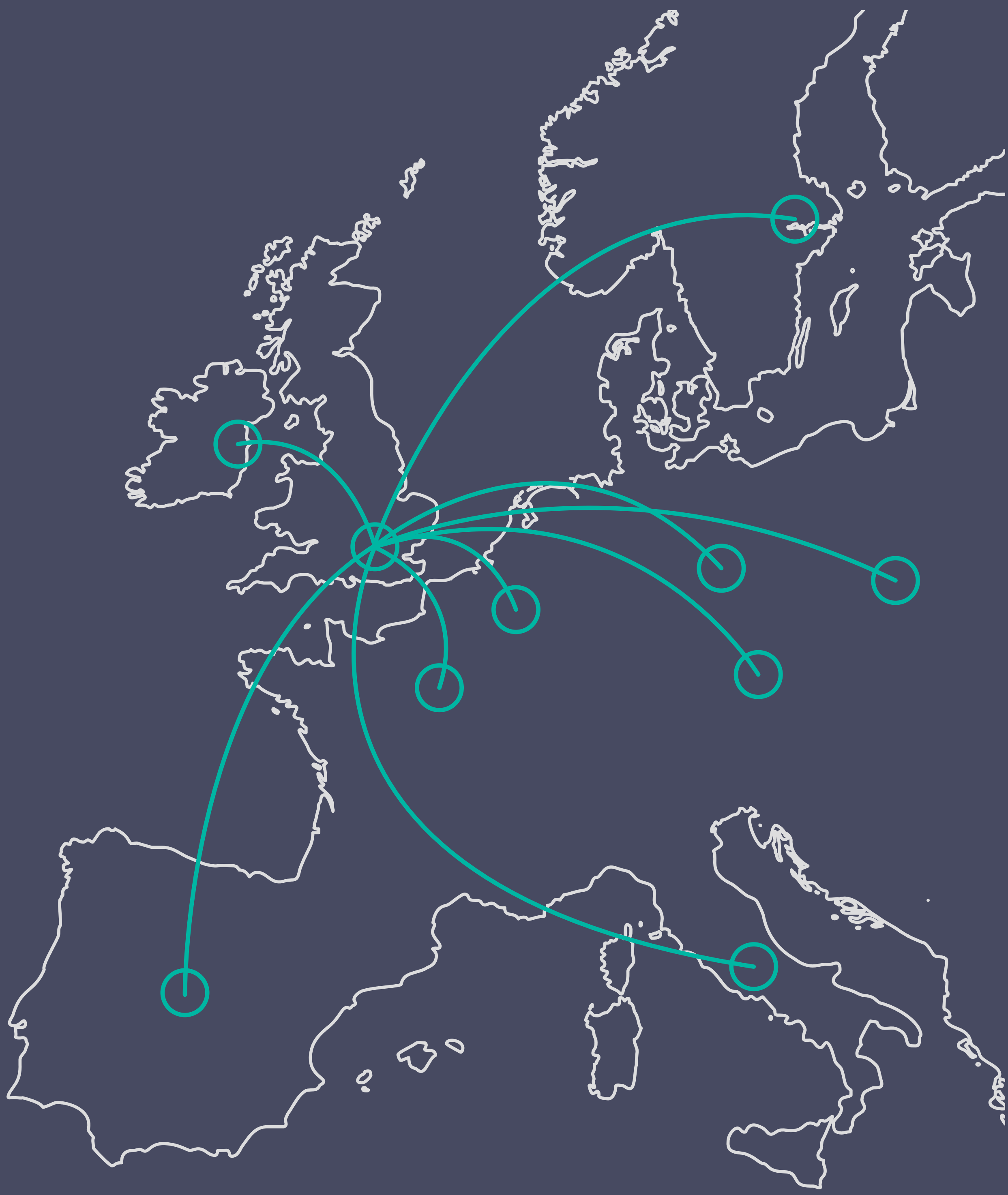
Supporting Europe's Economies and Citizens

A modern approach to financial services in an EU-UK Trade Agreement

UK FINANCE



September 2017

CLIFFORD CHANCE

Global Counsel

Acknowledgements and contacts

This report was prepared by UK Finance with support from Clifford Chance LLP and Global Counsel LLP.

UK Finance

UK Finance represents nearly 300 of the leading firms providing finance, banking, mortgages, markets and payments related services in or from the UK. UK Finance has been created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association. UK Finance has an important role to play helping negotiators understand how the interests of UK and EU customers, and the financial services they all depend upon, can be best protected. Our members are large and small, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. Our members' customers are individuals, corporates, charities, clubs, associations and government bodies, served domestically and cross-border. These customers access a wide range of financial and advisory products and services, essential to their day-to-day activities. The interests of our members' customers are at the heart of our work.

Contacts: Ronald Kent, Conor Lawlor, Diederik Zandstra, Andrew Rogan, Rebecca Park, Parisa Smith

www.ukfinance.org.uk

Clifford Chance LLP

Clifford Chance is one of the world's pre-eminent law firms with significant depth and range of resources across five continents. As a single, fully integrated, global partnership, we strive to exceed the expectations of our clients, which include banks and other financial institutions, corporates from all the commercial and industrial sectors, governments, regulators, trade bodies and not for profit organisations. We provide them with the highest quality advice and legal insight, which combines the firm's global standards with in-depth local expertise.

Contacts: Chris Bates, Jessica Gladstone, Phillip Souta

Global Counsel LLP

Global Counsel works with clients navigating the critical area between business, politics and policymaking, we help companies and investors across a wide range of sectors to anticipate the ways in which politics, regulation and public policymaking create both risk and opportunity – and to develop and implement strategies to meet these challenges.

Contact: Stephen Adams

Table of Contents

Foreword

The UK's exit from the EU will transform the provision of financial services between the two parties from a relationship based on a deeply integrated EU single market finance supply chain to one based on trade between two separate jurisdictions. For the tens of thousands of EU and UK customers and millions of financial transactions currently relying on cross-border services, this is a significant and potentially disruptive change. It will produce a new relationship based on very different political, functional, legal and regulatory terms.

The practical question for customers, their financial services providers and their regulators is how different that relationship will be in terms of the cross-border services available. This report is intended to be a contribution to the debate about what that future relationship might look like and how it might be built in such a way to preserve some of the commercial and economic benefits of the existing close ties under a new agreement.

This report assumes that one of the core elements for that new relationship will be a free trade agreement between the two sides. It describes a model for market access and trade in cross-border services that could be part of that new agreement. This model has been built to be flexible and could also be readily adapted to be used for other service sectors of the EU and UK economies if desired. We believe the framework for the model has a number of advantageous features – it enables both parties to calibrate its scope to their preferences and their political objectives, is prudentially robust and politically credible as it acknowledges the value placed by both parties on regulatory and legal autonomy. In doing so it also provides a mechanism for recognising how the UK outside the EU single market cannot receive the privileges of a single market member.

At the heart of this model are the basic principles of alignment and mutual recognition between the EU and the UK regulatory regimes, a level playing field, and close and deeply embedded regulatory and supervisory cooperation. Building upon these basic principles, we have proposed a set of three core cross-border commitments that would preserve some of the benefits, choice and competition of the existing close economic, commercial and social connections for three core sets of users of financial services on both sides, including governments and large banks or businesses, export orientated and growing companies, pension and savings institutions and a range of investors.

It is often noted that past and current free trade agreements have fallen short in the area of cross-border trade in financial services compared to the EU single market; this is true. While previous free trade agreements provide useful precedents, the fact that the EU and the UK start from a position of complete regulatory convergence and deep market integration rather than on a third country basis makes the future partnership unlike any other existing arrangement. 'State of the art' free trade agreements between third countries such as the CETA agreement with Canada or the proposed EU-Japan free trade agreement fall short in services of what should be reflected in a free trade agreement that seeks to enable even a diluted version of the close economic trading relationships that exist between the EU and the UK. Recognising that an ambitious approach is required and desirable, the model proposed in our report draws on WTO principles together with approaches used in national licensing regimes in leading developed markets or by the EU to enable a high level of market access between the UK and the EU if this is politically agreed.

For this model to be feasible a number of things must happen. The EU and the UK need jointly to agree that closely aligned and high regional standards are a common and mutually beneficial objective – that they are not only the potential basis for a trading framework, but also desirable as a continuing pillar of the future EU and UK relationship. Above all, the EU and the UK need jointly to agree that there is value for the citizens, customers, and economies of both sides in maintaining a strong and healthy regional capital and banking services market in Europe, even if the UK is outside the EU and its banking union.

If this is accepted, then we believe that a robust and flexible market access model like the one set out here can contribute to a positive, reframed and close relationship that serves as a foundation for a new partnership for the benefit of Europe and its 500 million citizens.

Stephen Jones
CEO UK Finance

Executive Summary

The purpose of this report is to propose an alternative model for a future trade framework for banking and capital markets services between the EU and the UK that is both robust and flexible. It is based on the premises (i) that in the near future the EU and the UK will have separate regulatory jurisdictions, which are nevertheless part of a developed regional market for banking and capital markets that provides critical services for customers, and (ii) that the EU and the UK wish to remain as closely connected as is politically, economically and socially feasible. Negotiated, refined and codified as appropriate for both sides, this model could be embedded in a preferential trade agreement or sit alongside such an agreement as a flanking framework. Elements of the model could also usefully inform the framework for other industries covered by a future trade agreement between the EU and the UK.

From a single market to cross-border trade flows

The UK's exit from the EU will transform the relationship between the EU and the UK for financial services. The largest supplier of sophisticated financial services in the European region, and the largest single financial centre of the EU – the City of London – will be outside the EU single market. For the tens of thousands of EU and UK customers that contract tens of billions of euros of products and services annually, the UK exit from the EU poses not just the question of immediate disruption, but also the long-term question of how these two markets will serve each other in future.[1]

If there is no agreement on a new future trading arrangement at the point of UK exit, and in the absence of clear and comprehensive transitional measures, EU customers will find accessing key products and services much more challenging as a result of the loss of access to UK-based banking services. This cross-border activity is now deeply integrated into the financial supply chains of EU governments, businesses and even households. Behind a huge range of EU and UK business and financial activities – from the infrastructure investment funded by government borrowing, to a loan to a small company in Italy, to a foreign exchange derivative contracted against a foreign currency loan to a German exporter – lies a cross-border link between the EU and the UK. A trade agreement – or transitional framework – that materially rolls back the right of such EU customers to be served by UK-based banks and capital market service providers will have a similar limiting effect.[2]

[1] EU-UK trade totalled £552.6 billion in 2016. See Matthew Ward, *Statistics on UK-EU Trade*, UK House of Commons Library Briefing Paper Number 7851, page 9 (17 August 2017).

[2] For an elaboration of the many practical implications of both a sudden and phased withdrawal of these rights of EU-based customers to contract with UK, international or EU banks or capital markets services firms based in the UK, see the UK Finance Report *Time to adjust: an EU customer perspective* (March 2017). See also, UK Finance, *Serving Europe: navigating the legislative landscape outside the single market* (September 2017) and UK Finance Online, Brexit Quick Briefs.

...in the near future the EU and the UK will have separate regulatory jurisdictions, which are nevertheless part of a developed regional market for banking and capital markets that provides critical services for customers...

The aspect of EU-UK trade in financial services that will need particular consideration in designing a future framework for the EU and the UK is the direct contracting of a financial service by an EU customer from a UK-based provider, or vice versa. At present, the right to buy and sell 'cross-border' in this way is created and protected by the EU's internal passporting regime. This in turn is underpinned by the single rulebook of the EU. This is a unique arrangement that reflects the evolution of mutual recognition frameworks inside the EU over the last three decades.

This freedom to contract cross-border is not a right that is established in the general commitments that World Trade Organisation ("WTO") states make to each other, and not one that the EU commits to provide as a WTO member. Nor has it been replicated in the EU's preferential agreements with third countries. While the EU's free trade agreements ("FTAs") with markets such as South Korea, Canada and Singapore have improved the conditions under which firms in these markets can enter the EU market to provide financial services, they have not touched materially on the question of cross-border trade.

This omission is not due to any inherent limitation of the FTA model itself. Rather, it reflects the fact that FTAs are typically signed between jurisdictions with established – and often divergent – regulatory frameworks for financial services, limited forms of institutional cooperation in regulation and supervision of financial services firms and limited appetite for aligning their two models as a basis for cross-border financial services trade. None of these self-imposed constraints need to apply to any preferential trade agreement between the EU and the UK. Both parties have the scope – and arguably the incentive – to go much further in reaching the potential of a preferential trade agreement than has been presented by any previous bilateral agreement.

An EU-UK FTA will not recreate the status quo, because it will be built on different legal, political and prudential foundations. One of the EU's established requirements for such an agreement is that EU-based customers should not be able to use and rely on UK-based services in the same way they can today if the UK is outside the single market. Both the EU and the UK have been clear that they will prioritise their freedom to regulate and the autonomy of their legal and regulatory regimes. The question is whether it is possible to design a model for cross-border trade in financial services between the EU and the UK that maintains some of the advantages of the current choice for customers while respecting these principles. The intention of this report is to demonstrate how the answer to this question can become 'yes'.

Three overarching principles

An EU-UK framework for cross-border contracting of financial services should be based on three overarching principles:

(a) It should be based on a principle of mutual recognition of the regulatory approaches of the two sides. Mutual recognition can take a range of forms. Here its core pillar is mutual recognition of the authorised status of a firm from another market based on either (a) an assessment of quality and capacity of the regulator providing that authorisation, (b) the comparability of the specific regulatory framework to which that firm is subject, or (c) both;

(b) It should approach the question of cross-border contracting by assessing the nature of the customer seeking a provider in the other market. This report argues that these users can be placed in three broad categories, each with a unique and important economic role. However, what differentiates them is their level of sophistication as users of financial services, and the commensurate level of concern that should be attached to their protection as consumers. The report uses this distinction to assess the terms on which customers could be provided with the freedom to contract cross-border.

An EU-UK regime for cross-border contracting of financial services should be based on a very high degree of regulatory and supervisory cooperation...

They are:

Large sophisticated institutions, including governments, large banks, large non-financial companies and large institutional investors. These customers are often the core channels through which liquidity moves between the UK and wider EU financial and capital markets through governments, corporate borrowing and interbank lending;

Financial professionals, being qualified individuals managing the contracting of banking or capital markets services for purposes of running a mid-size business, managing risk or accessing markets for securities or other financial instruments. These service users make up the largest group of cross-border consumers, often using cross-border financial services to allocate savings and investment, secure credit or finance and hedge risk through derivatives markets; and

Smaller companies and retail customers. While these groups are relatively limited users of cross-border financial services, they benefit both directly and indirectly from the choice and competition provided by the cross-border market.

