EU Withdrawal Impact Assessment

November 2018

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Executive summary

The Treasury Select Committee requested the FCA to assess the impact of the UK's exit from the EU across three areas:

- The UK leaves the EU without an agreement either on 29 March 2019 or after the transitional period on 31 December 2020 (Section 2)
- The draft Withdrawal Agreement (Section 3)
- The outline of the political declaration on the framework for the future relationship between the EU and the UK (Section 4).

As a public body, the FCA takes no position on the UK's withdrawal from the European Union as such. Nor do we advocate a particular approach to withdrawal. Instead, we assess Brexit and what might happen over the coming months strictly through the lens of achieving our strategic objective to ensure that relevant markets function well, and our specific operational objectives - to protect consumers, enhance market integrity and promote competition.

The UK leaves the EU without an agreement either on 29 March 2019 or on 31 December 2020

If the EU and the UK do not ratify a Withdrawal Treaty in time for 29 March 2019, absent any alternative agreement, the UK would leave the EU with no implementation period. In a financial services context, this means defaulting to a "third country" relationship, with market access determined under World Trade Organisation (WTO) rules and EU or national Member State rules.

EU legislation would cease to apply in the UK. Instead, the relevant legislation would be converted into UK law through the EU (Withdrawal) Act and amended by Government and regulators to ensure the UK continues to have a functioning regulatory regime.[1] The Government has also proposed to provide the FCA and Bank of England with powers to smooth the transition to the new regime. In the event the UK leaves the EU with no agreement, it will be crucial that all the relevant statutory instruments intended to be laid by Government are in place by exit.

The UK and EU would become third countries from the other's perspective, which means passporting rights would cease to apply. The UK would no longer be part of the EU legal frameworks that provide for supervisory cooperation and data sharing between Member States. The European Commission has encouraged the European Supervisory Authorities to put the necessary agreements in place ahead of exit to ensure EU authorities can cooperate with the UK as with other third countries, but this will not cover all areas of cooperation that currently exist between EU Member States.

[1] EU (Withdrawal) Act

Firms are preparing for this scenario. Execution of firm contingency plans could lead to market fragmentation and increase cross border risk. Together with the Bank of England's Financial Policy Committee (FPC) and other UK authorities, we are monitoring the risks of disruption to UK financial services arising from Brexit. It will be difficult, ahead of March 2019, for financial companies on their own to mitigate fully the risks of disruption to households and businesses. As a result, the FPC has highlighted a number of activities which could be disrupted unless action is taken by the authorities in the UK and the EEA.

Consumers could also potentially be affected, either directly if firms are unable to continue providing services or indirectly as a result of wider economic or market disruption. Over time market fragmentation could have a harmful impact on financial services' markets more widely, through reduced competition and increased costs for customers in both the EEA and UK.

Working with the other UK authorities, we have put in place measures such as temporary permissions regimes to mitigate risks to consumers wherever possible, and we have clearly communicated our expectation to firms that individual consumers must be informed about material changes in their position related to EU withdrawal. However, fully addressing the risk to EEA consumers, including potentially UK nationals who reside in the EEA and hold contracts with UK firms requires action from firms and EEA regulators. Neither could UK actions alone fully solve the issue of contracts where both counterparties require local permission such as uncleared OTC derivative contracts.

The UK authorities have engaged in extensive contingency planning. As a result, the FPC has judged the UK financial system to be resilient to a disorderly exit without a deal or implementation period. Nonetheless, it notes that some market volatility is to be expected in this scenario, but this should not affect the ability of markets to function effectively.

Ultimately, the impact of a no-deal scenario greatly depends on the extent to which the UK and EU can continue to cooperate and take action together to minimise disruption. The Government, the FCA and the Bank of England/PRA have taken steps to ensure appropriate mitigation is in place for risks that can be dealt with unilaterally. However, outstanding uncertainties include:

- the extent to which firm and public-sector contingency plans can be executed smoothly and how any market disruption can be mitigated, which may be affected by the timing of a no deal outcome;
- the extent to which the EU and UK are able to treat each other's regulations as equivalent, including for the purposes of sharing data;
- the extent of supervisory cooperation and how we would manage the separation of shared systems for market oversight; and
- the solutions the EU puts in place to ensure continuity of contracts and other cliff-edge risks the Financial Policy Committee (FPC) has identified.[2]

Alternatively, in the event a Withdrawal Agreement is ratified but no future relationship is in place before the end of 2020, and absent any other agreement

[2] Bank of England's Financial Stability Report No. 44, November 2018

for financial services, or an extension of the implementation period, the UK would leave the EU with no specific framework in place governing its relationship with the EU.

We expect in this scenario firms would have had more time to prepare for such an outcome, and therefore the risks specifically for the financial sector would be lower than had the UK left without an agreement in March 2019. However, as identified above, some of the cliff-edge risks are dependent on actions taken by the EU, and while the UK and the EU may have had more time to coordinate their approaches to dealing with such risks, it is not possible to rule out that at the end of the implementation period new cliff-edge risks could arise.

The draft Withdrawal Agreement is ratified

The draft Withdrawal Agreement provides for an implementation period, which will run from 30 March 2019 to 31 December 2020, during which EU law applies to the UK. The implementation period may be extended once with both parties' mutual consent.

The FCA has consistently supported an implementation period to avoid cliff-edge risks and smooth the UK's transition to a new relationship with the EU. The draft Withdrawal Agreement achieves this by ensuring that EU law, and rights and obligations derived from EU law, continue to apply throughout the period. This includes new EU laws that are agreed and implemented during that period.

During the implementation period, the UK will no longer be part of EU decision-making structures, nor will it be represented in the EU institutions, agencies and bodies. The FCA will therefore no longer be a voting member of the European Securities and Markets Authority (ESMA). Some participation may be possible, but the EU and UK have not yet agreed how this would work in practice. In our view, there is time for this issue to be resolved. We believe there is a strong case for continued close cooperation given the size of the UK's financial services sector and the importance the UK's approach to applying EU financial services law has for the rest of the EU.

We have also reviewed the draft Withdrawal Agreement and identified the articles relevant to the FCA's objectives. The Agreement's main impact relates to the evolution of EU law during the implementation period and the extent to which the FCA and the Government continue to input into, shape and influence the evolution of financial services law.

We have reviewed the legislation that is currently under negotiation in the EU. More than 30 EU legislative files relating to financial services are currently under discussion. It is not certain how many of these the UK will ultimately need to put in place during an implementation period. Until 29 March 2019, the UK will remain involved in the decision-making structures of the EU and the FCA will still be a voting board member of ESMA. During the course of 2019, the EU will have parliamentary elections and appoint a new European Commission. Accordingly, the amount of legislation agreed in this period may reduce.

A new European Commission and European Parliament will follow and typically set a new agenda and make new proposals. These would take time to be agreed and implemented, reducing somewhat the risk from new rules coming into effect before December 2020. However, should the implementation period be extended, the greater such risks become. The UK authorities can seek to reduce these risks by continuing to engage closely with EU partners during this period, but the amount of influence we can have is uncertain.

For the FCA, the risks presented in an implementation period are preferable to the risks of a no-deal scenario. As the implementation period is extendable for up to two years by agreement between the UK and the EU, this could assist in helping to avoid further cliff-edge risks at the end of the period. However, it will be important to consider the risks associated with any extension and to work during the period to avoid new cliff-edge risks arising.

