Meeting Summary

EU Ambassadors Breakfast

'A New Basis for Access to UK/EU Financial Services Post-Brexit'

Mansion House, London, 5 December 2017

On 5 December 2017, IBDE and the City of London Corporation hosted the EU Ambassadors Breakfast. The meeting was held in line with the City of London Corporation's EU engagement strategy and as a follow-up of IBDE's 18 meetings debating the implications of Brexit for the UK, EU and the wider markets. Hosted by Alderman Charles Bowman, Lord Mayor of the City of London, and moderated by Nick Collier, Chairman of Diplomatic Engagement of IBDE, the meeting brought together senior representatives from the EU27 Embassies, City of London and IBDE Board and Advisory Board.

Attendees explored the recent report produced by the International Regulatory Strategy Group (IRSG), 'A new basis for access to UK/EU financial services post Brexit', which provides a blueprint for how the EU and UK can continue trading after Brexit. The UK is looking to secure an agreement for mutual market access starting from a position of regulatory alignment with the EU, and this unique situation should be the foundation of a historic trade deal. It is an ambitious plan that allows for access via remaining open by regulatory coherence and encourages strong trade links that will benefit the entire European continent.

The purpose of this meeting was to facilitate a post-referendum policy dialogue with the EU business and diplomatic community and identify how the IRSG proposals would work for the UK and EU post Brexit. The introductory remarks and the presentations of the report were delivered on the record. The remainder of the meeting was held off the record, under the Chatham House Rule.

Introduction by the Lord Mayor Alderman Charles Bowman and the Chairman of Policy and Resources Committee, Catherine McGuinness

The City of London, a global financial centre, is particularly keen to have a good working relationship with the EU and other financial centres with which the City deals. The City has been clear to the UK government about what the City would like to see take place: a clear and sensible transition, talent which the City can access (the City is nothing without its people) and lastly trade – an ambitious free trade agreement that is mutually beneficial for both the UK and the EU. These also form the basis of the proposals as put forward in a paper published by the International Regulatory Strategy Group (IRSG) in September 2017. IRSG is a practitioner-led body comprising leading UK-based figures from the financial and professional services industry. It aims to be one of the leading cross-sectoral groups in Europe for the financial and related professional services industries to discuss and act upon regulatory developments. The IRSG report deals with the starting positions of regulatory alignment before going over how to deal with the possible divergences in the post Brexit era. The City has a tradition of being an effective voice for the sector of financial services which is facilitated by being an effective listener. To this end, the City and its stakeholders are very keen to get the EU representatives' views on the proposals of IRSG.

Presentation of IRSG report by Rachel Kent, Partner, Hogan Lovells

Following the introductory remarks, Rachel Kent presented the IRSG report: a 'New Basis for the Access to EU/UK Financial Services post-Brexit', which assumes the free flow of trade in financial services as being beneficial both economically and socially to the EU and the UK. It was said that the 'oil in the wheel' of the financial services industry is passporting which is linked to choice as well. The loss of passporting would lead to increases in the cost of financial services for the consumer, while restricting consumer choice. The alternatives under European law are deemed inappropriate as they do not offer an optimal long-term, sustainable solution for such firms to access EU market. They would lead to increases in operational costs, fragmentation across Europe (which brings with it increased risks) and potential losses of business for Europe as whole to other jurisdictions such as the US. Therefore, the preferable model for a future relationship between the EU and UK is to have a bespoke arrangement under which mutual rights of access to each other's markets would be allowed.

The point was then made that the proposed agreement must go further than existing ones. Such access would require regulatory alignment, and as the UK is completely aligned with the EU rules and regulations, this makes the UK unique when it comes to trade agreements. Neither the EU nor the UK would like to be a rule taker, so the report proposes to manage divergence on a mechanism based on outcomes. Such divergence can manifest itself at the detail level. Future divergences can be managed via mechanisms built through ongoing supervisory co-operation in developments such as fintech at firm level but not for joint decision making. The report further proposes the creation of a Regulatory Alignment Forum to oversee the relationships.

The report proposes that any resolutions, must be undertaken through a separate and independent mechanism, but not the ECJ and not the UK Courts. Such an agreement has to be legally binding so that it does not require either side to change their laws. In the advent of such a proposed FTA being terminated then, unlike the EU's third country equivalence regimes, firms should be given the reassurance of sufficient notice periods for withdrawal from the EU/UK Agreement, to allow them to manage the consequences of termination. As mentioned earlier, regulatory alignment is already in place. The City of London wants a good working relationship with the EU and this report aims to put the structure in place to build that relationship.