(c) An EU-UK regime for cross-border contracting of financial services should be based on a very high degree of regulatory and supervisory cooperation between the EU and the UK. It should be underpinned by appropriate arrangements between regulators and supervisors for transparency, cooperation and consultation on rulemaking; cooperation in supervisory practice, enforcement and resolution and the sharing of information as required. The core of this would be an EU-UK financial services committee with a wide-ranging remit to institutionalise cooperation.

Three cross-border commitments

Based on these foundations, the EU and the UK could offer three reciprocal commitments covering the class of customers described above as part of a new partnership agreement encompassing financial services:

(a) A qualified counterparties commitment, allowing certain forms of large, sophisticated service users such as governments and large banks and companies to contract cross-border. This commitment would be based on the mutual recognition of the authorisation of the providers of services to such users. This recognition would in turn be based on mutual recognition of the competence, resourcing, credibility and general approach of the regulatory authorities of the two parties;

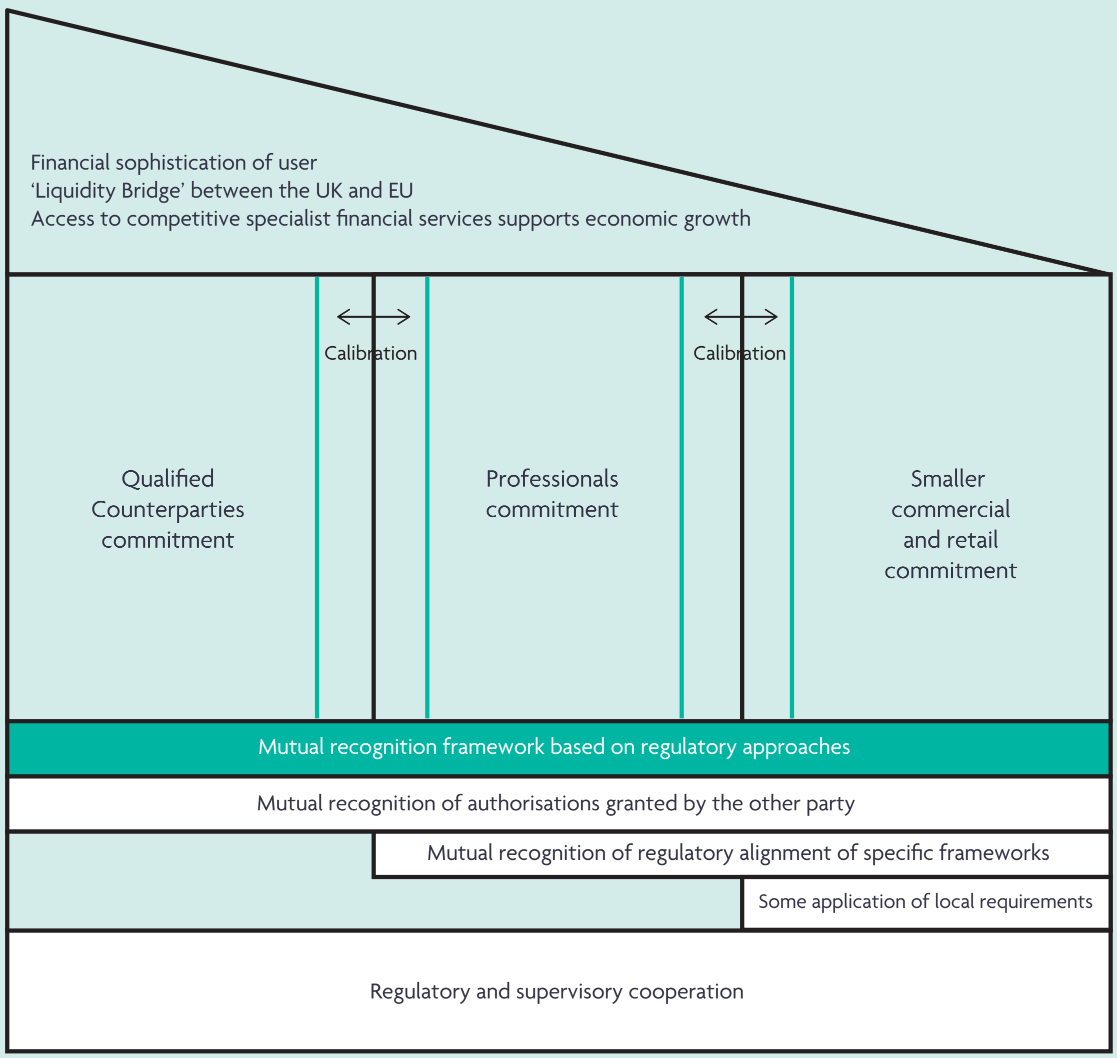
(b) A professionals commitment, allowing a defined set of professional service users to contract cross-border. Like the qualified counterparties commitment, this would be based on mutual recognition of the authorisation of the firm providing the services, but additionally based on, and subject to, close and demonstrated regulatory alignment between the two parties at the level of the relevant regulatory frameworks for that service. Clear principles and protocols should be agreed for how this contingency should be determined and enforced and how rights could be withdrawn; and

(c) A smaller commercial and retail commitment, allowing agreed forms of smaller commercial and retail customers to contract cross-border for defined services. Like the professionals commitment, this would be based on the recognition of the authorisation of the firm providing the services and additionally based on, and subject to, close and demonstrated regulatory alignment at the level of the relevant regulatory frameworks for that service between the parties. It would be additionally subject to compliance with agreed elements of local conduct and consumer protection regulation.

A level playing field for cross-border providers

The fundamental basis for any cross-border framework for trade based on mutual recognition, regulatory alignment and supervisory cooperation is confidence in the regulatory approach of the other party and the implementation of a mechanism for efficiently resolving differences among the parties about the applicability of mutual recognition in particular cases and adequate scope to withdraw trading privileges if regimes diverge or that underpinning confidence fails. However, having established that basis for trade, it is important that it is complemented by a set of principles that ensure a level playing field for local and 'importing' providers. An EU firm providing services cross-border to a UK customer should be afforded regulatory treatment that does not unnecessarily disadvantage it vis-à-vis a UK-based firm (of any national identity) – and vice versa.

Diagram 1: Mode 1 – proposed cross-border commitments



The three cross-border commitments above should be governed by six key protocols to enable trade in cross-border services to be properly competitive with local providers. Some of these are established WTO principles of non-discrimination. All reflect the basic principle of a true level playing field:

(a) Imported services should be subject to treatment no less favourable than that accorded to domestic firms providing the same service;

(b) Imported services should be subject to treatment no less favourable than the treatment that is accorded in similar situations to similar services provided from other third countries;

(c) Imported services should not be required to be provided through a subsidiary or a branch as a condition for a customer to access them;

(d) Imported services should not be subject to additional local authorisation requirements as a condition for a customer to access them if the provider is already fully authorised to provide that service in its home market;

(e) Imported services should not be subject to local rules that duplicate rules to which their provider is already subject in their home market, except under the terms of the smaller commercial and retail commitment, where application of local conduct rules may be appropriate to provide the necessary level of consumer protection; and

(f) No limits should be applied on the number of services, total value of service suppliers or any other form of quantitative restriction on imported services.

Treatment of branches

Both EU and UK banking and capital market institutions have a large number of branches in the market of the other. There are around 80 full branches of EEA banks in the UK.[3] These branches provide a valuable means of providing services to customers through a physical presence, without the full cost, complexity and duplication of establishing full subsidiaries. To protect this channel of service provision as much as possible, the EU and the UK should offer a commercial establishment commitment for branches.

This would establish a regime for the treatment of EU branches in the UK and vice versa that contained a strong element of deference to home state regulation of branches, especially with respect to capital and liquidity requirements, to minimise the fragmentation of balance sheets and the ring-fencing of capital. So far as practicable, this would be based on recognition of the authorisation of the firm providing the services, but additionally based on, and subject to, close and demonstrated regulatory alignment between the two parties at the level of the relevant regulatory frameworks for branches, and could involve some application of local requirements where appropriate.

Calibration: practical, political and prudential choices

Although this report sets out an approach that would, in practice, preserve many key areas of the current cross-border relationship in financial services for the EU and the UK, both parties could use a partnership agreement to calibrate the model set out in this report to achieve different degrees of market access:

(a) They would need to consider the precise type of service users covered by each commitment. This report proposes to group service users by objectively determined measures of their financial sophistication and thus capacity to procure services cross-border. These classifications can and should be debated;

(b) They would need to consider the precise services covered by the commitments. This report uses a combination of WTO and other EU definitions; and

(c) They would need to debate and agree the precise terms of the mutual recognition and regulatory and supervisory cooperation that underpins the commitments. This report proposes three increasingly robust forms of

[3] There are more than 100 branches of EEA banks in the UK. However, "full" denotes branches that may accept deposits in the UK. See Bank of England, *List of Banks as compiled by the Bank of England as at 31 August 2017* (31 August 2017).

mutual recognition for each commitment: from inter-regulator recognition for the qualified counterparties commitment to more detailed and contingent forms of regulatory and supervisory cooperation at the level of individual rule frameworks for the professionals and smaller commercial and retail commitments. This report proposes that this is an objective and practical reflection of the nature of the service users covered in each commitment. How, and where, those lines are drawn would be for the EU and the UK to determine.

Other FTA elements for negotiation

The cross-border element of an EU-UK partnership agreement encompassing financial services would inevitably be among the most important elements of any financial services chapter of a free trade agreement (or flanking agreement), and the area requiring the most evolution in the EU and the UK's current approach to agreements with third countries. However, there are a range of other areas where the EU and the UK should make conventional undertakings to each other, or establish other elements of their future relationship, as part of an agreement. These include:

(a) To support these commitments by ensuring that the professional staff who provide services have the temporary right to work in the market of delivery: a set of commitments that allow relative ease of short-term relocation by qualified financial professionals delivering defined services between the two parties to support services being provided under the terms of the framework. Commitments should be made to grandfather all existing mutual recognition of professional qualifications between the EU and the UK and to maintain the highest possible level of mutual recognition in the future;

(b) To preserve baseline conditions of non-preferential market access now and in the future: a commitment not to impose more restrictive terms than those applicable at the time the framework is agreed. This should be complemented by a commitment to reset this 'baseline' at the level of any future unilateral liberalisation by either party;

(c) To enable the other party's firms to access market infrastructure freely and on fair terms: guarantees of access to market infrastructure and payment, clearing and settlement systems on the same basis as local firms without requirements of local presence or authorisation, except for central counterparties and some payments and settlement systems, where local establishment requirements may be imposed on a national treatment basis. The two sides should also seek to maintain the alignment of their regulation of payments systems in a way that facilitates to the greatest extent possible UK membership of Single Euro Payments Area ("SEPA") and EURO1 payments systems;

(d) To ensure that the exercise of any prudential carve-out from commitments remains proportionate and transparent: an agreement to subject any prudential carve-out both to clear protocols for proportionality and transparency of rationale, and to require pre-notification of the intent to invoke it, subject to rights of consultation in most instances;

(e) To preserve the ability of firms from both parties to have judgments enforced in the courts of the other: an arrangement under which the UK can participate in one of the mutual recognition frameworks for court judgments to which the EU states are in whole, or in a large part, also party;

(f) To ensure non-discrimination and compatibility with existing double taxation treaties between the UK and EU states: a commitment by both sides to non-discrimination in the levying of taxes, with clear rationales and protocols for any derogation from this basic principle; additionally, a commitment to ensure that the terms of any EU-UK agreements on tax respect existing double taxation treaties between the UK and EU states;

(g) To underpin market access commitments with a data transfer and location framework: a commitment to the mutual recognition of data protection and privacy standards on both sides to facilitate the agreement of protocols for the cross-border transfer and storage of personal and sensitive data;

(h) To ensure that commitments adapt to reflect changes in technology and innovation: a mechanism for ensuring that new financial services that are developed or existing financial services that are evolved are covered by the existing terms of the framework;

(i) To provide recourse for investing firms in appropriate circumstances: a commitment to establish an impartial, transparent and fair investor-state dispute settlement ("ISDS") mechanism on the basis of the evolving approaches developed by the EU in the EU-Vietnam and EU-Canada Comprehensive Economic and Trade Agreement ("CETA") agreements; and

(j) To provide a mechanism for resolving disputes[4] between the parties, including as a minimum: a commitment to create a binding state-to-state dispute resolution mechanism that facilitates cooperation and consultations among the parties, and also combines the best features of systems such as the CETA arbitration panels and the WTO Dispute Settlement Body ("DSB"). These should be complementary to the framework of regulatory and supervisory cooperation created by an agreement, which would also have the capacity to address differences.

Moving ahead

The design of such a framework for cross-border trade in financial services between the EU and the UK touches on sensitive prudential and political questions and a capital markets and financial services landscape that changes over time. It is important to adopt an approach that is both based on clear principles, but adaptable within a negotiation, and by mutual consent in the future to reflect technological innovation, market changes and the evolution of the EU-UK relationship.

An agreement to enter into a negotiation on a framework like the one set out here would be a vital signal of commitment to establishing a new architecture between the EU and the UK that maintains choice and some degree of continuity for customers on both sides. However, both in recognition that such a negotiation cannot have a guaranteed outcome, and that it will produce an outcome that will fall short of the contracting freedoms provided by the single market, it is important that such a negotiation is supported in a timely manner by adequate transitional arrangements, allowing time to adapt for any services that ultimately fall outside of the scope of an EU-UK framework.

[4] This would need to fit with the wider framework for dispute resolution within the FTA as a whole.

Chapter 1: Introduction

1.1 Withdrawal of the UK from the EU

A future "partnership agreement" between the EU and the UK based on an FTA or similar form of preferential trade agreement has important implications for both sides and for the way they trade with each other in the future.

The UK's exit from the EU has now advanced to the important stage of agreeing the terms of the UK's withdrawal from the EU and consideration of what form the future relationship between the EU and the UK might take. The two questions are of course closely linked: the form of the future relationship will shape the way the UK leaves the EU and how closely it remains linked to the EU in the future. Withdrawal will inevitably reshape commercial and economic relations between the EU and the UK. The agreement on future relations between the two sides will in many respects dictate how this reshaping occurs.