The framework for the future relationship between the EU and the UK

At the end of the implementation period, the UK and EU are expected to have an agreed future trading relationship in place. The Government and the EU have agreed an outline of the political declaration setting out the framework for the future relationship between the EU and the UK. For financial services, this encompasses:

- commitments to preserve financial stability, market integrity, investor protection and fair competition, while respecting each parties' autonomy and ability to take equivalence decisions in their own interest;
- commencement of equivalence assessments by both parties as soon as possible after UK withdrawal, endeavouring to conclude these assessments before the end of June 2020; and
- close and structured cooperation on regulatory and supervisory matters, grounded in the economic partnership and based on the principles of regulatory autonomy, transparency and stability

The UK and EU will both have the ability and common interest to find each other's regimes equivalent post exit, facilitating market access across a range of sectors. The declaration appropriately recognises that this must be in the context of both sides retaining autonomy over the exercise of their equivalence regimes. Therefore, equivalence assessments will need to be based on equivalence of outcomes as opposed to identical rulebooks. It will also be necessary to consider carefully the process and scope of equivalence as it currently exists, to ensure that it provides an adequate framework for cross border business in the future. We believe that there is substantial scope for development and improvement of the framework.

The declaration also provides for close and structured supervisory and regulatory engagement, and the possibility for an enhanced relationship compared to a standard third country position. The FCA is committed to close cooperation with EU counterparts. If implemented, this could make it easier for us to continue to meet our objectives, and help manage cross border risks by ensuring that they can be identified early and managed effectively.

Leaving the EU creates a number of risks for us regardless of the form of exit. The implementation period helps address these at the cost of a lower ability to influence regulation during that period, for example due to the removal of our voting rights in the ESAs. An exit without agreement would carry much higher risk and carry significant uncertainty for us and for firms. Against that background, and viewed through the lens of our statutory objectives, the draft Withdrawal Agreement and the outline political declaration are preferable steps.

1. Introduction

In letters dated 27 June and 11 October 2018, the Treasury Select Committee asked the FCA to give an assessment of the impact the UK's exit from the European Union would have under three scenarios. Our focus in this assessment is our ability to meet the objectives set by Parliament. The FCA's strategic objective is to ensure that relevant markets function well, with specific operational objectives to:

- secure an appropriate degree of protection for consumers;
- protect and enhance the integrity of the UK financial system; and
- promote effective competition in the interests of consumers.

Our assessment considers those objectives which Parliament has given us. We take no position on the broader merits or otherwise of the UK's withdrawal from the EU and do not advocate a particular approach. Whatever the eventual outcome, we will continue to pursue our objectives, working with the Government, domestic and international regulators, industry and other stakeholders to manage any risks. We have worked closely with the Government and Bank of England to ensure that we are as prepared as possible to deal with any outcome. We discuss our contingency plans further as part of this assessment.

We are:

- providing technical advice to support the Government's negotiations with the EU and any other countries it may want to secure future agreements with;
- working with firms to understand their future operational plans, the impact on their customers and that customers are treated fairly (recognising that for the purposes of our statutory objectives customers means all customers of FCA authorised firms and users of markets wherever they are domiciled);
- working with the Government to provide technical advice on the EU (Withdrawal) Act legislation, and ensuring that we have a robust regulatory system in place on Day One; and
- seeking to manage any other risks of EU Withdrawal.

As part of this, we have considered the Bank of England's assessment of the wider relevant economic consequences.

In line with the Treasury Select Committee's request, we have focused our analysis on three areas:

- no Withdrawal Agreement is finalised by 29 March 2019 or no future relationship is in place at the end of the implementation period (Section 2);
- the draft Withdrawal Agreement is agreed (Section 3); and
- the future relationship is in place by 31 December 2020 (Section 4).

In line with this request, our analysis focuses on the FCA's ability to deliver its statutory objectives across these areas.

2: The UK leaves the EU without an agreement either on 29 March 2019 or after the transition period on 31 December 2020

EU law currently provides most of the institutional and regulatory framework for financial services in the UK. This consists of level 1 directives and regulations (agreed by the Council and the Parliament) and level 2 legislation (technical rules generally developed by the European Supervisory Authorities with input from national regulators). These common rules support the single market in financial services, ensuring firms in one Member State can provide services across the EEA using their home state authorisation (passporting). Alongside this, there are specific mechanisms for supervisors across the EEA to cooperate, to manage any emerging risks and deal with cross border issues.

If the EU and the UK do not ratify the Withdrawal Agreement in time for 29 March 2019, absent any other agreement, the UK will leave the EU with no implementation period or alternative arrangement in place. For financial services, this would mean an abrupt end to UK firms' access to the single market. The single rulebook and provisions on regulatory cooperation would cease to apply in the UK. Instead, the UK would default to a 'third country' relationship with the EU. In this case, the terms of market access would largely be decided by the national laws of each member state and the EU rules on third countries. This would limit firms' ability to undertake cross border business without having to physically establish themselves in the relevant jurisdiction or meet additional local authorisation requirements.

Summary of impact

We have categorised the key consequences of exit without a Withdrawal Agreement into the following areas:

- **EU rules cease to apply** – under the terms of the EU (Withdrawal) Act and as a result of the UK no longer being party to the EU treaties, EU legislation would cease to have direct effect in the UK. Instead, the relevant legislation will be converted into UK law, with changes to ensure it operates in a UK context. Ensuring this work is completed successfully is crucial to mitigating some of the key risks of EU withdrawal.
- **Loss of passporting** – currently, a series of financial services passports (set out under EU legislation) give UK financial services firms much of their access to EEA markets - and vice versa. When the UK leaves the EU, these provisions will end. While passporting could partially be replaced by both the UK and the EU agreeing their regulations are equivalent, our assumption based on the position of the European Commission is that there would not be blanket equivalence decisions that allow for similar market access as now.
- **Data sharing** – the UK and EU's ability to share data may be restricted without reciprocal action by UK and EU authorities.
- **Firms continue to implement contingency plans** – we have regular supervisory contact with larger firms and we are ensuring these firms either

have contingency plans in place or have decided not to continue to offer services in the EU. We have also communicated our expectations of all firms regardless of size through a variety of channels. Many firms have already begun to implement their contingency plans.
- **Reduced supervisory cooperation** – the UK's current regulatory and supervisory cooperation with EU and national authorities under EU law would cease to apply. Instead, the UK would rely on the existing third country framework for cooperation.
- **Wider economic impact** – the wider economic situation following exit will have both direct and indirect consequences on our objectives.

We have chiefly considered these impacts at the point of exit, rather than the long-term implications. In a long-term risk assessment, the impact will depend on several factors, such as the evolution of the UK's regulatory regime, the response from the EU and the broader relationship between the UK and the EU. We have summarised some of the key facts related to our EU withdrawal work in the table below.