Discussion

An attendee questioned that a proportion of transactions might be affected by passporting since there are nine different types of passporting to which the reply was that a precise answer is difficult to construct. Another attendee replied that the number of transactions is enormously high with regard to passporting, and it is crucial passporting is retained by UK firms, and it will be subject to the negotiations. Another attendee re-iterated the need for certainty and the key to this is having a transition period which will provide the much-needed certainty, and stability not just for the firms operating in financial services but also to the whole economy. The attendee went on to add that the banking operations are very complex and that end consumers such as Small-to-Medium-Enterprises are very concerned about not having an outcome which provides the certainty required within the timeline widely published. Another attendee added that a transition period is becoming more and more a must, but legally we are presented with an awkward position especially with the modus operandi “nothing is agreed until everything is agreed” which provides little certainty.

On alignment and divergence, another attendee, asked how the degree of divergence is gaged, between the UK, the City and the EU? The Bank of England had advised to find and to present examples where such divergences may be desired by a firm in the financial services. In reality, the City has no appetite for regulation change as it sees it as a cost of access and increased costs of compliance. In response to this question, another attendee observed that since London is a leading financial centre, it follows international standards, indicating that there is an inherent sense of convergence and that divergence comes into how they are implemented from regional to national settings. The system aims for convergence but where one wants to diverge, a process in place to manage it.

One attendee asked whether the proposals, convergences on outcomes, were based on an Anglo-Saxon model and since the EU uses rules-based practices how can this gap be bridged? This point goes to the heart of matter, and the gap can be bridged. However, going into details can also be perceived as a race to the bottom, and it is not what the report proposes. The outcomes benefit both parties. The attendee went on to point out that the number of inward branch passporting is significantly higher than the outward branch passporting for EU financial institutions that are London headquartered and are concerned about the lack of certainty. If there is no deal, they have to subsidiarise which will mean fragmentation. Also, the access to capital is done very efficiently in London since it is the regional financial centre. But can the region of Europe grow as well with many smaller and less efficient centres? The answer is most likely no. It must also be acknowledged that London is an asset for the EU and if it was to be fragmented, it is New York that would stand to benefit most, not Paris, not Frankfurt.

Another attendee informed the delegates that the feedback from various EU countries about the report is mixed. Many countries recognise that loss of access to international capital markets would be damaging, but at the same time there is a sense of the UK ‘having its cake and eating it’. On the other hand, there is great interest in regulatory co-operating agreements in many fields such as data handling and protection, mediation and so on.

An attendee pointed out that a lot seems to depend on the UK government making up its mind about what it wants. It is becoming clear by the size of the task at hand that if there were to be a transition period it needs to be more than two years as this is not something that can be allowed to go wrong. The EU would also benefit from such proposals, and the UK government would have to pay on a different basis. The issue of this being a political matter also needs to be addressed.

On divergence, one attendee brought into the conversation the remarks from Mark Carney about bonus caps being removed following Brexit and went on to state that the EU regulatory bodies would not agree to such moves. A response stated that Mark Carney’s comments were not entirely helpful but this is nonetheless where divergence can take place. However, this is divergence by agreement. Agreements which give each side to veto through a resolution mechanism while following a process which may end in access having been withdrawn can be in itself a severe penalty. One must also bear in mind that the size of the UK financial market constitutes a huge influence when it comes to financial market regulations. Thus, the natural inclination is to maintain high standards which ultimately all boils down to trust.

Another attendee said that while those based in London or regularly dealing with London may understand the City's procedures many others might not understand this. The view of EU27 regards divergence from EU regulation as an attack on the dream that is the European Union, and the dream will be defended with actions even if it is perceived as harmful.

The conversation moved on to another attendee asking about the future relationship between the UK and the EU post-Brexit and post-transition, reminding the others that the international community expected an agreement to be reached and that the EU has an obligation to do this, too. It must be noted that London is very good at attracting assets worldwide. Hence in London European firms have also benefited from this as London accounts for 36% of Europe's assets. Such accomplishments have to be thoughtfully considered when it comes to the future relationship.