The EU27 and the UK have both expressed interest in, and commitment to, a close future partnership for trade and economic interaction based on a deep framework of rights and obligations. As EU lead negotiator Michel Barnier has said: *"We agree with Theresa May when she recently called for a bold and ambitious free-trade agreement."*[5] This view was also expressed by German Chancellor Angela Merkel when she argued that: *"There must be a balanced relationship between rights and obligations in the future relationship between Great Britain and the European Union. If the UK is ready to do so, there should be nothing in the way of a close and long-term partnership with the European Union. We as the European Union strive for good, close and trustworthy relations with Great Britain."*[6] The model proposed here reflects this shared interest in a close economic relationship built on shared rights and obligations.

A future "partnership agreement" between the EU and the UK based on an FTA or similar form of preferential trade agreement has important implications for both sides and for the way they trade with each other in future. It places the UK outside the EU single market and its regulatory sphere, trading with that market in a similar way to other "third countries".

It assumes that both sides will be fully independent members of the WTO, bound to reflect its disciplines in their treatment of each other. It implies a high level of regulatory autonomy on both sides, limited only where both sides accept constraints. These will be key determinants of the kind of relationship the EU and the UK might build.

Nevertheless, the range of options open to the EU and the UK inside the parameters of an FTA is very wide. There are a very large number of existing FTAs between WTO members that might provide examples for the EU and the UK to draw on in designing an EU-UK FTA. But there are also many ways in which an FTA between the EU and the UK could draw on trade policy approaches or modes of agreement that have been used in other contexts but have yet to be tested or used in FTAs anywhere else.

The starting point for negotiation of an EU-UK FTA will not resemble any previous FTA negotiation under the WTO system. Rather than negotiating incremental new liberalisation of their two economies, the EU and the UK will be determining the baseline to which they wish to roll back the current levels of liberalisation provided by the EU single market. This is likely to shape the way the two sides approach an agreement and should provide an incentive to test new ground in designing one. This report starts from the premise that the EU and the UK should seek an outcome that minimises trade disruption for EU and UK customers wherever possible, while recognising that political or other considerations may impose some practical constraints.

[5] Michel Barnier, Speech at the plenary session of the European Committee of the Regions (22 March 2017).

[6] Angela Merkel, Statement to German Parliament, *"Muss es auch im zukünftigen Verhältnis zwischen Großbritannien und der Europäischen Union wieder ein ausgewogenes Verhältnis von Rechten und Pflichten geben. Wenn Großbritannien hierzu bereit ist, dann sollte einer engen und langfristigen Partnerschaft mit der Europäischen Union allerdings nichts im Wege stehen. Wir als Europäische Union jedenfalls streben gute, enge und vertrauensvolle Beziehungen zu Großbritannien an."* (27 April 2017).

1.2 The UK and the EU single market for financial services

The financial services relationship between the EU and the UK spans every level of the financial services economy.

The financial services relationship between the EU and the UK spans every level of the financial services economy.

There are few areas in which this consideration will be more important than in determining the way such an agreement addresses questions of cross-border trade in financial services. This is not because financial services matter more than any other sector of the EU and UK economy, but because financial services are amongst the small number of sectors in which the gap between the rights and obligations of firms inside and outside the EU single market is largest and where UK-based firms and their customers in the EU therefore face some of the greatest disruption to their ability to contract with each other cross-border once the UK has become a third country. This is made all the more important by the high volume of current cross-border trade between the EU and the UK in financial and related services, and the range of economic activity supported by this trade.

The financial services relationship between the EU and the UK spans every level of the financial services economy. At its base are the links between core banking and capital markets activities that provide the bedrock of any market for financial services – the lending of money between banks[7], the facilitation of payments of all kinds and the services that provide finance to large companies and that connect large companies and governments to global capital markets or match buyers and sellers of currencies or risk management products such as derivatives.

This can be thought of as the very basic plumbing of the financial services economy. The institutions providing and using services at this level are banks raising capital for onward lending or the largest actors in the economy, such as governments or large companies meeting their payments, financing or risk management needs. The role of, and services provided by, UK-based banks may not always be visible, but it is often a key component of any customer or business interaction. Behind a loan made to a "mittelstand" business by a bank in Germany or a small or medium-sized enterprise in Spain may be wholesale lending from a bank based in the UK. The trade finance provided to an exporting business in Italy may be hedged or risk managed with a foreign exchange derivative contracted and cleared in the UK. Underpinning all of these are the services facilitating payments between the parties to these transactions and their customers and suppliers.

Built on this foundation are a wide range of services provided to professional, smaller commercial and retail clients, from deposit-taking and lending to investment advice and investment services such as buying and selling shares and other securities. Many of the services that support the EU firms that export around the world – trade finance, international advisory, currency and currency derivative services – are drivers of EU economic success. These services are at the heart of modern economies and underpin deep and effective regional capital markets. They are classic examples of sectors in which wider choice and deeper markets spill over into a stronger and more resilient wider economy.

While there are many financial centres in the EU where such services are available, the UK is currently the largest by some margin. In total, this activity between the UK and the rest of the EU adds up to the largest nexus of cross-border activity in financial services in the global economy. An estimated €40 billion in banking, financial and insurance-related services were bought and sold between these two markets in 2016. Much of this trade is built on a combination of the unique global status of the City of London as a financial centre and the economies of investment and scale built up around the City and the regional centres in the UK that support it.

[7] In this report, the term "banks" is used to encompass the broad range of regulated firms providing banking and capital markets services, including credit institutions, investment firms and payment institutions and firms providing electronic money transfer services.

As set out in detail in the British Bankers' Association ("BBA") report *Time to adapt: achieving an orderly transition for banking* (November 2016), the impact on the availability of these services to EU customers when the UK exits the EU single market will be serious and the full scope of the ramifications hard to predict. Moving services inside the EU single market will be expensive, disruptive and may in some cases simply not be feasible – and customers may find themselves facing loss of provision, reduced choice and greater cost as a result. Whether these costs are an inevitable or discretionary part of a UK exit from the EU is ultimately for policymakers on both sides to decide.

It is clear that a UK outside the EU single market cannot have the rights and obligations of a state inside it, and some impact on the nature of services traded between the two markets is inevitable. However, this report starts from the premise that the soundest approach for both sides should be to see the valuable shared economic asset of the financial services relationship between them as something that should be preserved where possible and dismantled only where the political, prudential and practical obstacles to maintaining it are insurmountable.

1.3 From single market supply chains to cross-border trade flows

Understanding the impact of moving to a framework based on an FTA means in the first instance changing the way we think about financial service activity between the EU and the UK. The fact that the UK is a Member State of the EU at present generally means that we do not think of EU-UK activity in cross-border terms at all, but as internal supply chains or transactions within the single market. This is broadly how EU-UK financial activity is regulated and supervised today. This will change fundamentally when the UK leaves the EU, potentially in a way that will constrain many of the activities that businesses, households and the banks that serve them currently take for granted.

Moving from a relationship based on the rules and frameworks of the EU single market to one based on a relationship between two separate WTO members will have important implications for businesses buying financial services...

Moving from a relationship based on the rules and frameworks of the EU single market to one based on a relationship between two separate WTO members will have important implications for businesses buying financial services cross-border between the EU and the UK and the banks that currently provide them. Even if the two sides agree an FTA, it will fundamentally reshape the basis on which commercial relations are undertaken because it will replace the current model with one based on regulatory and supervisory cooperation between two separate jurisdictions. Amongst many other things, it will:

(a) Replace an EU model based on a requirement that appropriately authorised banks in the UK and the EU be granted broadly guaranteed cross-border access to the single market and the UK respectively for most key banking and investment services with one in which those rights and obligations will only exist if codified in a bilateral agreement of some form between the two sides;

(b) Replace a model in which the supervision of branches of EU and UK banks in the other jurisdiction remains in important respects with their home authorities with one in which host authorities have much greater prerogatives over prudential and conduct supervision; and

(c) Replace a model in which market access rights are embedded in the treaties and regulatory framework of the EU with one in which they are contingent on an agreement between the EU and the UK which grants market access but also provides an exception that allows their respective legislators and regulators to take measures for prudential reasons that may restrict that access.

The more that the EU and the UK fall back on the basic framework of the WTO system, or even the precedents for cross-border trade in financial services established by previous FTAs, the more cross-border services currently available are likely to be restricted or vulnerable to discontinuation.

This is because the WTO rulebook leaves members wide scope to set the terms for access to their financial services markets and they have generally used this prerogative to avoid making broad commitments on cross-border trade in financial services. The second chapter of this report sets out the WTO landscape for trade in financial services and explains why it provides limited scope for a cross-border relationship in financial services between the EU and the UK.

Even where WTO members have signed FTAs, they have chosen not to revise the restrictive approach to cross-border trade in financial services even where they have liberalised cross-border access in other sectors such as telecommunications. Generally, liberalisation has occurred at the level of permitting foreign firms to establish inside their markets where they are fully subject to domestic regulation. For example, although the EU-Canada and EU-South Korea FTAs both achieve significant new market access for services in other areas, neither go significantly beyond the parties' existing WTO commitments in relation to cross-border trade in financial services. The third chapter of this report reviews how existing FTAs have addressed the question of deepening financial services trade from the WTO baseline, where they have focused and why the outcome has universally been limited.

For this reason, an EU-UK model based on either no preferential trade agreement, or an FTA on the model of any extant agreement, would be likely to render many of the services currently provided between the EU and the UK impermissible or unfeasible. Given the high volume of trade between the two sides at present, a sharp overnight change in the cross-border landscape for financial services provision between the EU and the UK would be highly disruptive for customers and the financial system as a whole.

Avoiding such an outcome would require the EU and the UK to establish new ground in an FTA, above all in the treatment of cross-border provision of services. Hence the need to consider how an FTA might be used to establish a long-term basis for EU-UK trade in these services. The fourth chapter of this report provides its key arguments, setting out in detail a model of how the EU and the UK might approach the question of cross-border trade in financial services in an FTA. The fifth and sixth chapters review the ideal content in other areas of an EU-UK FTA, including mechanisms for dispute resolution.

1.4 The approach in this report

This report focuses on the specific question of how an EU-UK FTA might address the key questions of cross-border trade and cross-border commercial establishment for financial services. The concepts set out in this report touch on a number of key areas of a conventional FTA, chiefly, but not solely, the chapter on financial services and supporting elements. This report does not seek to be prescriptive in how they are finally realised in such an agreement – rather it focuses on the concepts that might be embedded in an FTA.

Box 1: The structure of a conventional EU FTA

The EU has an established model for negotiating FTAs which breaks an agreement into three core thematic sections – the model below was used for the negotiations on the EU-US Transatlantic Trade and Investment Partnership ("TTIP").

Market Access	Regulatory Cooperation	Rules
Goods trade • Reducing or eliminating tariffs; Establishing tariff-rate quotas; Agreeing rules of origin Services trade • Mode 1, for cross-border trade • Mode 2, for consumption abroad • Mode 3, to establish a commercial presence • Mode 4, through temporary transfer of staff Public procurement	• Broad approach and principles for regulatory cooperation • Technical barriers to trade, such as labelling, testing • Sector-specific agreements in areas like chemicals, vehicle safety, pharmaceuticals	• Trade facilitation to streamline customs and help smaller and medium-sized enterprises • Intellectual property and investment protections • Common standards for labour and the environment • State aid and competition policy

This report demonstrates how an EU-UK relationship embodied in an FTA based on, and consistent with, WTO disciplines and prudential and regulatory best practice could, in principle, be designed to preserve elements of the current cross-border relationship in financial services where both sides judge it valuable to do so. While it recognises that the detail of such an FTA cannot be prejudged, it proposes a broad practical approach that could work for both sides, and which would allow the EU and the UK to preserve a mutually beneficial level of market integration even as they operate as separate, but closely aligned, jurisdictions.

The core of this analysis relates to how the EU and the UK approach the question of cross-border trade in financial services. This report starts from some important assumptions:

(a) The first is that the EU and the UK should view cross-border financial services trade between them as operating at a number of levels, each of which can and should be treated differently, depending on its role in the wider economy, the prudential issues it raises and the kind of customer or client seeking the service. A bank borrowing funds from a bank in another country for onward lending, a bank receiving a multimillion euro payment from another bank or a government raising money on international capital markets are categories of users of cross-border services that cannot be regarded as raising the same issues for negotiators, regulators and supervisors as retail customers raising mortgages or seeking financial advice from or making a deposit with a foreign bank. There is no reason, in principle, why any of these services cannot be offered across borders – as they can be inside the EU. This report suggests how this could be achieved with regards to the different levels of regulatory and supervisory sensitivities each service requires;

(b) The second is that a distinction can and should be drawn between how a cross-border framework might be based and how it might be calibrated. This distinction is not trivial:

(i) How a regime is based will require the EU and the UK to debate and agree the key principles and the foundation for cross-border rights and obligations, an area where they will want to consider how market access rights are underpinned by regulatory alignment, recognition of regulatory standards, supervisory cooperation and reciprocity, and how these things are determined, rendered stable for businesses and customers and enforced. Here this report strongly endorses an approach based on mutual recognition and regulatory alignment; and

(ii) How such a regime is then calibrated will require the EU and the UK to judge what kinds of services and counterparties (i.e., service users) should be covered by such agreements, which will allow both sides to establish and delimit their prudential preferences and prerogatives.

(c) The final assumption is that the EU and the UK need not, and should not, rely on existing FTAs as the sole model for what is possible in an EU-UK FTA. Instead, they should consider examples both from the EU's own practice and the practice of others to inform the design of arrangements for cross-border trade in financial services to be embedded in such an agreement. This report looks at examples from across the global economy of how states have developed protocols for cross-border activity that are compatible with their prudential prerogatives and respect their desire to defend regulatory integrity. It proposes ways in which such approaches might be adopted in an FTA for the first time and strengthened to achieve a sound and stable basis for cross-border operations.

This report proposes three mutually reinforcing commitments between the EU and the UK that reflect the assumptions described above. All are based on a system of mutual recognition of the regulatory approaches of the two sides, calibrated differently in each case to reflect the nature of the commitment.

These are:

(a) A "qualified counterparties" commitment that would secure the basic interoperability of the capital markets and core wholesale banking markets of the two sides;

(b) A "professionals" commitment that sets out the terms on which other sophisticated professional clients in one party can access cross-border services from banks in the other party. This would enable the two markets to serve each other's financial professionals in a way that supports growing and dynamic economies on both sides; and

(c) A "smaller commercial and retail" commitment that acknowledges and addresses the complex prudential issues raised by the cross-border provision of financial services to smaller commercial and retail customers.

In each case it considers how such commitments should be defined; how they should be enforced; and how they can be made as stable as possible for businesses and their customers. It also proposes a system of regulatory and supervisory cooperation to underpin these commitments.