Table 1. Summary of key facts

Onshoring	• Around **60** Statutory Instruments (SIs) specific to financial services which HM Treasury is responsible for and a further **10** from other Government departments which are relevant to our objectives are planned under the EU (Withdrawal) Act • Amendments to **27** of the FCA's Handbook sourcebooks will be consulted on
Passporting	• **359,953** total passports into and out of the UK used by **13,484** firms to do business into or out of the UK • **8,008** EEA firms with passports to do business in the UK • **5,476** UK firms with passports to do business in the EEA • More than **1,300** firms and funds have responded to an FCA survey indicating they will want to receive a temporary permission
EU Legislation	• More than **30** EU financial services files currently under negotiation

EU rules cease to apply

The UK's current financial services legislation is largely taken from EU legislation. This includes Regulations, Directives and binding technical standards[3] developed by the European Supervisory Authorities (ESAs). When the UK leaves the EU, this legislation will cease to apply in the UK. This creates two challenges:

[3] This incorporates implementing and regulatory technical standards

- how to ensure regulatory continuity at the point of exit if legislation ceases to apply or if it applies in an uncertain way (for example, if it is not adjusted to reflect the UK's position outside the EU); and
- how to maintain and update legislation after exit to keep up to date with international standards and regulatory developments

UK actions to support legal certainty at the point of exit

To address any legal uncertainty at exit, the European Union (Withdrawal) Act 2018 will repeal the European Communities Act 1972. At the point of exit it will preserve existing UK law which implements EU obligations and convert existing 'directly applicable' EU law into UK law. The Withdrawal Act also gives Ministers powers to amend this legislation to ensure it works effectively when the UK leaves the EU.

We have worked with HM Treasury and the Bank of England to review the relevant EU legislation and UK domestic financial services legislation to identify gaps that will exist when the UK leaves the EU and existing EU law is transferred to UK law. HM Treasury and other Government ministries are drafting Statutory Instruments (SIs) to fix these gaps in Primary and Secondary UK legislation and have started laying these SIs in Parliament.

As part of this, HM Treasury has tasked the FCA and the Bank of England with amending and maintaining EU binding technical standards[4] (BTS). These are detailed EU rules, currently developed by the European Supervisory Authorities and endorsed by the European Commission, European Parliament and the Council. These rules provide technical detail on how firms must meet EU regulations and directives. We will also amend our Handbook to ensure it is consistent with Government changes to financial services law and that it functions effectively when the UK leaves the EU.

We have published three consultation papers setting out our proposals should the UK leave the EU on 29th March 2019 with no deal. Our consultations cover amendments to our Handbook and BTS, and the temporary permissions regime for EEA passporting firms (discussed below).

The EU (Withdrawal) Act and related secondary legislation will ensure the UK has a functioning regulatory regime in time for day one. In June 2018, HM Treasury announced it will bring forward legislation to support a smooth transition and avoid firms having to prepare for several different outcomes in a short space of time. This legislation will allow the FCA and the Bank of England to phase in changes to regulatory requirements.5 We expect to use this power in a proportionate way, bearing in mind our statutory objectives and the challenges firms face in implementing these changes. This power will mean that we can take steps to

[4] BTS are EU legislation but they do not set overall policy direction. They sit underneath Level 1 EU legislation and give technical detail on the overall legislative requirements. Generally, where BTS are required, they are drafted by the ESAs for adoption by the European Commission. They are differentiated from Level 2 delegated acts and implementing acts in that they 'should be technical, shall not imply strategic decisions or policy choices and their content shall be delimited by the legislative acts on which they are based'.

[5] HM Treasury's approach to financial services legislation under the EU (Withdrawal) Act, 27 June 2018

support a smooth transition and reduce any potential disruption that changes to requirements might cause.

Maintaining and updating financial services legislation after exit

In the medium term, the UK would have greater freedom to tailor financial services rules to ensure high standards that meet the needs of its domestic market and consumers, as well as our role as a global financial centre. This adjustment would need to be compatible with broader international standards and take account of the type of EU-UK relationship we may have in future.

It is important that UK financial services legislation stays up to date with international standards, changes in markets and the need to meet our objectives in the most efficient way possible. As a result, it will be necessary to ensure that legislation can evolve rapidly. For example, the EU are currently discussing several legislative proposals which provide benefits for UK firms by increasing proportionality and reducing burdens. It will be important to ensure the UK can incorporate these changes in a timely way and maintain consistency with other financial centres. The Government has proposed legislation[6] that will provide a mechanism to enable it to implement certain EU proposals after exit.

Loss of passporting

A significant volume of cross border financial services business within the EEA is carried out through financial services passports. Under a passporting regime, financial services firms established and authorised in any EEA Member State have access to the single market for the relevant financial services. This means they can set up branches in other EEA countries or provide financial services on a cross-border basis within the EEA without having to get further authorisation in other Member States.

A similar mechanism applies under the passporting provisions in the Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Fund Managers (AIFM) Directives. Under these, EEA managers can market funds throughout the EEA according to the passport's terms without needing further authorisation.

A summary of the volume of cross border passports included in previous correspondence with the Treasury Select Committee is included in Annex I. This includes 8,008 EEA firms with passports allowing them to undertake business in the UK, and 5,476 firms in the UK hold passports allowing them to undertake business across the EEA. When the UK leaves the EU, passporting rights will cease to apply.

Risk of market disruption

If the EU and UK do not take action to manage risks caused by the loss of passporting, existing cross-border flows of business may be disrupted on the UK's exit on 29 March 2019. In the short term, a loss of passporting creates a number of cliff-edge risks, such as a need for firms to secure regulatory permissions to

[6] Financial Services (Implementation of Legislation) Bill

service existing and new business. Without this, firms may lose the ability to conduct cross border business, which creates legal and operational risks.

EEA and UK firms may also be unable to trade certain securities across both jurisdictions. This could lead to a fragmented market as UK and EEA firms would no longer be able to use the same pool of liquidity. Over time, this could have a harmful impact on financial services markets more widely, through reduced competition and increased costs for consumers in both the EEA and UK. A potential reduction in the depth of the markets available to UK and EEA participants could also lead to higher costs or make it more difficult to execute larger transactions.

Our objective to ensure competition in the interests of consumers would be affected if the loss of market access led to firms withdrawing from the UK market. Given the size and openness of the UK's financial market, in the short term the risks appear low although specialist markets may be disproportionately affected. Over time, more significant restructuring could affect markets more widely.

Contract continuity risks

The loss of passporting could have consequences for outstanding cross-border contracts. The performance of many contractual obligations agreed before exit is unaffected by the UK's withdrawal. However, the performance of certain activities that are linked to those contracts may be subject to authorisation in certain Member States.

After the UK's withdrawal, firms may need to get local authorisation to service existing cross-border contracts. Our analysis to date suggests the impact is most significant in the insurance, uncleared OTC derivative and cleared derivative markets.[7] There are also potential risks to financial stability and consumer protection – in particular in the EU - if firms cannot service these contracts.

The Bank of England's Financial Policy Committee (FPC) has considered the impact of contract continuity, and identified three areas relevant to the FCA's objectives:

- **Insurance** - EU or Member State rules may prevent UK insurance companies collecting premiums from, or paying claims to, their 38 million policyholders in the EU. Most UK insurance companies are making good progress in restructuring their business so they can serve their EU customers after Brexit. However, firm action alone is unlikely to address all risks that may be faced by EEA policy holders, and there are no EU wide proposals to mitigate this risk.
- **Uncleared OTC Derivatives -** National rules in some EU Member States may prevent EU clients and banks from performing specific contractual activities (known as lifecycle events) on derivative contracts they have with UK banks. This will limit the ability of EU clients and banks, as well as UK banks, to manage risks particularly in situation of market stress. These affected contracts account for the majority of (uncleared) derivatives between the EU and UK, which have a total notional value of £28 trillion. An increasing share of these (£18 trillion) mature after March 2019. The Government has legislated to

[7] Over-the-counter (OTC) derivatives are contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary

ensure, after Brexit, EU firms can still perform these lifecycle events on derivative contracts that UK clients such as asset managers have with EU banks. In contrast, the European Commission[8] does not appear to see a generalised problem of contract performance. Instead, it calls for firms to continue preparing for this situation by transferring contracts and seeking the relevant authorisations. Some Member States are legislating to allow, in some cases, the continued performance of the back-book of derivatives.

