Bank of England has said that “an ambitious future financial services relationship, founded on commitments to achieving equivalent outcomes and supervisory cooperation, remains both feasible and in the interests of the UK, Europe and the world.”<sup>41</sup>

### Conclusion

26 When passporting rights between the EU27 and the UK under the Single Market in financial services cease, there are cliff-edge risks for international capital market firms operating cross-border between the EU27 and the UK, particularly in cases in which they are not yet authorised to operate in both the EU27 and the UK and they rely on the Single Market for access. These cliff-edge risks will arise on Brexit, if there is no withdrawal agreement which includes a transition period after Brexit; and even if there is a transition period, they may still arise at the end of it, depending on the form of the trade agreement negotiated between the EU27 and the UK. The best way of avoiding these risks is by agreement between the EU27 and the UK. To remove uncertainty and prevent instability in international capital markets, agreement is needed as soon as possible.

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41. See Mark Carney, Governor of the Bank of England: *New Economy, New Finance, New Bank*: Mansion House speech, 21 June 2018. In addition, Steven Maijoor, Chair of ESMA, has proposed to start negotiations with the UK FCA on MOUs, which “are essential to meet our regulatory objectives and allow information exchange for effective supervision and enforcement.”: Athens, 3 October 2018.