Customers' access to cross-border financial services is critical to enabling centralisation of service provision in efficient financial hubs which reduce costs to customers and improve the range of available services. However, it is also important that banks can establish local branches and subsidiaries where appropriate to support their services to local customers. The EU-UK FTA should also address the barriers to these local commercial presences. This report also addresses the commitments necessary to support banks' ability to provide a wide range of services through local operations, building on commitments in other FTAs.[8]

[8] Many of these questions are central not only to the future relationship between the EU and the UK in the area of financial services but also to the design of potential transitional arrangements. For more on this, see the BBA reports *Time to adapt: achieving an orderly transition for banking* (November 2016) and *Time to adapt: an EU customer perspective* (March 2017).

Although this report sets out an approach that would, in practice, preserve many key areas of the current cross-border relationship in financial services for the EU and the UK, the EU and the UK could use the FTA to calibrate the model set out here in a range of ways:

(a) They would need to consider the choice of service users covered by each commitment. This report proposes to group service users by objectively determined measures of their financial sophistication and thus capacity to procure services cross-border. These classifications can and should be debated;

(b) They would need to consider the services covered by the commitments. This report uses a combination of WTO and other EU nomenclature; and

(c) They would need to debate and agree the precise terms of the mutual recognition and regulatory and supervisory cooperation that underpins the commitments. This report proposes three increasingly robust forms of mutual recognition for each commitment: from inter-regulator recognition for the qualified counterparties commitment to more detailed and contingent forms of regulatory and supervisory cooperation at the level of individual rule frameworks for the professionals and smaller commercial and retail commitments. This report argues that this is an objective and practical reflection of the nature of the service users covered in each commitment. How, and where, those lines are drawn would nevertheless be for the EU and the UK to determine.

This report takes the approach of proposing a model that maintains many – but not all – of the current rights of clients and customers to procure services cross-border between the EU and the UK.

This report takes the approach of proposing a model that maintains many – but not all – of the current rights of clients and customers to procure services cross-border between the EU and the UK. However, as noted above, exit from the single market and its shared regulatory and supervisory framework will automatically leave the UK in a less advantageous position for the provision of cross-border services into that market.

The proposals set out in this report do not address all the issues that would need to be addressed in the financial services chapter of an EU-UK FTA. It is restricted to the treatment of banking and capital market services[9] and does not address the treatment of insurance or insurance-related services. It also does not address the regulation or supervision of market infrastructure, such as exchanges or markets or central counterparties, clearing, settlement or payment systems or issues relating to the location of central counterparty or clearing services for particular activities. It does not discuss any transitional arrangements that might provide a bridge from the current regime to the new arrangements.[10]

Nevertheless, much of what is proposed here is applicable beyond this set of banking and capital market services. Indeed, the basic approach to the key issue of designing an approach to cross-border market access in regulated services based on robust regulatory and supervisory cooperation could also be exported to other sectors.

[9] See chapter 4 below for a fuller description of these services, which include deposit-taking, lending, payment services and services relating to securities, derivatives and foreign exchange.

[10] BBA report, *Time to adapt: achieving an orderly transition for banking* (November 2016).

Chapter 2: The WTO framework for international trade in goods and services

2.1 The key principles of the WTO system

The key principles underlying the WTO framework are the most favoured nation ("MFN") and national treatment principles – both based on a fundamental principle of non-discrimination.

With its 164 member states, the WTO provides the international legal framework for international trade: a forum for trade negotiations, institutional oversight of trade agreement implementation, and a dispute resolution process. It embodies the principles and structures for trade law agreements, and so provides essential context for the EU-UK negotiations. The key instruments are the General Agreement on Tariffs and Trade 1948 ("GATT") and the General Agreement on Trade in Services 1994 ("GATS").

WTO rules and practice will be centrally important in establishing a new trade framework for the EU and the UK because:

(a) They will dictate the basic terms the two must apply to each other's trade in the worst-case scenario of failure to agree a new set of preferential bilateral trade arrangements; and

(b) They establish a set of norms that the EU and the UK will have to respect in establishing any preferential trade between them.

In this chapter, we outline the existing WTO rules and structural perimeters which will shape the EU-UK trade negotiations.

The key principles underlying the WTO framework are the most favoured nation ("MFN") and national treatment principles – both based on a fundamental principle of non-discrimination. The MFN principle requires all WTO members to treat other WTO members equally and not favour any member over another. The principle of national treatment prohibits discrimination between imported goods and services and "like" domestic products.

This basic framework will dictate the way the EU and the UK treat each other if they are unable to agree a new trade framework between them at the point of a UK exit from the EU. It will require, for example, that in the absence of an FTA between them, that they apply their MFN tariffs on goods and MFN market access conditions for services to each other in the same way they currently do to non-EU countries. It is this basic requirement that creates the prospect of tariffs being re-imposed on EU-UK trade after the UK's withdrawal from the EU. By the same principle, if the UK decided for any reason to unilaterally reduce any of its MFN tariffs after its withdrawal from the EU, it would have to do so equally for all WTO members.

It is important to note from the outset that WTO members have made very limited GATS commitments with respect to financial services, in particular cross-border financial services. A WTO member's GATS commitments simply provide the minimum level of access that the member is willing to codify. In addition, there are broad exceptions such as the "prudential carve-out".

Box 2: Re-establishing the UK within the WTO system

The UK has been a WTO member in its own right since 1995 and a member of the GATT since 1948. However, as an EU Member State, its commitments for trade in goods and trade in services are set out in the EU schedules.

The UK Government has declared its intention to establish its own schedules while continuing to offer third countries the same level of market access they currently enjoy. Some elements of resetting the schedules are likely to be less complicated than others. For trade in goods, tariff commitments for an individual UK schedule could simply be transposed from tariff commitments set out in the common EU schedule. Similarly, for trade in services, the EU commitments could again be transposed.

However, there are numerous instances where tariff quotas and subsidies are specified in quantitative terms for the entire EU – the method by which such quotas are apportioned will be one of the important matters for negotiation between the UK and EU.

Depending on the nature of changes, these might be made by way of rectification (and if the changes are of a purely formal character, it would give other WTO members very limited grounds on which to object).

The UK can continue to trade legally even if no agreement is reached with the EU on the status of the UK's schedules of commitments. The EU itself has been trading without updated or certified schedules for many years. In December 2016, 12 years after the EU expanded from 15 members to 25 members on 1 May 2004, it finally revised its commitments on tariffs, tariff quotas and agricultural subsidies to take into account those 10 additional members. This has not yet been certified by the other members; and yet to be accounted for are Bulgaria, Romania and Croatia, which have joined since 2007.

However, until the schedules are agreed by all members of the WTO, it is possible that other WTO members may choose to bring a complaint if they have suffered losses as a result of the new schedules or the apportioning of quotas between the EU and the UK. It may be noted that the commencement of a dispute neither affects the ability of the WTO member to continue trading under the framework nor does it invalidate the new schedules or the apportioning of the quotas.

2.2 The exception to MFN: preferential trade agreements

To avoid breaching the WTO MFN principle, any FTA must qualify for the exception to the MFN standard.[11] This permits more favourable treatment between WTO members where this is granted in the context of a comprehensive customs union or free trade area – provided that the arrangement encompasses "substantially all the trade" between the members.

Without this exception to the MFN principle, any free trade agreement or customs union between WTO members would be ruled incompatible with WTO rules. These rules are designed to create scope for such agreements, but also prevent WTO members using them for a targeted number of sectors or limited number of goods unless they are part of a genuinely ambitious liberalisation framework.

These exceptions for goods and services are separate from each other. It is not necessary for an FTA to cover both goods and services to qualify as an acceptable derogation from the MFN principle. However, where either component of trade is covered, it must meet the threshold in Article XXIV of the GATT or Article V of the GATS.

[11] Set out in Article XXIV of the GATT and Article V of the GATS.

2.3 The WTO framework for trade in services

The GATS defines trade in services by reference to the "modes" by which a service can be performed. These classifications are important, because it is generally by reference to each of these that members identify what commitments or restrictions they make for different services.

WTO rules for trade in services codified in the GATS are not as comprehensive as those for trade in goods. While the GATT has developed over almost seven decades, the GATS is a relatively new agreement, as services were not always conceived as being traded internationally.[12] It was in fact the US financial services sector which helped put the liberalisation of trade in services on the international agenda in the 1980s and 1990s.

Trade in services is not constrained by tariffs, but rather by non-tariff barriers. In order to liberalise trade, GATS provisions therefore extend into "behind the border" measures.[13] It is also generally recognised that there is scope for and value in developing particular rules for individual services sectors that reflect both the different ways sectors are regulated and the unique features of the services themselves.

The GATS defines trade in services by reference to the "modes" by which a service can be performed. These classifications are important, because it is generally by reference to each of these that members identify what commitments or restrictions they make for different services. The following four modes of supply are identified in the GATS framework:

(a) Mode 1 is cross-border supply: This is the export of a service from one country, where the seller is based, to a buyer in another where the seller has no legal presence. Under current WTO jurisprudence this also covers services delivered over the internet;

(b) Mode 2 is consumption abroad: This is the "export" of a service to a national of another country via their temporary presence in the market of the seller. Tourism and certain forms of higher education are the classic examples of this mode;

(c) Mode 3 is commercial presence/establishment: This is the export of a service via an established legal presence in the market of sale. This overlaps in many respects with foreign direct investment; and

(d) Mode 4 covers the presence of natural persons in the market of sale: Agreements in this area can be seen as supporting commitments in Modes 1 and 3, as they often define the terms on which people from exporting operations can move in and out of the importing market in order to support commercial operations.

2.4 Making GATS commitments

Commitments made by WTO members under the GATS may be general or specific.

General commitments are the minimum obligations (the MFN standard) that apply to all sectors and sub-sectors of services supplied. There is also a general commitment of transparency under Article II of the GATS, which requires (subject to emergency situations) the prompt publication of all relevant measures which pertain to or affect the operation of their commitments under the GATS.

Specific commitments can be made by WTO members in relation to market access and national treatment in specific sectors and sub-sectors of supplied services. The modes of supply to which these commitments are applicable may also be specified:

(a) A market access commitment means that, subject to any restrictions in its schedule, the member may not impose limitations with respect to: the number of service suppliers, the total value of services transactions or assets, the total number of service operations or total quantity of service output, the number of natural persons that may be

[12] Most recently, in 2016, the WTO Working Party on Domestic Regulation circulated a concept note to its members for an Agreement on Trade Facilitation in Services, to address key issues that are pertinent to facilitating trade in services, such as transparency, streamlining procedures, and eliminating bottlenecks S/WPDR/W/55 (27 September 2016).

[13] I.e., non-tariff barriers that arise in-country, usually in the form of regulatory or administrative burdens.

employed, the foreign shareholding percentage or the total value of foreign investment. The member must also not take measures that restrict or require a particular form of legal entity organisation; and

(b) A national treatment commitment means that the member is required, again subject to any restrictions in its schedule, to treat services and service suppliers of other members no less favourably than it treats like domestic services and service suppliers. The treatment can differ in form but it must not modify the conditions of competition in favour of domestic services or suppliers compared with those from other members. However, GATS makes clear that a commitment to grant national treatment should not be construed to require a member to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant services or service suppliers.

It is important to note that, for practical purposes, a WTO member's GATS commitments to bind market access do not describe the minimum level of market access they provide to other WTO members. Rather, they provide the minimum level of access that the state is willing to codify and bind. In many cases, WTO members will provide wider access in practice than they have committed in their GATS schedules to maintain. This gives members the policy space to reverse market access rights if they wish without breaching their WTO commitments. In practice, it can mean that many services firms are currently trading on the basis of rights and obligations that are embedded in national law, and national licensing regimes, but which could nevertheless be reversed without breaching WTO commitments.

2.5 The GATS and financial services

...complex balance between facilitating trade in financial services and preserving the rights of regulators to manage prudential risk is at the heart of the modern WTO landscape for trade in financial services...

Financial services, including banking, asset management, payments and capital markets services are defined as a single sector in GATS nomenclature. Different WTO members then define sub-sectors of financial services differently. For example, the EU divides its GATS schedule broadly between commitments in insurance and insurance-related services and banking and other financial services. Typically, states have made very limited GATS commitments with respect to financial services, in particular cross-border financial services.

Even where a state has made commitments under the GATS framework to give market access and national treatment to financial services, the commitments may have limited practical impact, particularly for firms seeking to supply cross-border services. Most importantly, GATS rules do not require that WTO members recognise the home regulatory system of a service supplier as a sufficient basis for market access rights. Therefore, even if they make these commitments, GATS members can still impose national licensing or other requirements on foreign firms seeking to provide cross-border financial services to customers in their territory, at least where they apply the same rules to domestic firms. These requirements can often duplicate – or even conflict with – capital, liquidity or other prudential or conduct requirements applied under the firm's home state regime and can in practice make cross-border supply economically or practically unfeasible.

Similar issues can arise where foreign firms wish to operate in another country through a branch rather than a subsidiary, particularly where the host state seeks to apply its prudential or other rules to the whole legal entity. Despite the fact that, in principle, WTO members are required to provide competitive regulatory equality for a local subsidiary of a foreign firm comparable to that of domestic firms, foreign-owned firms could still be put at a competitive disadvantage by local rules that apply equally to domestic firms. This complex balance between facilitating trade in financial services and preserving the rights of regulators to manage prudential risk is at the heart of the modern WTO landscape for trade in financial services. As examined below, this will be an important issue in designing an EU-UK regime.

As a way of deepening the GATS' treatment of financial services, some WTO members have signed the Understanding on Commitments in Financial Services ("GATS Understanding"). This is not an integral part of the GATS but an adjunct instrument that allows WTO members to take on specific commitments to liberalise financial services as an alternative approach to the national schedules of commitments under the GATS. The Understanding aims to widen the scope for trade in financial services, but subject to some safeguards:

(a) Signatories must permit non-resident suppliers of financial services, whether as a principal, through an intermediary, or as an intermediary, to supply certain cross-border financial services on the basis of national treatment. However, this only covers a range of insurance-related services, some financial information services and other auxiliary services, and not any mainstream banking or capital market services;

(b) Signatories must permit financial services suppliers of other members to establish or expand a commercial presence in their territory, including by acquisition. However, it allows the member to impose authorisation and other requirements on the supplier; and

(c) It adds additional guarantees for the treatment of foreign financial services firms which have a commercial presence in the member's territory. These include expanded rights to move staff into a market and non-discrimination in terms of access to payment and clearing systems operated by public entities and organised securities markets. However, even these rights of access to market infrastructure fall short of the rights to remote access (without a commercial presence) to securities and derivatives market infrastructure conferred by EU legislation.