- **Cleared OTC Derivatives** – Post-exit, absent EU action, EU clearing members may be unable to access clearing services from UK central counterparties (CCPs). Based on ECB estimates, EU-based firms clear 90% of their interest rate swaps in the UK.

Steps the Government and FCA have taken to manage the risks

The FCA, Bank of England and Government have taken action to manage risks in the UK. This includes setting up a temporary permissions regime (TPR), which will allow inbound EEA firms and funds that want to continue operating in the UK after exit to continue to operate as before, including carrying on new business, while applying for full authorisation in the UK.[9] This would also enable EEA firms to carry out existing contractual obligations and manage the risks from the sudden loss of permission. The Government has also legislated to ensure that UK businesses can continue to use clearing services provided by EU-based clearing houses.

To help maintain protection for consumers, we are proposing that the Financial Ombudsman Service will cover EEA firms that enter the TPR. The FCA and the PRA are also consulting on arrangements for FSCS cover for EEA companies that enter the temporary scheme. Most EEA firms providing UK consumers with financial products and services are currently not covered by the FSCS. Under the temporary scheme, we are proposing to extend the reach of FSCS cover to include more EEA firms so as to help maintain protection for UK consumers.

We are also advising Government on its draft legislation to deliver similar transitional arrangements for other types of firm. These include:

- central securities depositories;
- credit rating agencies;
- trade repositories;
- data reporting service providers;
- systems currently under the Settlement Finality Directive; and
- depositaries for authorised funds.

The Government has also committed, alongside the TPR, to introduce a contract continuity solution to enable EEA firms to wind down their UK business in an orderly fashion. These regimes would help manage the risks from EEA firms losing the ability to conduct business in the UK.

[8] https://ec.europa.eu/info/sites/info/files/brexit_files/info_site/communication-preparing-withdrawal-brexit-preparedness-13-11-2018.pdf
[9] Draft statutory instrument amending EEA passport rights legislation and establishing a Temporary Permissions Regime, to be laid under the EU (Withdrawal) Act 2018.

Taken together, these regimes would cover, for example, the 16 million insurance policies that UK households and businesses have with EU insurance companies so that they can continue to be serviced after EU withdrawal. For uncleared derivatives they would ensure that EU firms can still perform lifecycle events on derivative contracts that UK clients such as asset managers have with EU banks.

However, addressing the risk to EEA policyholders and counterparties, including potentially UK nationals who reside in the EU and who hold contracts with UK firms, requires action from firms and EEA regulators. Neither could UK actions alone fully solve the issue of contracts where both counterparties require local permission such as derivative contracts.

Actions by firms to manage these risks

One way to manage risks to contractual continuity and a loss of market access is for firms to take action within the current regulatory framework. Key actions firms can take are restructuring and getting new authorisations by the point of the UK's exit, or transferring contracts to other firms or legal entities with appropriate regulatory permissions. Some sectors, such as retail banking, are more domestically focused and so relatively less affected. Other areas, such as wholesale banking, undertake relatively more cross border business and so the impact will be greater.

Wholesale banks are implementing their plans to move or expand their EEA business to ensure they can continue to service EEA clients. Some of the larger firms have applied for new licences or amendments to existing permissions to EEA regulators. Progress towards implementing the plans in part depends on the timeframes for other EEA regulators to approve new licences and amend existing ones.

Some UK trading venues are obtaining necessary regulatory permissions to establish EU-based venues to offer further trading options. Firms are setting up or enhancing their EU offices to enable them to carry out trading in the EU or for EU clients, where this business is significant for them, while some EU firms are doing the same in the UK to enable access to UK markets.

The largest UK asset managers are at the stage of finalising their legal structures in Europe. Smaller firms without a European presence face more limited options to continue to service EU27 clients and may have to rely on third parties for the cross-border management and marketing of their funds. Asset managers are dependent on cooperation agreements between the FCA and National Competent Authorities being in place to continue to manage portfolios for EU clients and funds.

Major insurers are setting up or expanding operations in the EEA to service European clients. The transfer of existing insurance business from the UK to the EEA requires a Court process (called a 'Part VII transfer'). A number of the current Part VII transfers may not be completed by exit-day. And there remain contract continuity issues for existing cross-border insurance policies and data transfers. For example, many insurers are working to complete the transfer of existing clients by the end of the transition period, and some may not complete the process by March. In this situation, they may be unable to service existing contracts without first receiving new permissions from EEA authorities. The FCA has said it will not stand in the way of such firms paying out valid claims.

There are significant challenges in undertaking this kind of restructuring and managing contractual continuity risks through individual actions alone. The complexity and time needed to deliver the solutions in the short time remaining is a key issue for industry and poses operational and delivery risks alongside additional costs for firms. To address these risks, we have been working closely with firms to ensure they are adequately prepared for exit and able to service existing contracts as far as possible.

In particular, we expect UK regulated firms to develop contingency plans for EU withdrawal and have been working with firms to consider the implications of those plans. Given the short timeframes and the complexity of EU withdrawal, we believe there remain challenges and operational risks to implementing these plans.

Actions by the EU to manage the risks

The European Commission can choose to carry out an assessment of a third country's legal and supervisory framework and can decide it meets the necessary standards to find it equivalent. The time this process takes varies. There is currently no process by which a third country can require the EU to undertake an equivalence assessment or appeal if the assessment found the country not to be equivalent. Equivalence is also limited to those areas where it has been provided for under European legislation. As such it currently operates as a patchwork with equivalence a possibility in some areas, such as wholesale trading activity, but not in others, such as retail investment funds.

Many of the effects of a no-deal scenario could be managed if the EU and UK were able to find each other equivalent ahead of exit. There is a strong case for this since the UK and EU would have the most equivalent frameworks in the world at the point of exit.

The European Commission has set out its expectations of how it would treat the UK if there is no agreement, and we have factored this into our assumptions:[10]

- the European Commission has said it is willing to adopt temporary and conditional equivalence decisions for cleared derivatives, helping minimise the risk of disruption in central clearing and in depositaries services;
- the European Commission is not planning on taking any further contingency action for other areas in financial services, such as insurance or OTC derivatives; and
- the European Commission has also encouraged the European Supervisory Authorities to begin preparing Memorandums of Understanding (MoUs) with UK supervisors to ensure all parties can exchange information immediately from exit.

[10] European Commission Communication: Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: a Contingency Action Plan, 13 November 2018

We welcome the European Commission's comments on clearing and MoUs. On clearing, following through on this statement of intent will help provide clarity and reduce, though not fully mitigate, the risk that EEA clearing members will need to close their positions in short timeframes, reducing the potential for disruption. The commitment on MoUs will ensure cooperation can continue. However, the European Commission has not committed to providing further equivalence decisions where they are available, such as in relation to MiFID II. As a result, we have not assumed that such decisions would be put in place even though they would be mutually beneficial. Nor are there any proposals for solutions similar to the UK's temporary permissions regimes at EU-level.