Another attendee was prompted to state how for decades the UK seems to have underestimated the political, cultural and emotional aspects of its relationship with the EU as compared to the purely economic terms and this is important for the UK Government. The UK government has major decisions to make about the degrees of alignment and convergence it wants to have with the EU. At the same time, the EU itself must face some questions in the context of Brexit which have not yet been adequately addressed. Does the EU value the London primacy and how it supports the EU economies? Alternatively, does the EU want to break down London's dominance in favour of financial centres in the EU27 or other global financial centres even if there may be negative economic consequences in so doing? Does the EU see a model of engagement with the UK with 100% EU rules applying within the UK as opposed to not having any engagement at all? Alternatively, can the EU be more flexible when it comes to strategic choices?

The replies to the above questions revolve around the EU as a victim of Brexit while the UK is not worse off as a result of the negotiation: i.e. having a situation where the UK contributes less than it does now while benefiting from the access to financial markets – why should the EU accept this scenario? Consultations during the compilation of the report included many national jurisdictions. Ultimately, the Norway model falls shorts on financial services. While it encompasses other sectors, it is very much less applicable to financial services.

These exchanges led an attendee to remind the others that currently London is not just the UK's financial centre, it is everybody's. Half the activities here are non UK (half of which are of EU). It is important to understand how large and complex this global reach is. As such it is not easily replicated. The supporting infrastructure and the accumulated experience (decades in the making) has made this financial centre what it is. These highly complex institutions are best left alone. The advent of fragmentation would lead to an increase in the operational risk to the financial instruments to a degree that will increase inefficiency, inflating the cost of operations and capital outlay significantly. Such an outcome is in no one's interest. Ideally, we would not be in this situation, but we must make the most of what we have been presented with. With such a massive trade surplus with the UK it is transparently in the EU's interest to do a trade deal with the UK. Therefore, the EU and the UK must be encouraged to approach the negotiations sensibly to take them forward. The spheres of politics must not negate the economic ramifications at stake. Reality dictates that getting these negotiations wrong would hurt everyone: the EU, the UK, their businesses and people.

Conclusion

IRSG, after many rounds of consultations with international stakeholders and others based in the City of London, has presented an ambitious and optimistic report which goes beyond any free trade agreement currently extant between the EU and third parties. The UK is in a unique position since it has all the legislation and regulations in place and thus is well-aligned. The report also proposes that any future relationship regarding access to financial markets between the EU and the UK be based on outcomes rather than existing details. Future divergences can be managed via mechanisms which are built upon ongoing supervisory co-operation. However, London is a global financial centre, and thus it is in its interest to uphold international standards. Hence it has little appetite to diverge from current regulation since any changes are seen as overheads offering little or no benefit. Delegates were reminded that London's financial centre is not just a UK institution: EU banks and firms, in a sense the EU27 economies benefit, from London's ability to operate efficiently and its ability to account for 36% of Europe's assets. These are abilities and services built up over decades, and any efforts to curtail them would have adverse economic consequences. The scale of operations and supporting infrastructure are highly complex and therefore not transferable or easily replicated. Furthermore, no European financial centre stands to gain from such attempts. While a degree of emotionality colours the Brexit outlook, both the EU and the UK negotiation parties are strongly urged to think of the future relationship beyond Brexit and post-transition which is expected to be more than two years. In the short term, business is craving much needed certainty. The language of negotiations must be suitable to the topics it covers: politics, trade, financial services and so on. The City of London will retain an ambitious and optimistic view of the future. There is a lot of concern on how these arrangements will be made which affect the savings and pensions of hundreds of millions of people. These points and concerns must charge us all with an urgency to make our voices heard with politicians, governments, and negotiators among others, so that for the latter may more readily understand the gravity and implications of the situation.

Full IRSG Report: **A new basis for access to UK/EU financial services post Brexit,** is available for download **here**

On 15 December 2017, the EU leaders have agreed to move Brexit talks on to the second phase.

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About IBDE

International Business and Diplomatic Exchange (IBDE) is a London-based membership organisation providing leadership in promoting international trade and investment flows, financial and professional services, energy, infrastructure and ICT sectors as well as championing corporate, commercial and trade diplomacy. Bridging the gap between business and governments is the game changer for business people and diplomats today, and this is the focus of IBDE. IBDE provides an independent, accessible platform for debate and exchanges of views to help inform international trade & investment policy and decision-making. In its approach IBDE considers the risks to business, including political risks, and the political aspects of business risk.

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