In addition, the GATS contains an overriding provision which recognises a state's "right to regulate" for broadly defined prudential reasons, including investor or customer protection or market integrity or financial stability, even if the measures taken conflict with the state's other commitments in the GATS (see Box 3). This preserves the regulatory autonomy of a state but affects the extent to which firms can rely on the commitments made under the GATS.

Box 3: GATS Prudential carve-out

Notwithstanding any other provisions of the Agreement, a member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policyholders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the member's commitments or obligations under the Agreement.

Paragraph 2(a) GATS Annex on Financial Services

2.6 Bridging the regulatory gap: mutual recognition and regulatory convergence in the WTO system

As noted above, one of the challenges of facilitating trade in financial services often lies in their highly regulated nature and the fact that regulators are often cautious in liberalising market access dependent on the basis of the confidence provided by the home system of the exporter. This is a much wider issue in trade policy and applies far beyond financial services to any product or service that must pass a conformity standard to be placed on a local market. WTO members have long sought ways to balance the sometimes competing objectives of trade and import facilitation and the desire to enforce local quality and safety standards.

One way this is routinely undertaken in the WTO system is via the use of mutual recognition agreements ("MRAs"), which support the liberalisation of trade through states' mutual recognition of each other's conformity assessments. MRAs are most commonly applied to goods – for example, covering quality control, or health and safety provisions. With respect to services, these agreements can include the recognition of professional qualifications and other standards. Such agreements can help reduce the need for duplicative requirements in two markets with high levels of trade between them. In principle, members can also unilaterally recognise other members' measures as equivalent to their own.

Regulatory convergence is another means through which it may be possible to remove barriers to trade, and is particularly important for trade in services. The WTO Agreement on Technical Barriers to Trade and the Agreement on Sanitary and Phytosanitary Measures are the most far-reaching examples of regulatory convergence under the WTO. They concern government regulation relating to public health, consumer protection and environmental protection, and go significantly further than the GATT – which generally does little to restrict unilateral regulatory measures provided they are applied in a non-discriminatory manner.

Regulatory convergence can help promote the development and effectiveness of good regulatory practices, transparency as to the measures that are imposed and, over time, transparency as to their review and rationalisation where appropriate.

Regulatory convergence can help promote the development and effectiveness of good regulatory practices, transparency as to the measures that are imposed and, over time, transparency as to their review and rationalisation where appropriate.

In the area of financial services, the GATS acknowledges that members may – through an agreement or arrangement or unilaterally – recognise the prudential measures of any other country in determining how their own measures should be applied. For example, the various "third country regimes" under EU financial services legislation unilaterally give firms from third countries similar treatment to EU firms without compliance with all the requirements of EU legislation if the European Commission determines that the relevant third country has an "equivalent" regulatory regime, appropriate regulatory and supervisory cooperation arrangements exist and, in many cases, there is an effective reciprocal regime for equivalent treatment of EU firms. Under the GATS Annex on Financial Services, a member that is a party to such an agreement or arrangement must afford adequate opportunities for other interested members to negotiate their accession to the agreement or arrangement or to negotiate comparable agreements or arrangements, where there would be equivalent regulation, supervision and enforcement and, if appropriate, information sharing procedures. Alternatively, where a member unilaterally recognises other countries' regulatory regimes, it must give other members the opportunity to demonstrate that such circumstances exist.

2.7 Conclusion: the limitations of the WTO framework

This chapter has set out the basic WTO landscape for trade in financial services and the way that it reflects both the underlying principles of the WTO systems and a range of idiosyncratic features linked to the regulated nature of financial services themselves. A number of observations about this landscape are useful in considering the future trading relationship between the EU and the UK for financial services.

Firstly, a reversion to a baseline of MFN GATS trading conditions for the EU and the UK would mean relying on a system in which many of the core market access rights created by membership of the single market simply have no analogues. This is especially the case for Mode 1 cross-border trade in financial services, which is widely permitted in the single market, but largely absent from the binding GATS commitments of WTO members and from the commitments of the both the EU and – assuming the UK adopts the EU's GATS schedule as its own – the UK.

The EU's commitments allow EU Member States to maintain their current regulatory approach to cross-border trade in financial services, which in many Member States is highly restrictive of cross-border business by third country firms. The UK's cross-border regime is very liberal by comparison, although not because of commitments under the GATS, but because of the choices that the UK has made about the general value of access to cross-border financial services for UK-based customers.

Secondly, there is ample scope in the WTO rulebook for the EU and the UK to remedy some of these lost trading rights via a preferential trading agreement between them, provided they respect the criteria set out in Article V of the GATS and other conditions.

Thirdly, it is clear that the key obstacle to replicating some of the cross-border trading conditions established by the single market will be replicating the high level of shared and mutually respected standards embedded in the single market that underpin those trading conditions. However, there is an established landscape of approaches to mutual recognition and regulatory and supervisory cooperation for the EU and the UK to draw on in considering how they might "break the link" between prudential concern about cross-border provision and restricted trading rights – both in policy and in practice. At the very least, these establish the starting point for innovative thinking.

The next chapter of this report moves on to assess how WTO states have used preferential agreements compatible with Article V of the GATS to move beyond the WTO baseline for trade in services, and where they might be applied to an EU-UK arrangement.

Chapter 3: Free trade agreements under the WTO framework

3.1 Moving beyond the WTO baseline

The previous chapter of this report has described the "WTO baseline" in trade in financial services. As noted, this is in general underdeveloped and restrictive, especially for cross-border services. Even where WTO states adopt more liberal approaches to cross-border services in their national licensing regimes for banking and financial services, they have been resistant to codifying these in their WTO commitments.

One obvious channel for deepening these cross-border rights and obligations for certain trusted and strategic trading partners is the negotiation and signing of FTAs. At present, it is assumed that this will be the basis for the future long-term EU-UK relationship following the UK's withdrawal from the EU.

All recent EU and US FTAs have covered financial services in some form. However, their focus has generally been on deepening and securing the rights and obligations of EU and US firms owning and operating financial services businesses in the markets of their negotiating partners, and on liberal terms for the movement of financial professionals and data between operations in the two markets. In all of these respects they have made material progress.

All recent EU and US FTAs have covered financial services in some form. However, their focus has generally been on deepening and securing the rights and obligations of EU and US firms owning and operating financial services businesses in the markets of their negotiating partners, and on liberal terms for the movement of financial professionals and data between operations in the two markets.

However, Mode 1 cross-border trade in financial services – between a seller in one market and a buyer in the other – has generally received only minimal treatment. The EU single market remains the only treaty-based arrangement in the global economy that substantively liberalises cross-border trade in financial services between countries.

The coverage of financial services in most modern EU and US FTAs can be summarised as follows:

(a) They are most substantive on Mode 3, placing clear limitations on rules that block the participation of foreign capital in ownership of local financial services suppliers, including percentage limits or caps on the total value of individual or aggregate foreign investment; seeking in some cases to eliminate requirements that investment take a certain legal form or require a local joint venture partner; and seeking to restrict any rules that dictate that locals must have predefined roles in an invested company or its governance. These can be important guarantors of the ability of investor firms that they will be able to make and control material investments in the local financial services economy;

(b) They address Mode 1 at the level of general principle, often seeking to impose limitations on the ability of parties to impose economic needs tests, quotas or other restrictions on cross-border supply. This approach has the merit of clarity but the considerable disadvantage of adopting a default position of no bound liberalisation, from which each and every exception must be stated. However, these limitations only apply to sectors or sub-sectors where the parties have explicitly indicated they will apply, and such commitments are (generally) exceptionally limited for regulated financial services activities. In particular, they generally do not cover regulated banking and capital market services;

(c) In both Modes 1 and 3, such FTAs will set out a national treatment obligation stipulating – in the language of Article XVII of the GATS – that the parties agree to "accord to services and service suppliers of the other Party treatment no less favourable than that it accords to its own like services and service suppliers." However, as noted above, while this is an important check on potential discrimination in some cases, as exporting firms are also required to be fully regulated in their home market, even regulatory requirements that meet the national treatment standard can impose duplication on an exporter that makes activity unfeasible.

The national treatment obligation is generally explicitly extended to the right to provide new financial services, echoing the similar commitment in the GATS Understanding (see page 24). However, again, the Mode 1 commitments generally do not cover regulated banking and capital market services. National treatment is also generally applied to the terms of membership of self-regulatory bodies, especially where this is a required part of market participation but – as in the GATS Understanding – only for foreign firms that have established a commercial presence;

(d) They address Mode 4 commitments and generally seek to ensure that financial services professionals can enter the market of the other party for temporary periods, to service an exporting relationship or investment;

(e) They may contain investment protection provisions for financial services. These provisions apply to investors and investments in the financial services sector and include core obligations in relation to: national treatment and non-discrimination, fair and equitable treatment and full protection and security, compensation for losses (in the event of war or other armed conflict, revolution, etc.), expropriation, freedom to transfer funds, subrogation, and termination. This is further accompanied by a provision that provides for ISDS;

(f) They may contain regulatory transparency provisions, requiring certain forms of consultation on the regulatory process and the development of new rules or protocols. They will often have similar requirements that licensing and authorisation procedures for foreign firms be based on clear, objective, transparent, pre-established and accessible criteria;

(g) They may encourage professional standards bodies to consider and facilitate the mutual recognition of standards. They will also acknowledge the potential value of this at a regulator-to-regulator level, including prudential standards, as a factor in easing trade or the operational treatment of invested firms;

(h) They generally contain data transfer provisions requiring that both parties permit a financial service supplier to transfer information in electronic or other form for data processing where such processing is required in the ordinary course of business of such financial service supplier. These will generally be coupled to a commitment to maintain a high level of data privacy and protection;

(i) They generally stipulate that parties should grant to financial service suppliers of the other party access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business. This obligation does not extend to central bank lender of last resort facilities. As in the GATS Understanding, these rights and obligations are limited to firms that have established a commercial presence; and

(j) They assert the right of parties to regulate or take measures in defence of financial stability or the soundness of the financial system, based on the GATS prudential carve-out, but generally subject to some additional requirements for necessity and proportionality.

Box 4 (see page 31), sets out in more detail how some of these commitments have been captured in recent EU FTAs. Taken together, commitments such as these can be important and valuable increments on the baseline established by the general WTO disciplines described in chapter 2. Nevertheless, it should be immediately apparent that they fall far short of an arrangement that would enable even a small part of the cross-border contracting rights currently available to EU clients accessing services in the UK, even taking account of the wider cross-border scope in some of the national licensing regimes of individual EU Member States. They do not protect cross-border contracting rights in any substantial degree and make no significant attempt to consider how such rights might be underpinned by a regime of regulatory and supervisory cooperation and alignment of rules and standards.

However, this limited nature of financial services commitments in FTAs is not a result of the FTA model itself. In principle, adopting the structure of an FTA for a cross-border trading framework prescribes nothing with respect to its content except respect for WTO rules. The substantive commitments within the framework of an FTA can, in principle, be anything that the parties choose them to be. The depth of cross-border commitments in financial services in FTAs is much more reflective of the extent of prudential and regulatory convergence between jurisdictions and the inherent challenges attached to cross-border provision of highly regulated services.

It can also reflect a desire to concentrate regulatory convergence efforts at the multilateral level where levels of convergence are more generic (but where standards are commensurately less suitable as a basis for cross-border trade). This concern was expressed, for example, with respect to the possibility of regulatory convergence efforts in the TTIP agreement.

However, in this respect it is important to note that all extant models of FTAs have been designed to bring two jurisdictions closer from their pre-established WTO baselines, each defined by idiosyncratic and separate regulatory approaches. The EU and the UK will be starting from a position of regulatory unity and parity between the parties.

3.2 The approach to financial services in recent EU FTAs

The EU has negotiated comprehensive trading agreements with a number of strategic partners, and continues to do so. The first FTA with which the EU sought concessions in the financial services sector in a significant way was the EU-South Korea FTA in 2011. Since then the EU has completed FTA negotiations with a group of Central American states (2012), Colombia-Peru (2013), Ukraine (signed in 2014), Singapore (concluded in 2014 and pending ratification), and Canada (approved in 2016 and pending ratification), all of which have also included additional commitments for market access for financial services, and enhanced rules governing financial regulation. The EU has recently announced an agreement in principle with Japan. The EU is also currently negotiating the Trade in Services Agreement ("TiSA") with a group of WTO members with the aim of further liberalising global services at a plurilateral level.

The EU has for the most part taken the GATS, GATS Annex on Financial Services and the GATS Understanding (see page 24) as a starting point for its FTA negotiations on financial services. Some of these agreements have a similar structure to the GATS and, like the GATS, provide limited market access for cross-border financial services. This is the model that underpins the EU's FTAs with Singapore, South Korea and Canada.

The CETA introduced a number of policy innovations that have the potential to deepen the focus on financial services and to widen the scope for liberalisation:

(a) It contains for the first time a dedicated financial services chapter (Chapter 13), which contains most of the rules relevant to trade and investment in financial services, particularly in relation to cross-border supply of services, establishment and the regulatory framework. In addition, the chapter includes sections with respect to a Financial Services Committee, consultations, and dispute settlement mechanisms particular to investment disputes in financial services. The proposed TTIP agreement also anticipated a dedicated financial services chapter, although there were differences between the EU and the US about how the TTIP agreement should cover financial services. Previous EU FTAs incorporated financial services content in a single services chapter; and

(b) It adopts for the first time a "negative list" approach, reversing the logic of the conventional "positive list" approach in the GATS and previous EU FTAs whereby all disciplines apply to all relevant sectors and measures, other than those set out in a party's Schedule/Annex (see Article 13.10). A "negative list" negotiating modality tends to yield greater levels of liberalisation, simply because the default position in this context becomes the application of all rules to all sectors and all modes of supply. This approach should be used in an EU-UK FTA.

Both these innovations should be part of an EU-UK FTA structure. However, while these mechanisms improve the potential scope of liberalisation by placing a clearer bias towards openness and treating financial services as a sector requiring specialist assessment in its own right, in most other respects CETA reflects the core limitations of other FTAs with respect to cross-border services. In particular, as with other FTAs, the EU only makes extremely limited commitments in relation to cross-border regulated banking and capital market services, although some smaller EU Member States make some broader commitments and there is a general commitment by the EU to grant market access and national treatment to

Canadian firms providing cross-border portfolio management services to EU collective investment undertakings (subject to application of EU prudential requirements and a prior equivalence assessment by the European Commission).