Data sharing

Without action by EU authorities, EU rules would limit the flow of personal data from the EU to the UK. This could restrict EU households and businesses accessing financial services from, and continuing contracts with, UK financial service providers. Although companies can seek to add clauses into contracts in order to comply with the EU's cross-border transfer rules, there remain legal and operational risks given the volume of contracts involved.

For personal data, the Government has announced that it intends to continue to allow the free flow of personal data from the UK to the EU. Once in effect, this would support UK households and businesses' use of EU financial service providers. However, the European Commission has said that it is not planning to take similar action as part of its contingency planning for a no-deal scenario. As such, companies transferring personal data from the EU to the UK would need to consider alternative mechanisms for sharing personal data as set out under GDPR. Given the large range and critical nature of activities, the variety of financial services sectors potentially affected and the scale and importance of cross-border flows of financial services between the UK and EU, the UK authorities believe there are significant risks if there is disruption to cross-border flows of personal data from exit day.

Impact on supervisory cooperation

Cooperation between authorities within the EEA is currently set out under relevant EU sectoral legislation and is largely automatic. For example, regulators are under an obligation to provide certain information to each other or ESMA or to respond to requests for information from competent authorities in other Member States. Such cooperation covers:

- providing information and support if a Member State identifies a cross border issue;
- contributing data provided by firms for the purposes of detecting market abuse
- pooling data to calculate pan-EU thresholds;
- supervisory colleges to help understand and address emerging cross border risks in the EU; and
- intervening on serious product failures and emergency powers to prevent market disruption.

Key risks to supervisory cooperation

When the UK leaves the EU, these requirements will no longer apply between UK and European regulators. For example, in a no-deal scenario UK regulators will lose the right to participate in EU supervisory colleges. Supervisory colleges allow supervisors in different jurisdictions to share information and coordinate their approach to cross border firms, particularly banking and insurance groups. Areas of cooperation unrelated to EU legislation will not change – for example our role in global colleges (similar to EU colleges, but with a wider scope of participation) will not be affected. Equally, from an enforcement perspective, the FCA is a signatory to the IOSCO multilateral MoU (MMoU) which covers the majority of our global cooperation on enforcement issues. The MMoU does not depend on our membership of the EU, and will remain in place after exit.

The importance of ensuring cooperation between supervisors will be emphasised as the UK leaves the EU. Firms' restructuring is likely to lead to more complex cross border arrangements that require closer working between authorities in the home and host state. In the third-country context, cooperation typically relies on agreements (MoUs) between relevant regulators.

Action to reduce these risks

How far we are able to put arrangements in place for supervisory cooperation will have a significant impact on our ability to meet out statutory objectives. We continue to engage closely with EU and national regulators and would expect our counterparts to be open to coordination and cooperation wherever possible in any scenario.

The European Commission has also encouraged the European Supervisory Authorities to start preparing cooperation arrangements with UK supervisors. The aim here is to ensure that exchange of information about financial institutions and participants is possible immediately after the withdrawal date if there is no deal.

Ensuring cooperation agreements are in place will help effective supervision of cross-border activities, not least with firms undergoing restructuring that could move some risk and/or activity. This includes the operation of cross border branches. It will also help UK and EEA asset managers to rely on delegation and outsourcing arrangements which are currently a key part of the industry structure.

Residual risks

Agreements to cooperate as a third country alone are unlikely to replicate the extent of cooperation that occurs currently. For example, the automatic exchange of transaction reporting and other types of market data is critical to both the UK's and the EU's ability to detect market abuse. Since the introduction of MiFID II in January 2018, we are now processing over 30 million transaction reports per day and currently share around 70% of these transaction reports with the other 27 EU (and EEA) national competent authorities. In addition, the UK is one of the largest recipients of data. This exchange is underpinned by common European financial services and data protection legislation.

EU legislation also tasks the ESAs with maintaining various registers and databases.[11] These range from compiling sanctions applied and published in Member States under EU regulations (MAR, MiFID and UCITS) to data such as those reported by firms under AIFMD which can be used to identify the extent to which the use of leverage contributes to risks in the financial system. UK data would cease to be included, and this could undermine both sides' ability to understand and tackle market developments.

Currently, the rules around market transparency and other requirements for trading shares, bonds and derivatives are set at EU level and ESMA has calibrated this regime on the basis of pan EU trading data. Following exit, UK trading data will no longer be used for the calibration of the EU regime and vice versa. This may mean that different rules could apply to the same financial instrument in the UK and EU which may create risks of regulatory arbitrage. To deal with this in the UK, HM Treasury has proposed that the FCA will have powers to vary the application of trading thresholds and limits to reduce disruption for a temporary period; however, a longer-term solution will be needed.

There may also be some potential implications for our enforcement activities. Access to certain EU organisations, such as Europol, provides support for law enforcement activities. This may become more complicated post-exit, though there is precedent for continued attendance by non-EU jurisdictions. More generally, our enforcement function benefits from access to certain wider network information systems and databases established under EU law, and so any loss of access or reduced access would be harmful to our enforcement capability.

Another part of the FCA's overall mandate is its competition enforcement powers. Alongside a number of other authorities, including in particular the CMA, the FCA has powers to investigate suspected breaches of the prohibitions against anti-competitive agreements and abuse of a dominant position contained in the Competition Act 1998. The FCA's powers relate to financial services only.

The Government has published its proposed legal framework relating to the operation of the Act in the event of a no-deal exit. Under the Government's approach, UK competition authorities such as the FCA would have discretion to conduct investigations into potential breaches of the domestic competition law prohibitions under the Act that occurred before or after exit day. The framework provides that the power would be limited to the UK aspects of any potential breaches.

The FCA would exercise its discretion in accordance with its published prioritisation criteria for Competition Act cases. The desirability of close cooperation between UK and EU competition authorities post-exit has already been highlighted by a range of stakeholders including the House of Lords EU Internal Market Sub-Committee, CMA, BEIS and the NAO. Any inability for UK and EU competition authorities to cooperate on investigations (for example by assisting with certain investigative steps and/or sharing confidential information) may make investigations less straightforward for both UK and EU authorities, though as a number of these stakeholders note it may be possible to mitigate such issues over

[11] ESMA Registers and Data Webpage

time, for example by the UK and the EU or Member States concluding separate cooperation arrangements outside the context of a withdrawal agreement.

Wider economic consequences

The FPC has assessed the macroeconomic impact of the UK leaving the EU without an agreement, based on a number of scenarios, including the impact of a disorderly Brexit. The FPC has judged that the UK financial system is resilient to a macroeconomic shock arising from a no-deal Brexit, and that many of the risks to disruption in the provision of financial services from the EU to UK have been addressed, or will be addressed through future legislation, there are a number of wider risks.

In particular, it noted that some market volatility is to be expected and significant asset repricing could test market functioning and affect the provision of market-based finance. It also highlighted that large scale asset sales could affect some markets. Notably, market functioning could be impacted by high demand for liquidity, including from open-ended investment funds. Overall, it concluded that market functioning should be supported by the resilience of dealers who intermediate between buyers and sellers, and that insurers are also sufficiently resilient to be able to support stressed markets. Despite this, it noted that as a result of insufficient action on the EU side, there may be some disruption to financial services provided by UK institutions to UK and EU households and business.