The EU does have a small number of FTA-based relationships that go beyond this CETA model with a greater potential scope for cross-border trade in financial services, essentially through forms of "partial participation" in the single market:

(a) The EU-Ukraine Association Agreement (2014) goes far beyond the standard EU FTAs, even CETA, by including a mechanism for the approximation of Ukrainian legislation to EU internal market legislation.[14] This envisages an EEA-like arrangement under which Ukraine transposes EU sectoral legislation into its law and whereby, subject to an assessment, Ukraine can then participate in the internal market for that sector. However, under this arrangement Ukraine has no vote in new EU law-making, does not participate in the EEA, has to choose between transposing new EU law and the EU suspending Ukraine's internal market access and is subject to the jurisdiction of the Court of Justice of the EU ("CJEU") with respect to disputes about its compliance with its obligations. Under this arrangement, internal market treatment is also only available once Ukraine has liberalised its currency. This is a valuable precedent in the extent to which it reinforces the scope to base market access rights on regulatory convergence, but it reflects a high level of asymmetry in the EU-Ukraine relationship and a potential willingness on the part of Ukraine to forego regulatory autonomy in return for market access treatment in the single market; and

(b) The EU-Switzerland relationship is built on a similar model, albeit developed in a more ad hoc way over time through a series of flanking agreements to the original EU-Switzerland FTA. By mutual consent the EU-Switzerland trade arrangements do not in general cover financial services, even though they involve intensive commitments in other areas. However, there is no reason, in principle, why the "Swiss model" could not be extended to do so.

These models clearly provide greater scope for cross-border contracting than any other EU FTA. However, they do so by binding the non-EU party into harmonisation of regulatory and supervisory approaches with the EU.

3.3 Conclusion: the unfulfilled potential of the FTA models

This chapter has set out some of the ways in which WTO members, and the EU in particular, have attempted to build on the baseline of WTO disciplines in financial services through FTAs. A number of observations can be made:

(a) Firstly, although the EU's most recent FTAs, with Singapore and Canada in particular, have taken great steps to improve trade liberalisation for financial services, the sector still faces significant limitations. Even CETA, which contains a number of important innovations, only made a few advances beyond prior FTAs in relation to financial services. The lack of progress with respect to regulatory alignment acts as a check on establishing the levels of regulatory and supervisory cooperation and trust that might, in principle, act as the basis for cross-border contracting rights for service users on both sides. The prudential carve-outs on both sides, while an understandable reflection of regulatory prerogatives in a highly sensitive area, can also render market access commitments unstable and uncertain;

(b) Secondly, while an agreement like the EU-Ukraine FTA has in principle further developed the EU's model for facilitating cross-border trade in financial services, it has done so on the basis of an asymmetric arrangement that ties market access rights very tightly to the transposition of EU rules. This transforms the basic FTA template into something much closer to a treaty-based framework for establishing

[14] Article 133 in Chapter 6 entitled Regulatory Approximation refers to an arrangement set out in Annex XVII in particular sectors, including financial services.

the non-EU party as a satellite jurisdiction of the EU for the purposes of cross-border trade. Such a model has obvious disadvantages if both parties wish to reserve an element of regulatory autonomy; and

(c) Finally, there is, however, nothing in the FTA model itself that prevents it from being used as the basis for ambitious cross-border liberalisation of financial services on the basis of mutually acceptable terms of regulatory alignment. An FTA is simply the expression of the level of interest in cross-border integration of the two parties and the mechanisms that they choose to design to underpin that.

The next chapter of this report looks at how the EU and the UK might draw on a range of precedents from around the global economy to design a set of commitments in financial services that go further than any of these agreements and have the potential to preserve some of the most valuable elements of the status quo.

Box 4: Approaches to financial services in recent EU FTAs

Mode 1 – Cross-border supply of services

In most EU FTAs, the market access obligation[15] is the core provision by which the parties to FTAs open their services markets to the other parties' service suppliers for Mode 1 cross-border trade. The market access obligation does not entail an obligation to remove *all* restrictions on market access in that sector, rather, it requires only the removal of the following:

- limitations on the number of service suppliers, whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
- limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test; and
- limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test.

Similarly, the national treatment obligation for Mode 1 is only applicable to the sectors and services for which specific commitments have been undertaken.

Mode 3 – Establishment

For Mode 3 establishment, EU FTAs use a similar framework to Mode 1, adding rules on limitations on majority ownership and control. Typically, the EU's reservations with respect to establishment require foreign firms to have their registered office in the EU, a certain proportion of senior management to have permanent residence within the EU and for branches of foreign firms to adopt a specified juridical form. The national treatment obligation applicable to commitments undertaken with respect to establishment is the same as the national treatment obligation applicable to the cross-border supply of services.

Mode 4 – Presence of natural persons

With respect to the temporary presence of natural persons, modern EU FTAs generally stipulate that the parties must permit the temporary entry of workers for certain purposes and within certain limits as specified in a Schedule or an Annex.

[15] As previously explained, the GATS contains a single market access obligation which applies, in principle, to all modes of service supply.

Investment protection provisions	Neither the EU-South Korea FTA nor the EU-Ukraine Association Agreement contains investment protection provisions.[16] CETA and the EU-Singapore FTA contain investment protection provisions in the investment chapter of the agreement. This is further accompanied by a provision that provides for ISDS.
Prudential carve-out	EU FTAs usually include a carve-out for "measures for prudential reasons" including measures "for the protection of investors, depositors, policyholders or persons to whom a fiduciary duty is owed by a financial service supplier", as well as measures "ensuring the integrity and stability of the financial system". The safeguard is usually subject to qualification, and although this varies between agreements, these usually require that: • prudential measures "shall not be more burdensome than necessary to achieve their aim" (the proportionality test); • non-conforming prudential measures "shall not be used as a means of avoiding each Party's commitments or obligations" under the FTA; • prudential measures are applied on a non-discriminatory basis; • prudential measures are not a disguised restriction on trade in services; • the agreement will not require public entities of the parties to disclose confidential or proprietary information; and • allows the parties to require the registration of cross-border financial services suppliers and of financial instruments. The carve-out in the EU-Singapore FTA includes a provision which requires the parties to use their best endeavours to ensure that international standards are implemented and applied. In CETA, the approach offers further comfort for financial regulators by including the following: • Annex 13-C, which provides guidance on the application of the prudential carve-out, including that interpreters ought to defer "to the highest degree possible" to the decisions and determinations of domestic financial regulatory authorities. It also provides that a measure shall qualify for protection where it "has a prudential objective" and "is not so severe in light of its purpose that it is manifestly disproportionate to the attainment of its objective"; • a "filter mechanism" incorporated in Article 13.18.3(c) and Article 13.21.1(b) whereby the Parties agree (through the Financial Services Committee or the CETA Trade Committee) that a measure in question falls within the prudential carve-out and as a result the investor shall be deemed to have withdrawn its claim and proceedings be discontinued; and • The Financial Services Committee is empowered to review and decide on the reasonableness of the use of the "prudential carve-out".
Regulatory transparency	Recent EU FTAs tend to include a clause relating to regulatory transparency. Some FTAs contain specific rules within the financial services sections[17] while other FTAs[18] include general transparency rules covering all measures relating to the supply of services under the FTA.

[16] Although it is important to note that Article 89 of the EU-Ukraine Association Agreement requires the Parties to review regularly the establishment legal framework and assess obstacles to address these, with a view to including investment protection provisions and ISDS procedures in the future.

[17] EU-Singapore FTA and EU-Ukraine Association Agreement.

[18] e.g., EU-South Korea FTA.

Although the approach may be different between FTAs, the provisions typically require the parties:

- to establish mechanisms to provide the other party with prompt information on international agreements that may affect mutual recognition or other relevant regulatory measures;
- in respect of applications, to make the requirements for completing applications publicly available, to inform applicants on request of the status of their application, to take decisions within a reasonable period of time (within 120 days), and to notify applicants promptly of decisions;
- to publish all measures of general application promptly and reasonably in advance of their coming into force, and to give on request an explanation of their objective and their date of entry into force;
- to establish enquiry points to provide information to the other party and to respond promptly to requests for information;
- to administer all measures of general application in a reasonable, objective and impartial manner;
- in respect of administrative decisions and proceedings, to provide appropriate notice of proceedings, to provide affected parties with an adequate opportunity to make representations, to conduct such proceedings in accordance with law, and to provide an opportunity for review and appeal where necessary; and
- in respect of regulatory quality, to cooperate and subscribe to the principles of good administration behaviour through exchange of information and best practices. The EU-Ukraine Association Agreement goes further and requires the parties to use their best endeavours to ensure the use of international standards for regulation and supervision in the financial services sector.

The transparency provisions typically do not require parties to provide confidential information where to do so would impede law enforcement, be contrary to the public interest, or prejudice the legitimate interests of particular enterprises, public or private.

Recognition of standards

Recent EU FTAs tend to include a clause on negotiating mutual recognition arrangements. The provisions provide a degree of encouragement for the adoption of such arrangements, outline a process for their ongoing consideration, and include requirements to encourage relevant professional bodies to undertake work.

In CETA, Article 13.5 also provides that a party may recognise the prudential measure of a third country. Such recognition may be achieved unilaterally, through harmonisation or based upon an agreement or arrangement with the third country. In the case of an agreement, the party which recognises a prudential measure must provide the other party with an opportunity to accede to the agreement if the circumstances exist in which there is equivalent regulation, oversight and implementation, among other things.

Licensing and qualification requirements

EU FTAs include rules on trade in relation to licensing and qualification requirements and technical standards. Although the wording and approach may vary between agreements, they usually require that standards and requirements be "based on clear, objective, transparent, pre-established and accessible criteria".

In addition, CETA, the EU-Singapore FTA and EU-Ukraine Association Agreement specify points of procedure, including:

- to be as simple as possible and not unduly complicate the supply of any service;
- to involve competent authorities that are impartial with respect to all applicants;
- to allow applicants to be allowed a reasonable amount of time to apply;

	• to provide a final decision within a reasonable period of time; • to provide in writing the reasons for rejecting an application; and • to ensure that a licence or authorisation, once granted, enters into effect without undue delay. Unlike the GATS (Article VI: 5), the EU FTAs do not impose a necessity test which requires the parties to ensure that the licensing and qualification requirements are "not more burdensome than necessary to ensure the quality of the service".
New financial services	Similar to the GATS Understanding, EU FTAs typically require the parties to "permit any new financial service." However, the parties can: • limit the provision to the extent that the importing party would permit its own service suppliers to supply the new service in like circumstances; • limit the provision to the extent that the new financial service does not require a new law or the modification of an existing law; and • request authorisation for the new financial service, and specify the juridical form in which the new financial service may be supplied, provided a decision is made within a reasonable period of time. The approach in CETA does not prevent a financial institution from applying to the other party to consider authorising the supply of a financial service that is not supplied within either party's territory. However, the application is subject to the law of the party receiving the application.
Data processing	EU FTAs typically include a clause which requires the parties to "permit a financial service supplier to transfer information in electronic or other form for data processing where such processing is required in the ordinary course of business of such financial service supplier".[19] This obligation is usually coupled with an obligation on each party to adopt adequate safeguards for the protection of privacy, in particular with regard to the transfer of personal data. In CETA, the transfer of personal data must occur in accordance with the laws governing the protection of personal information of the territory of the party from which the transfer has originated.
Payment and clearing bodies	EU FTAs stipulate that parties should grant to financial service suppliers of the other party access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business.[20] Such access is to be provided on a national treatment basis but it does not confer access to the party's lender of last resort facilities. In addition, these rights are only available for firms that have established themselves in the party's territory.
Self-regulatory bodies	EU FTAs typically include a clause which seeks to ensure that "self-regulatory bodies" adhere to national treatment and MFN principles for both cross-border supply of services and establishment-related commitments. The provision applies only where a party requires membership or participation in such a body, or where a party provides such bodies with privileges or advantages. In the financial services sector, "self-regulatory bodies" include professional associations, securities exchanges, futures exchanges, national stock exchanges and clearing agencies.

[19] A provision to this effect was included in the GATS Understanding without the obligation requiring members to adopt adequate safeguards for the protection of privacy.

[20] In the EU-Singapore FTA, this provision only applies to the extent "access is permitted by each Party's access criteria" and can only be extended to financial service suppliers which are "regulated as financial service suppliers under" a Party's "domestic law".

Most Favoured FTA agreement	Some recent EU FTAs have included MFN provisions that restrict the ability of the EU to agree more favourable terms with third countries in respect of services and investment even under a comprehensive FTA. In particular, the EU-South Korea FTA and CETA contain MFN commitments which would require the EU to offer the other parties the benefit of a more favourable FTA entered into with another country unless the FTA meets certain standards, e.g., the new FTA creates an internal market on services and establishment or encompasses both the right of establishment and the approximation of legislation (EU-South Korea) or the new FTA creates an internal market in services and investment, grants the right of establishment or requires the approximation of legislation in one or more economic sectors (CETA). These commitments apply to measures relating to cross-border services and establishment under the EU-South Korea FTA and measures relating to cross-border services and investment under CETA. In addition, these treaties would require the EU to offer South Korea and Canada an opportunity to negotiate comparable arrangements if the EU enters into recognition arrangements with a third country even if it does so as part of a comprehensive FTA, but only under circumstances in which there would be equivalent regulation, oversight, implementation of regulation, and, if appropriate, procedures concerning the sharing of information between the parties to the agreement or arrangement.

Chapter 4: An ambitious EU-UK free trade agreement for financial services

4.1 Objectives for cross-border financial services

Although the last five decades have seen a growing web of commitments between states to open their markets to direct investment by foreign banks and financial services companies, similar commitments to guarantee the right to sell financial services cross-border remain very limited.

The previous two chapters of this report have described the landscape for trade in financial services as it has been defined by the WTO rulebook and the bilateral agreements that WTO members have agreed between themselves. The key feature of this landscape is the very limited nature of commitments between WTO members to guarantee cross-border market access for financial services. Although the last five decades have seen a growing web of commitments between states to open their markets to direct investment by foreign banks and financial services companies, similar commitments to guarantee the right to sell financial services cross-border remain very limited.

This poses a particular challenge for the EU and the UK precisely because the EU single market is one of the very few contexts in which such cross-border trading rights are guaranteed in many areas, and are the basis for large volumes of important economic activity at present. Banks in one Member State can use their EU "passport" rights to provide vital cross-border banking and capital markets to companies, financial institutions, governmental entities and retail investors in other Member States without the need to set up a local branch or subsidiary, without needing additional local licences and, in many cases, without the need to comply with significant additional local rules. This has enabled the concentration of financial services in efficient financial hubs which can reduce costs and improve the services offered to customers.