Summary: impact on FCA objectives of a no-deal scenario

We have worked with the Government, the Bank/PRA and industry to reduce the risks arising from a no-deal scenario.

This work includes:

- onshoring the Acquis (body of EU law) to give firms regulatory certainty and maintain protections for consumers;
- implementing temporary permissions regimes to ensure that EEA firms can continue to service their UK contracts after exit, and to avoid a rushed restructuring process;
- working with firms on their plans and ensuring they carry out appropriate communications with consumers; and
- preparing to supervise those activities (such as credit rating agencies) where responsibility currently sits with ESMA.

Taking into account the actions the FCA, the Bank of England and the Government have taken unilaterally, and the contingency planning by firms, risks have been reduced significantly. However, there remain a number of residual risks. These include:

- the potential for disruption as firms implement their no-deal plans, particularly where plans are less developed, or firms do not get appropriate EEA authorisations in time for exit. For smaller UK firms, or those with less EEA business, establishing a cross border presence may be a less viable option;

- uncertainty for consumers about financial services provision, especially for consumers in the EEA, where there is no direct equivalent of the temporary permissions regime at EU level. We have clearly communicated our expectation to firms that individual consumers must be informed about material changes in their position related to EU withdrawal. Where firms are unable to continue to supply services into the EEA and without action by EEA states to manage this, this could have an impact on the EEA-based clients of these firms;
- cliff-edge risks, particularly those that affect contract continuity and the ability to transfer data, as identified by the FPC; and
- the impact on our ability to supervise and manage cross border risks from any loss of supervisory cooperation with national competent authorities in the EEA.

Despite extensive action taken by UK Authorities, a no-deal exit could have consequences for the UK financial system given the short remaining timeframes to develop and execute mitigating actions. Some firms may not be able to fully implement their contingency plans ahead of March 2019, which could cause disruption to markets and clients. There are also operational risks associated with such plans, as well as risks that clients may not be treated fairly, or appropriately informed of the impact of firms' plans on the services they receive. Overall this may result in market disruption which, taken together with impacts on the sector arising from wider disruption in the economy, may affect the financial system and our markets.

Taking all the above into account and without further action from the EU, the downside risks of no deal on the FCA's objectives remain significant and particularly if a wider economic shock were to exacerbate market disruption leading to declines in asset prices and wider disruption.

Failure to secure a future relationship covering financial services

Alongside the draft Withdrawal Agreement, the Government has agreed an outline political declaration that details the terms of the future relationship, with both sides committed to seek final agreement before the end of the implementation period.

Nonetheless, if at the end of the implementation period no future relationship has been agreed, for financial services as described earlier the UK would default to a third country relationship with the EU, with market access determined under WTO rules and EU or national Member State rules.

In principle, this could pose similar risks to those we have identified with exit next year without an agreement or implementation period. Some of those risks could be reduced because firms would have more time to prepare and regulators have more time to agree on actions to manage them and contract continuity concerns may be partially addressed. However, this will also depend on the degree of advance notice on the future relationship.

3: The draft Withdrawal Agreement

This section assesses the impact of the draft Withdrawal Agreement[13] on the FCA's objectives. The Withdrawal Agreement will be an international treaty between the UK and EU setting out the terms of the UK's withdrawal from the EU. The main benefit of this scenario from our perspective is that it manages the uncertainty covered in Section 2 by providing for an implementation period, as set out in Part Four (Articles 126-132) of the draft agreement. For the purposes of this assessment, we have assumed that the implementation period will run from 30 March 2019 to 31 December 2020.

During this implementation period, the UK will no longer be a Member State. Despite this, EU law will apply to the UK (including the continued use of financial services passports), UK competent authorities are generally treated as Member State competent authorities, and the duty of cooperation still applies, meaning that relevant parties are obliged to assist each other in carrying out their tasks– although there will be specific exceptions, for example we will lose the right to participate, as we do now, in the European Supervisory Authorities.

Draft Withdrawal Agreement provisions

Article 5 - Good faith

The draft Withdrawal Agreement commits both the EU and the UK to act in good faith when carrying out the tasks that flow from the agreement. This clause acts as the foundation for continued close cooperation with the FCA's EU counterparts during the implementation period.

Article 8 - Access to networks, information systems, and databases

The agreement specifically states that, when the implementation period ends, the UK will no longer have access to networks, information systems, or databases established on the basis of EU law. This provision would remove the current legal basis for our ability to access key data for market oversight, supervision and enforcement. While we will lose the right of access to this information on Day One, the Withdrawal Agreement ensures we will have continued access during the implementation period.

Articles 126 – 132 - implementation period

During the implementation period, the UK will no longer be a Member State. Despite this, EU law will apply to the UK (including the continued use of financial services passports), UK competent authorities are generally treated as Member State competent authorities, and the duty of cooperation still applies – although there will be specific exceptions. The main implications for the FCA arising out of the text of the draft Withdrawal Agreement are related to the UK's participation in EU decision making and our participation in ESMA.

Article 128 - Institutional arrangements

Article 128.5 prevents the FCA from participating in ESMA's governance and decision making during the implementation period unless it is invited to attend for either of these reasons:

- the discussion concerns individual acts addressed during the implementation period to the UK or UK natural or legal persons; or
- it is in the interests of the Union for the effective implementation of Union law during the implementation period.

Article 128.7 states that the EU will consult the UK where draft acts identify or refer directly to specific Member State authorities, procedures or documents. This consultation is to ensure proper implementation in the UK.

Losing our role in the governance of EU decision making creates challenges, particularly to managing legislation and technical standards that are in development. Our involvement in the work of ESMA ensures that it understands and takes into account the specifics of UK markets. We would seek to continue to engage with ESMA and other competent authorities to provide technical input into their work where they invite us to do so. However, it is unlikely that the FCA will have the same ability to input as compared to being a full member.

Article 129 – Specific arrangements relating to the EU's external action

Article 129.2 states that during the implementation period the UK cannot participate in the work of any bodies set up by international agreements concluded by the EU or Member States acting on its behalf. The exceptions are either if the UK attends in its own right, or the EU invites the UK for specific reasons.

On international bodies, Article 124.3 says the principle of 'sincere co-operation' means that the UK must not undertake any action or initiative that is likely to prejudice the EU's interests. It particularly highlights such action in the framework of any international organisation, agency, conference or forum which the UK is a member of in its own right. This provision recognises the UK's freedom to negotiate and ratify international agreements, as long as the agreement does not apply until the end of the implementation period, unless authorised by the EU.

Article 132 - The 'backstop'

If a future trade deal is not agreed by the end of the implementation period, a backstop clause provides for the UK to remain within a single customs territory. Alternatively, it can be extended once. Remaining within a single customs territory would not cover financial services. Market access would be provided on the basis of the EU and Member states' national third country regimes, and the UK would have full autonomy to legislate for financial services.

Extending the implementation period would increase the time that the UK has to comply with the rights and obligations in the draft Withdrawal Agreement. It would also extend the period during which the UK was required to implement EU legislation, without having a vote in EU institutions.

Articles 9-39 - Citizens' rights

The draft Withdrawal Agreement also protects EU citizens' rights in the UK, and vice versa. EU citizens in the UK and UK nationals in the EU, legally resident before the end of the implementation period, will be able to stay. Once they have been resident for five years, they will have a permanent right to reside. Their family members will also be given rights under this agreement.