As the analysis of the two previous chapters makes clear, this is an exceptionally liberal arrangement in global terms. Outside the single market framework, licensing requirements in many EU27 Member States prevent banks from outside the EU providing cross-border services to their companies, financial institutions and governmental entities. In many cases, it is simply not possible for a non-EU bank to provide cross-border services even to large companies, financial institutions or governments without a licence, which is often not available to non-EU banks unless they are set up and act through a local branch or subsidiary.

Even where national regimes allow the cross-border provision of banking and capital markets services, the foreign bank may be subject to duplicative rules and to discriminatory treatment as compared with local firms. The EU's obligations under the GATS or under an EU-UK FTA modelled on the EU's existing FTAs would not address these barriers simply because the EU has, up to now, made very limited commitments to allow the cross-border provision of financial services from entities outside the EU's single market.

Subjecting EU-UK trade in financial services to these barriers would impose significant change on, and disruption to, many thousands of current users of banking and capital market services. These services are critical for economic growth in the EU and the UK. For these reasons, an EU-UK FTA must move significantly beyond existing models by designing and building a framework which enables cross-border financial services to continue.

This chapter sets out a proposal for the key elements of a financial services chapter of an ambitious EU-UK FTA that would provide a framework to address these barriers to cross-border services. This proposal is built on a number of starting premises:

(a) That it is useful to think of users of financial services as a spectrum from the large, sophisticated institutional users like governments, banks and large institutional investors and non-financial companies that are the basic actors and providers of liquidity in the economy, through sophisticated professional users of financial services to retail investors and retail customers of various kinds. This spectrum is helpful, not because it suggests that any user matters more than any other – it does not – but because it underlines that each of these classes of user plays a different role in the economy and that the prudential and customer protection issues attached to cross-border contracting for each of these classes of user are distinct and can and should be treated differently;

(b) That there is a strong argument for adopting a "variable approach" to the basing of cross-border market access rights that reflects this spectrum. Broadly, the proposal here is that three incrementally different levels of mutual recognition and regulatory alignment should be used to reflect different levels of prudential concern represented by each class of service user. The greater the level of regulatory concern for the user's capacity to contract reliably and without personal financial risk cross-border, the greater, in principle, the level of required regulatory and supervisory cooperation between the two markets should be. Individual EU Member States already adopt such a "dual approach" to cross-border rights in their combined national and EU-level policy approaches. The proposal here is that adapted elements of those EU national regimes could, in principle, be elevated to the EU level and applied to an EU-UK framework. All of this must be underpinned by institutionalised regulatory and supervisory cooperation;

The merit of the model proposed here is that once the parties have agreed on how the model should be based in terms of underlying regulatory and supervisory cooperation, the parties can then calibrate the model in the FTA in a range of ways...

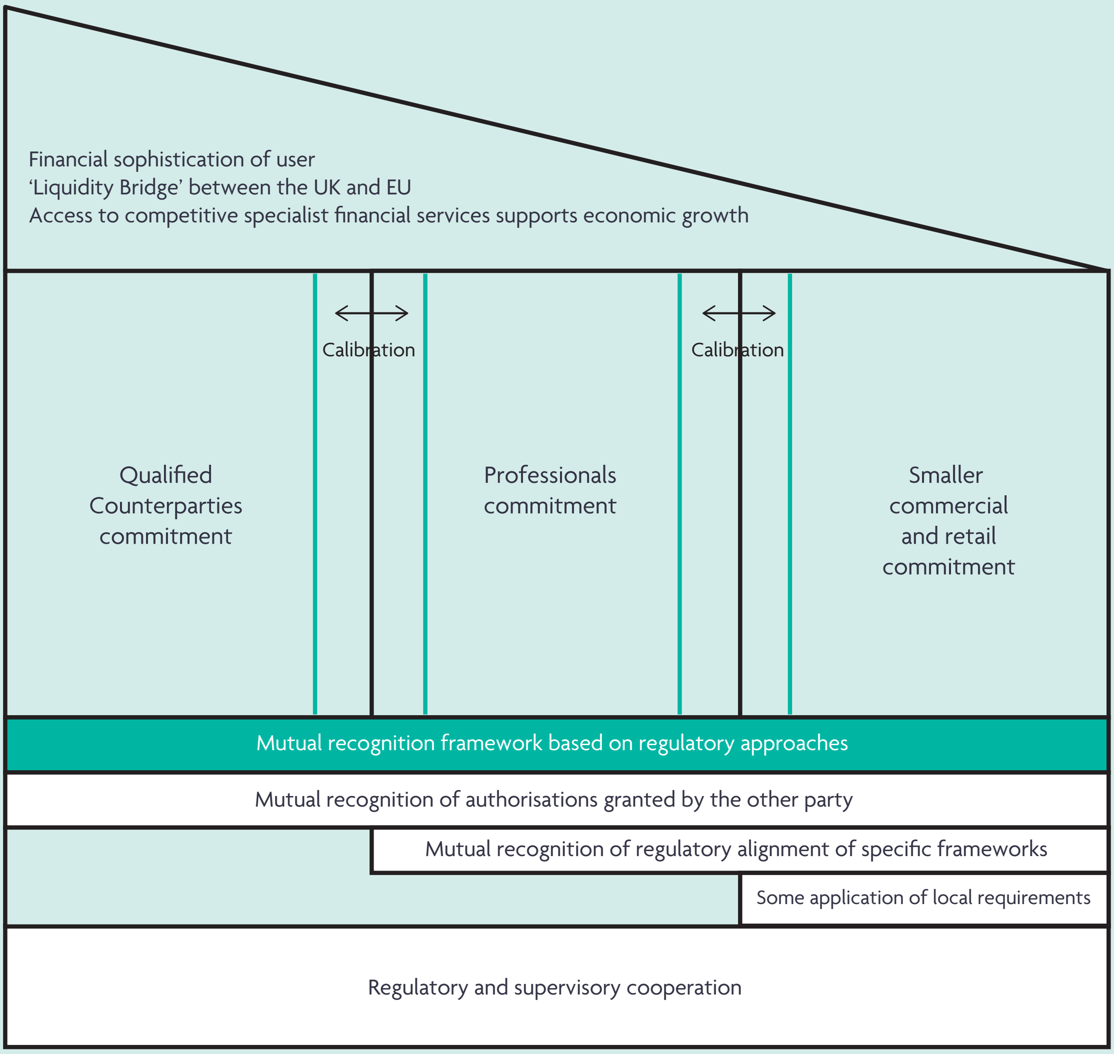
(c) That it is desirable to design a cross-border financial services framework for the EU and the UK that is adaptable now and in the future. The merit of the model proposed here is that once the parties have agreed on how the model should be based in terms of underlying regulatory and supervisory cooperation, the parties can then calibrate the model in the FTA in a range of ways to allow (or disallow) different kinds of customers to seek different kinds of services across the border between the EU and the UK. In principle it also means that, in the future, the two parties have an established framework for recalibration, by mutual consent, in response to technological change or other developments;

(d) That the EU and the UK will both place a very high value on their legal and regulatory autonomy in a post-exit world. The corollary of this is that existing models of cross-border trade with the EU that are based purely on agreement by a third country to adopt and enforce EU standards will be problematic for the UK. A workable model is likely to require a more symmetrical approach based on mutual acceptance of regulatory and supervisory cooperation and reciprocity. While the proposal envisages that some of the rights of the parties in the FTA would be conditional on the parties' regulatory regimes remaining sufficiently aligned, the parties would retain the overriding "right to regulate". All of the rights would be based on close consultation on legislation and rule-making, as well as cooperation on supervision, enforcement and resolution; and

(e) Finally, this report recognises that while preserving a high volume of cross-border trade in financial services after a UK exit from the EU makes economic sense from the point of view of customers, the relationship must inevitably involve reduced freedoms to procure services cross-border when measured against the rights attached to single market membership.

The basis for this proposal is that if the EU and the UK can agree on these premises then it is in fact possible, in principle, to build a framework for cross-border trade in financial services that would leave open the possibility of preserving a high level of choice for many key EU and UK customers, while respecting political and prudential red lines on both sides. This should be based on three core commitments, set out in the following diagram.

Diagram 1: Mode 1 – proposed cross-border commitments



Box 5: Defining banking and capital market services

In formulating the commitments under an EU-UK FTA, it will also be necessary to define the services that should be available to the defined classes of service users. For these purposes, the FTA should define the relevant services by reference to the GATS Annex on Financial Services, adapted where appropriate to reflect the categorisation used in EU regulations such as the new EU Markets in Financial Instruments Directive ("MiFID II") and EU banking and payment services legislation. Thus, banking and capital market services should comprise the following services:

1. acceptance of deposits and other repayable funds;
2. lending of all types, including consumer credit, mortgage credit, factoring (with and without recourse) and financing of commercial transactions (including forfeiting);
3. financial leasing;
4. all payment and money transmission services, including credit, charge and debit cards, traveller's cheques and banker's drafts and all operations relating to payment accounts and the issue, administration or acquisition of payment instruments or other means of payment (including electronic money);
5. guarantees and commitments;
6. trading for own account or for the account of customers, including the reception and transmission of orders, the bringing together of two or more investors (thereby bringing about a transaction between those investors), and the provision of trading services via the operation of a multilateral system in which multiple third-party buying and selling interests interact in the system, whether on an exchange, in an over-the-counter market or otherwise, in relation to any of the following:

   (a) money market instruments (including cheques, bills or certificates of deposit);

   (b) foreign exchange;

   (c) derivative products, including futures and options;

   (d) exchange rate and interest rate instruments, including products such as swaps and forward rate agreements;

   (e) transferable securities; or

   (f) other negotiable instruments and financial assets, including bullion and emissions allowances;
7. participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately), and supply of services related to such issues;
8. money broking;
9. asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services (including the safekeeping and administration of securities);
10. settlement and clearing services for financial assets, including securities, derivative products and other negotiable instruments;
11. provision and transfer of financial information, and financial data processing and related software; or
12. advisory, intermediation and other auxiliary financial services on all the activities listed in sub-sub-paragraphs 6(a) through (f), including credit reference and analysis, investment and portfolio research and advice, and advice on acquisitions and on corporate restructuring and strategy.

4.2 The qualified counterparties commitment

When embedded in an EU-UK FTA, the qualified counterparties commitment would only be extended by the EU and the UK to each other's regulated banks. Neither party should be able to suspend or withdraw the commitment during the term of the FTA.

The EU and the UK should develop a market access commitment for "qualified counterparties" and the services they use to provide the basic foundations of the financial economy. "Qualified counterparties" should include:

(a) Banks (possibly of a predefined scale);

(b) Large non-financial enterprises;

(c) Large institutional investors;

(d) National and regional governments (and their related bodies, such as central banks); and

(e) International organisations located in the territory of the other party.

These are the actors that provide the bridges connecting the financial systems of the EU and the UK and which enable liquidity generated on either side to move between the two systems.

Alongside this vital function, what unites these qualified counterparties is the need to be able to access a broad range of international banking and capital markets services. Imposing commercial presence, licensing requirements or duplicative rules on banks supplying services to these qualified counterparties restrict their scope to play their basic economic role in a way that is unnecessary because they do not require the imposition of the customer protections that those requirements are typically designed to ensure.

For this reason, while firms providing such services would be required to be regulated and supervised by their home regulator for the service they propose to provide and their authorisations recognised by the other party, such assessments would not be based on whether the foreign firm is subject to equivalent regulation. Rather, a commitment relating to the provision of services to these qualified counterparties should be based on a reciprocal recognition of the comparability of the regulatory sophistication, reliability, resourcing and general approach of the two parties, not on the principle of close comparability of individual regulations. This commitment would be based on "regulator to regulator" alignment rather than "rule to rule" alignment. This would, in turn, be underpinned by a very high degree of regulatory and supervisory cooperation (see below).

In this case, this willingness to substitute the judgement of the regulatory counterpart for a stricter form of regulatory and supervisory cooperation based on a close reading of law and regulation (as applied to the professionals and smaller commercial and retail commitments below) would reflect both the sophistication of the class of service user in this case and the importance of preserving the critical role they play in supporting cross-border capital markets and the flow of liquidity throughout the regional economy. This kind of regime is already present in the national licensing regimes of some EU Member States, which allow foreign firms to provide cross-border services to some categories of local clients or counterparties on the basis of a recognition of the regulatory sophistication of that jurisdiction – and without imposing licensing or related requirements.

When embedded in an EU-UK FTA, the qualified counterparties commitment would only be extended by the EU and the UK to each other's regulated banks. Neither party should be able to suspend or withdraw the commitment during the term of the FTA. Thus, the qualified counterparties commitment creates closer underlying parity of access between the EU and the UK at least for this class of qualified counterparties. The UK generally already allows non-EU banks to provide a broad range of cross-border banking and capital market services to a wide range of clients and counterparties. In contrast, the other EU Member States have a patchwork of different approaches,[21] some of which are very restrictive while others are much more liberal. This underlying parity would be particularly important if either party were to seek to suspend or withdraw the professionals commitment under the mechanisms described below as it would ensure that such action would not disrupt continued access by qualified counterparties to cross-border services.

[21] See also, UK Finance, *Serving Europe: navigating the legislative landscape outside the single market* (September 2017).

4.3 The professionals commitment

...the EU and the UK should also make a set of commitments to allow "professional clients" to access cross-border banking and capital markets services from the other party's regulated banks.

Alongside the qualified counterparties commitment, the EU and the UK should also make a set of commitments designed to enable a defined class of "professional clients",[22] to access cross-border banking and capital markets services from the other party's regulated banks.

This class should be defined to cover at least the class of persons that would be considered to be "per se" professional clients under Part 1 of Annex I of MiFID II. The accompanying EU Markets in Financial Instruments Regulation ("MiFIR") already envisages that third country investment firms from "equivalent" jurisdictions should be able to provide cross-border services covered by MiFID II to this class of user. An EU-UK FTA should build on this but allow this class of user to access the full range of cross-border banking and capital market services. This class covers:

(a) Entities required to be authorised or regulated to operate on financial markets, including banks, investment firms and other regulated financial institutions, as well as collective investment undertakings and pension funds;

(b) Large undertakings (see Box 6);

(c) National and regional governments, including public bodies that manage public debt, and international and supranational organisations; and

(d) Other institutional investors whose main activity is investment in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions.