The success of the UK's financial sector relies, in part, upon it being able to recruit and maintain the right people with the right mix of skills. A diverse workforce with varied experience and requisite expertise is a key ingredient in ensuring the UK's markets and firms are well run and remain competitive, protecting consumers.

Key issues

The draft Withdrawal Agreement provides benefits by removing cliff-edge risks and preserving cooperation between the FCA and EU27 regulatory authorities. However, it presents challenges because of the risk of the UK being subject to rules where the UK authorities have not played a role in the decision making.

Following the referendum result, we have continued to actively engage with European authorities. This has helped to ensure we have continued to play a role in shaping legislation during the Article 50 period. During an implementation period, we would continue to engage and, given our role in providing data and our knowledge of the markets, we would expect this to help manage risks from future EU legislation. However, this can provide no guarantee of how UK interests would be reflected in legislation put in place during this period.

There are more than 30 pieces of EU legislation involving financial services that are currently under discussion. During an implementation period, we do not know how many of these the UK would need to implement. This is because the timelines for implementation and entry into force for most are yet to be agreed. We have therefore categorised this legislation in the following way:

- **certain to come into force** – legislation which has been agreed and entered into the EU's official journal but which will not be fully in force by exit;
- **uncertain to come into force during the implementation period** – legislation that has been proposed pre-exit but has not yet been agreed and is still going through the legislative process; and
- **unlikely to affect FCA objectives** – some legislation will have no bearing on our ability to meet our objectives.

We include a list of specific legislation in Annex II.

When it implements this legislation, the UK will be in the same position as if it had remained a Member State. This means we would continue to benefit from the flexibilities and discretions given to Member States in the transposition of EU Directives into their own legislation. This flexibility has been used in the past to adopt higher standards than provided under 'minimum harmonising' EU law, or to apply 'options and national discretions' contained in legislation to tailor it for national markets. We would expect that EU Regulations will continue to apply in the UK directly, meaning they cannot be tailored. It is also possible that the EU proposes additional new legislation during the transition period which the UK would need to implement.

Legislation certain to come into force

The EU will have agreed this legislation by exit and the UK will have been present while it was negotiated. This means we know the content of the legislation to some extent and the UK perspective will have been taken into account to some degree when it was finalised.

For example, the Prospectus Regulation was entered into the Official Journal of the EU (OJEU) on 30 June 2017, with most of its provisions taking effect from 21 July 2019. The Government, supported by the FCA, played a leading role in shaping this legislation. We are satisfied that our objectives have been reflected in the final legislative text and the changes support our objectives.

Legislation uncertain to come into force

Legislation may be agreed after the UK's exit. In these cases, the Government would have more limited involvement in the EU legislative process and the FCA would not have a vote in the ESMA Board of Supervisors. Legislation in this category could contain requirements which pose risks to our objectives.

For example, the European Commission's proposal to overhaul the prudential framework for investment firms was adopted on 20 December 2017, and could potentially be agreed before March 2019. We support the proposal's objectives, which would introduce more proportionate and risk-sensitive rules for investment firms, and we would most likely advocate the implementation of the legislation during an implementation period.

However, if an agreement is not reached on this legislation before March 2019, there is a greater risk that the final legislative text would not reflect our objectives, and our ability to meet them could therefore be affected.

Legislation unlikely to affect FCA objectives

There is some legislation which has already been proposed which we know has little relevance to our objectives. An example of this would be the proposal for European Deposit Insurance Scheme (EDIS), which forms part of the EU's Banking Union. The scope of the EDIS proposal only covers euro-area Member States (and is open to non-euro area Member States willing to join the Banking Union), and so is not directly relevant to FCA objectives.

Future proposals

Further legislation could be launched after exit and, while we are involved in discussions in the ESAs until exit, it cannot be guaranteed that our objectives will be fully reflected in such legislative proposals published after exit. This also applies to ongoing discussions on level 2 rules (technical standards developed by the ESAs) under existing legislation.

However, the typical EU legislative lifecycle from proposal to implementation takes several years. Once legislation has been proposed, it must be negotiated by the Council and the European Parliament and subject to 'trilogues' - three way negotiations between the Council, European Parliament and Commission. When legislation is eventually finalised, an implementation period of 12-18 months usually follows, although this can be shorter. This means that legislation falling 'due' within the implementation would typically be in the later stages of negotiation at the point of exit.

Financial services legislation is also heavily shaped by international standards. These standards exist independent of the UK's membership of the EU. We would expect the EU to seek to meet these standards after exit, as would we. We remain fully engaged with global standard setting bodies, and continue our work to inform the content of their standards to ensure they reflect our objectives.

During the course of 2019, the EU will have parliamentary elections and appoint a new European Commission. In this period, the flow of legislation that is agreed may decrease. A new European Commission and European Parliament will follow, typically setting a new agenda and making new proposals. These proposals would take time to be agreed and implemented, reducing the risks of new rules coming into effect before December 2020.

We will only be able to judge the risks from the possible extension of the implementation towards the end of 2020 as the evolution of EU legislation is uncertain. The longer a transition continues, the greater these risks. The UK authorities can seek to reduce these risks by continuing to engage closely with EU partners during this period, but the amount of influence we can have is uncertain.

4: The outline of the political declaration on the framework for the future relationship between the EU and the UK

During the implementation period, European law will continue to apply in the UK. UK and EEA firms will be able to provide financial services into each other's markets under the existing passporting provisions. EU legislative requirements on supervisory cooperation will also continue to apply.

At the end of this period, it is expected that the UK and EU will have agreed a future trading relationship that includes agreement on financial services. To support this, alongside the draft Withdrawal Agreement, the UK and European Commission have published an outline political declaration setting out the terms of a future UK and EU relationship. Specifically, the outline political agreement includes the following text in relation to financial services:

- commitment to preserve financial stability, market integrity, investor protection and fair competition, while respecting the Parties' regulatory and decision-making autonomy, and their ability to take equivalence decisions in their own interest. This is without prejudice to the Parties' ability to adopt or maintain any measure where necessary for prudential reasons;
- agreement to start equivalence assessments as soon as possible after the UK leaves the EU, aiming to conclude these assessments by June 2020; and
- an expectation of close and structured cooperation on regulatory and supervisory matters. This will be grounded in the economic partnership and based on the principles of regulatory autonomy, transparency and stability, recognising this is in the Parties' mutual interest.

In a letter to the Treasury Select Committee, Andrew Bailey set out five principles for a future regulatory framework, and this has guided our advice to Government and our discussions with the sector.[12] These principles are:

- cross border market access – open markets are an important enabler of healthy competition, supporting FCA objectives;
- support for the principle of consistent global standards where markets are also global;
- cooperation between regulatory authorities - a robust framework which provides for continued cooperation will be fundamental in enabling us to meet our objectives;
- influence over standards - the FCA should continue to play a part in shaping international standards building on existing relationships with other regulators around the world through multilateral bodies such as IOSCO and the FSB; and
- opportunity to recruit and maintain a skilled workforce - being able to recruit and retain the right people from across the world, with the right mix of skills, is important to the health of the FCA, and indeed to the health of the wider UK financial sector.

[12] Letter from Andrew Bailey to the Treasury Select Committee, 28 October 2016

As part of our work on EU withdrawal, we have been clear that maintaining open and innovative financial markets helps support our objectives. Free trade and open markets in financial services, including wholesale services, significantly benefit the UK consumer as well as the wider UK economy, as indeed they benefit EU27 consumers and economies. So, we are strongly supportive of open financial markets, cross border trade and recognition of cross border regimes on the basis of equivalent outcomes.

Agreement on equivalence assessments

We welcome the commitment to undertake equivalence assessments by June 2020, six months before the end of the implementation period. Assuming the equivalence assessments are completed successfully, this approach will help avoid a cliff edge scenario, give firms reassurance in advance of the end of the implementation period, and help to manage any negative impacts on our objectives caused by uncertainty on the future position. The political declaration appropriately recognises that this must be in the context of both sides maintaining autonomy over the exercise of their equivalence regimes, as this is a key tool for managing cross border risk in the financial sector.

However, to make the most of this commitment it will be necessary to consider carefully the current process and scope of equivalence and seek to ensure that it provides an adequate framework for cross border business in the future. In this context, the commitment to transparency and appropriate consultation in the adoption, suspension or withdrawal of equivalence decisions is welcome. Such commitments will help ensure that equivalence should operate in a sustainable fashion, providing greater clarity and certainty to all involved parties.

We would welcome the EU and UK also committing to expand the scope of equivalence frameworks over time, to provide for greater coverage across a wider range of financial services. This should be possible since the UK rulebook will be equivalent to the EU's on day one of exit. It will also be important to provide the market with greater predictability and transparency on equivalence processes.

We believe an outcomes-based approach is critical to ensuring both the UK and EU can respect each other's autonomy and regulate their markets in line with their objectives. Outcomes based equivalence focuses on the key outcomes different regulatory regimes seek to achieve, rather than requiring line-by-line equivalence. Coupled with the principle of autonomy this would ensure that the UK and EU remain free to make their own equivalence determinations on the basis of the outcomes of each other's regimes, while retaining flexibility to address specific needs of the individual markets.

Supervisory cooperation

The political declaration also provides for close and structured supervisory and regulatory engagement, with transparency and consultation on issues of shared interest. This gives rise to the possibility for a much better relationship than a standard third country position. This reflects how deeply the respective markets are integrated and will make it easier for us to continue to meet our objectives, and manage cross border risks by ensuring that that they can be identified early and managed effectively.

Close supervisory and regulatory dialogue is also envisaged at both the technical and political level. This will help ensure that equivalence can be managed in a sustainable fashion. Through consultation and dialogue the FCA can work with our European counterparts to develop shared approaches wherever appropriate, helping to maximise continuity in regulatory standards and minimising any risk of conflicting or incompatible standards.

We also welcome the commitments given on citizens' rights as part of the draft Withdrawal Agreement. While this is a matter for Government policy, we welcome the clarity this will provide to EEA citizens resident in the UK, and it will minimise any disruption where those individuals are currently employed in the financial services sector.

As such, the political declaration is consistent with the FCA's objectives. However, we recognise that it remains necessary to establish further detail on the operation and maintenance of the equivalence regimes, and the institutional framework for supervisory and regulatory cooperation. We stand ready to support this work.

Annex I: Firm passports (FCA database, July 2016)

Passporting Figures[13]

	Total	Outbound	Inbound
Number of passports in total	359,953	336,421	23,532
Number of firms using passporting	13,484	5,476	8,008

Total number of firms with at least one passport under each directive

Number of firms with at least one passport under each directive		
Directive	Outbound	Inbound
Alternative Investment Fund Managers Directive (AIFMD)	212	45
Insurance Mediation Directive (IMD)	2758	5727
Markets in Financial Instruments Directive (MiFID)	2250	988
Mortgage Credit Directive (MCD)	12	0
Payment Services Directive (PSD)	284	115
UCITS Directive	32	94
Electronic Money Directive	66	27
Capital Requirements Directive IV (CRD IV)	102	552
Solvency II Directive	220	726

[13] Letter to TSC: August 2016

Annex II – EU Financial Services Legislation during the Implementation Period

accurate as at 27 November 2018

Files certain to come into force

- Central Securities Depositories Regulation[14] (CSDR)
- Delegated Cash Penalties Regulation[15]
- Delegated Liquidity Coverage Ratio (LCR) Regulation[16]
- Markets in Financial Instruments Regulation[17] (MiFIR)
- Prospectus Regulation[18]
- Securities Financing Transactions Regulation[19] (SFTR)

Legislation uncertain to come into force

- Bank Recovery and Resolution Directive II (BRRD II)
- Capital Requirements Directive V (CRD V) / Capital Requirements Regulation II (CRR II)
- Central Counterparties Recovery and Resolution Regulation (CCPs R&R)
- Cross-border Distribution of Collective Investment Funds
- Cross-border Payment Regulation (CBPR)
- EU Covered Bonds
- European Crowdfunding Service Providers (ECSPs) for Business
- Law applicable to the third-party effects of assignments of claims
- Non-Performing Loans (NPLs)
- Promotion of the use of SME Growth Markets
- Review of European System of Financial Supervision
- Review of Motor Insurance Directive (MID)
- Review of the European Market Infrastructure Regulation (EMIR)
- Review of the Prudential Framework for Investment Firms
- Sustainable Finance Package:
  - Disclosures relating to sustainable investments and sustainability risks
  - Framework for the facilitation of sustainable investment
  - Low-carbon and positive carbon impact Benchmarks
  - Amendments to delegated acts under Markets in Financial Instruments Directive II (MiFID II) and the Insurance Distribution Directive (IDD)
- Pan European Personal Pension Product (PEPP)

Legislation unlikely to engage FCA objectives

- EU Sovereign Bond-Backed Securities (SBBS)
- European Deposit Insurance Scheme (EDIS)
- Pan European Personal Pension Product (PEPP)

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[14] Articles 6 and 7 of the Central Securities Depositories Regulation relating to the Settlement Discipline Regime which apply from 13 September 2020.
[15] Articles 2 and 3 of the Delegated Cash Penalties Regulation which apply from the date of entry into force of the delegated act adopted by the Commission pursuant to Article 7(15) of the Central Securities Depositories Regulation.
[16] Article 24(4) of the Delegated Liquidity Coverage Ratio Regulation relating to the derogation on deposits covered by a Deposit Guarantee Scheme which applies from 1 January 2019.
[17] Article 37 and 38(2) of the Markets in Financial Instruments Regulation relating to access and obligation to licence benchmarks.
[18] See Article 49(2) of the Prospectus Regulation relating to the provisions which apply from 21 July 2019.
[19] Article 4(1) of the Securities Financing Transactions Regulation relating to the relevant provisions

Potential future legislative proposals

It should be noted that there are a number of procedures that are ongoing at both Level 1 and Level 2 which could give rise to legislative proposals which could be agreed and published in the OJEU during the implementation period. For example, the potential forthcoming reviews of the Regulations governing packaged retail and insurance-based investment products (PRIIPs) and short selling (SSR).

In total, we estimate there to be around 30 review clauses within existing Level 1 legislation that would be triggered during an implementation period, which would sit alongside any new Level 1 legislative proposals adopted by the Commission during this time.

Additionally, a number of pieces of Level 2 legislation underpinning existing rules are expected to be adopted during an implementation period. This would be on top of a number of Level 2 measures already published in the OJEU which would apply during an implementation period, and those measures which have already been adopted by the Commission but not yet agreed and published (some of which may apply during an implementation period).