However, it is clear that this class would not cover all the customers and counterparties that need to be able to access cross-border banking and capital market services and that, in the context of an EU-UK FTA, can be treated as having the necessary sophistication and expertise to be able to access these services. Therefore, the EU and the UK should consider extending the class of qualified counterparties and professional clients to include:

(e) Mid-size undertakings not falling within the MiFID II definition of large undertakings (see Box 6). Many businesses that do not meet the MiFID II thresholds would still be sufficiently sophisticated to need to be able to access the services of a broader range of banks. Including such businesses – many of whom will be active exporters, growing employers or have a potential global footprint – in the professionals commitment would help them access the wide range of services they currently procure in both the EU and the UK and support their important contribution to economic growth and job creation across the EU and the UK;

(f) A class of "high net worth individuals", that is, natural or legal persons whose total (gross) financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds a threshold appropriate for the provision of high net worth banking services (such as €5million). As an example, high net worth family offices will typically demand the type of sophisticated services required by consumers and counterparties in this segment; and

(g) Other users that are categorised by a bank as professional clients based on a procedure to be set out in the EU-UK FTA that allows clients or potential clients of a bank to request that they are treated as professional clients for these purposes, subject to the bank making an assessment of the experience, knowledge and expertise of the client and determining that the client is able to make financial decisions and to understand the risks involved (similar to the criteria and procedure set out in Part 2 of Annex I of MiFID II, but without the quantitative financial and other thresholds that have made it excessively difficult to use that procedure).

[22] The definition of professional clients should also encompass all qualified counterparties so that any broader commitments made in respect of services to professional clients based on alignment of regulatory and supervisory regimes also apply in respect of services to qualified counterparties.

Box 6: Large and mid-size undertakings

There are a number of definitions that could be used as the base for a test of when a company is large enough to be considered eligible for access to a wider range of services. The test in MiFID II sets thresholds that are different from those set by the European Commission in its Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises. These are different again from the test used in the UK to determine whether a company is a "qualifying organisation" that can choose to hold its deposits with a non ring-fenced bank under the Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014. In addition, any test should take account of group structures by applying tests on a consolidated basis.

	Test	Balance sheet total	Net turnover	Own funds	Employees
MiFID II large undertaking	Exceeds any two thresholds	€20m	€40m	€2m	N/A
EU SME	Below employee and one other threshold	€43m	€50m	N/A	250
EU small company	Below employee and one other threshold	€10m	€10m	N/A	50
EU micro-enterprise	Below employee and one other threshold	€2m	€2m	N/A	10
UK qualifying organisation	Exceeds any one threshold	£3.26m	£6.5m	N/A	50

The professionals commitment would provide the basis for continuing a deeper and broader level of integration between the parties' financial markets than would be provided by the commitments in relation to cross-border business with qualified counterparties. It would underpin, in particular, the ability of savers, investors and the funds that serve them to access opportunities in both markets.

Like the qualified counterparties commitment, the professionals commitment would be based on mutual recognition of the authorisation of the firm providing the service and 'regulator-to-regulator' recognition of the comparability of the two regimes. However, additionally it should be conditional on the parties' legal and supervisory regimes remaining sufficiently aligned in intent and outcomes in agreed and appropriate areas. Thus, the professionals commitment should be based on an agreed way of determining that the two sides' approaches to the regulation and supervision of banks providing these services to professional clients are aligned in intent and achieve substantially the same regulatory outcomes.

This outcomes-based approach should include an assessment of whether the parties' approaches conform to any applicable international standards and any principles agreed between the two sides and should include both an assessment of the parties' legislative and regulatory framework and the arrangements for supervision and enforcement of the relevant rules. However, parties' regimes should not be treated as ceasing to be sufficiently aligned because there is no longer an exact match for every regulatory requirement between the two regimes. In that context, an EU-UK FTA should avoid the use of "line by line" comparisons of regimes. Assessments based on "strict equivalence" or similar approaches would not be appropriate in the context of a professionals commitment.

To support this cooperation, the EU-UK FTA should also create a process for addressing the possible future divergence of the parties' regulatory and supervisory regimes. As both parties would retain regulatory autonomy, the FTA needs to create a framework in which the parties can review and discuss changes to their legal and supervisory regimes to address any possible concerns. This should make use of a specialist EU-UK financial services committee established by the parties for the purposes of the FTA. The process should involve at least the following elements, each of which should be subject to appropriate time limits:

(a) Each party should notify and consult with the other party via the EU-UK financial services committee if there is any proposal for a material change in its relevant legal and supervisory regime;

(b) If a party considers that a change in either regime means that the regimes would no longer be sufficiently aligned, such that it may wish to suspend any of its commitments, it should notify the other party via the EU-UK financial services committee with its reasons;

(c) That notice should trigger a period of public consultation and consultation between the parties via the EU-UK financial services committee, including as to what remedial actions should be taken (e.g., the taking of steps to make corresponding changes to a party's regime to bring the two regimes back into alignment);

(d) If the parties agree on remedial action, then no further steps can be taken to suspend the commitments until the agreed time for taking those steps has elapsed without the action having been taken;

(e) Failing that, a party should be able to give notice suspending all or part of its commitments with respect to the provision of cross-border services to professional users (or access to market infrastructure), but only to the extent that the change to the relevant regimes affects those commitments;

(f) However, any such notice should only take effect after an adjustment period that is sufficient to allow affected banks to adjust their business or to apply for any available licences. In addition, such a notice should itself be suspended if the other party refers the giving of the notice to the parties' agreed dispute resolution process within a specified time after the notice is given;

(g) The parties should be able to agree via the EU-UK financial services committee to override any time limits and to reinstate any suspended commitments; and

(h) Any suspension of commitments under this mechanism should not affect the continuation of the parties' commitments with respect to the cross-border provision of services to qualified counterparties.

Case studies: EU-UK trade in financial services today and the commitments proposed in this report

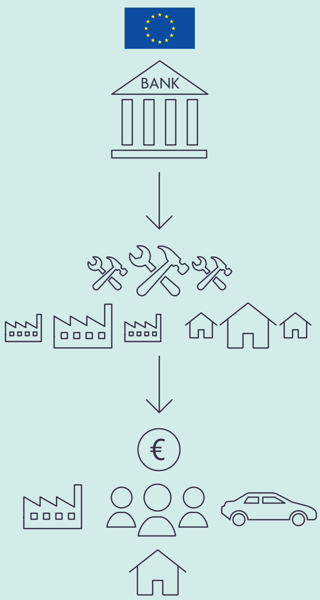
Below are a range of examples of the routine cross-border activities that characterise EU-UK trade in financial services today. All of these examples have the common feature of not generally being possible after a UK exit from the EU, except in limited cases where national licensing regimes permit such cross-border contracting. The kinds of commitments proposed in this report of individual EU Member States would preserve the range of choice and service for customers across all of the EU and the UK.

Figure 1: EU retail bank has a large portfolio of mortgages and wishes to securitise to free up capacity for new lending

A large EU retail bank has developed a substantial portfolio of mortgages and business loans in its local market. It wishes to securitise a portion of this portfolio for onward sale to institutional investors in the EU and elsewhere, in order to free up new scope for lending in its balance sheet. The EU retail bank wishes to access a provider in the largest and most developed securitisation market in Europe – which is the UK – to achieve the best terms and reach the most attractive investors for its offering. The retail bank can rely on the qualified counterparties commitment to contract a UK-based investment bank to undertake the securitisation and arrange the marketing of the securitised loans to institutional investors in the UK, the EU and the rest of the world. The UK-based bank could also rely on the professionals commitment to market the securitised loans to EU-based investors.

Scenario

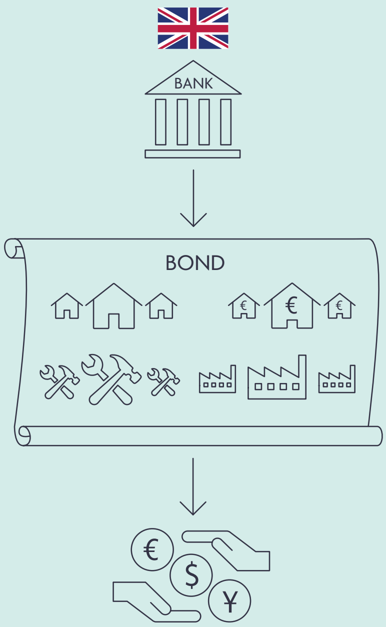
EU-based retail bank needs to securitise large portfolios of business loans and mortgages...



...in order to free up balance sheet capacity for new SME and retail lending to support EU economic growth

Opportunity

UK-based bank advises on securitisation structure and underwrites the offering of securitised bonds in the international capital markets



EU and international institutional investors purchase bonds for investment portfolio

Commitments used

Qualified Counterparties Commitment

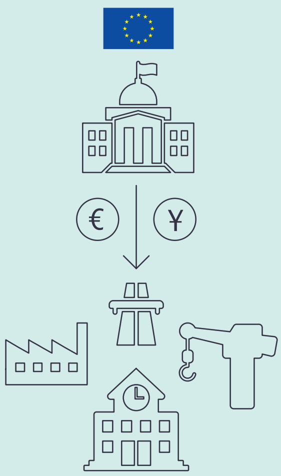
Professionals Commitment

Figure 2: EU sovereign raising long-term debt on capital markets

A Eurozone government wishes to issue long-term debt on international capital markets via a syndicate of primary dealers to fund national infrastructure projects. As with most sovereigns raising debt it uses a pool of banks as primary dealers to encourage competition and secure the most competitive interest rate and other terms for taxpayers. It can rely on the qualified counterparties commitment to contract this debt-raising service to a mix of both EU and UK-based banks. At present, a significant portion of EU sovereigns' primary dealers are UK-based banks – one of the most marked potential impacts of the UK withdrawal from the EU is the sudden loss of access to their primary dealers by EU sovereigns constrained to use EEA banks to raise debt in a cost-effective way for taxpayers.

Scenario

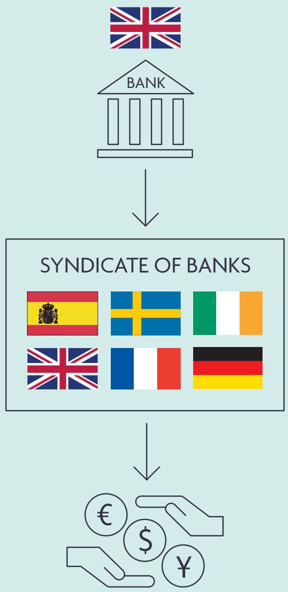
An EU Member State wishes to raise long-term debt on international capital markets...



...in order to invest in national infrastructure projects such as new roads and schools

Opportunity

Primary Dealers include UK-based banks in the syndicate underwriting the bond offerings



EU and international institutional investors purchase bonds for their investment portfolios

Commitments used

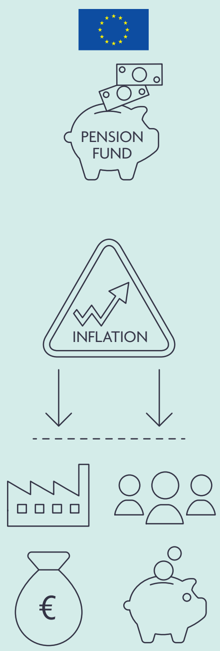
Qualified Counterparties Commitment

Figure 3: Pension fund protecting pensioners by purchasing a long-term inflation hedge

The pension fund of a large company wishes to put in place a long-term hedging tool to manage its risks where its pension obligations to members are linked to inflation. Its preferred way of doing this is to contract an inflation-swap with a bank that guarantees that it will be able to meet its liabilities to pay pensions on the basis of its existing assets even if inflation exceeds expected investment returns. The professionals commitment enables the pension fund to contract this service directly with the specialist derivatives provider in a UK-based bank. While the fund is administered by a group of qualified financial managers experienced at procuring such services, the professionals commitment provides the additional security of being based on close regulatory alignment between the UK and the EU and underpinned by robust regulatory and supervisory cooperation.

Scenario

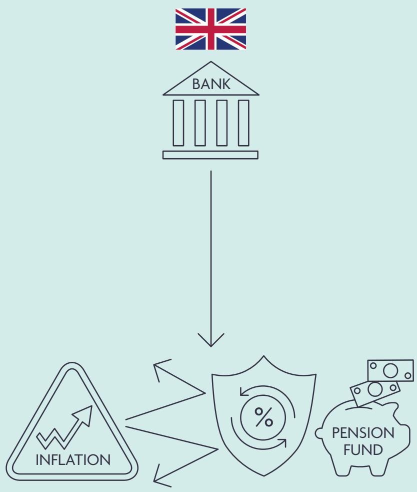
An EU-based pension fund wishes to manage elements of its long-term investment risk...



... and protect employees' savings / pensions against rising inflation

Opportunity

UK-based bank advises on inflation-linked swaps and provides 30 year swap to EU pension fund



Commitments used

Professionals Commitment

Figure 4: A mid-sized EU company with a global production footprint wishes to raise a US dollar loan to expand a factory in the United States

A mid-sized EU company with a global production footprint wishes to raise a dollar-denominated loan for investment in a factory in the United States. It can rely on the professionals commitment to contract the loan, in whole or part, from a UK-based bank. The professionals commitment also enables the company to contract a range of services supporting the loan that would otherwise potentially be unavailable: high quality advice around the structuring of the loan or alternative forms of financing such as syndicated lending; hedging or risk management services for the loan such as foreign exchange or interest rate swaps and depositary services for the funds.

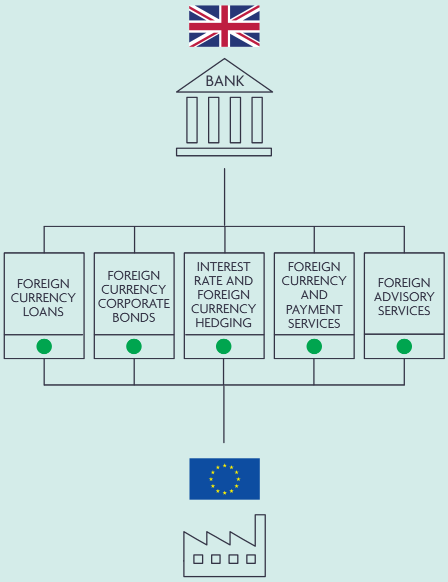
Scenario

A mid-sized EU company with a global production footprint wishes to raise a dollar-denominated loan ...

... in order to expand a factory in the United States

Opportunity

UK-based bank arranges to provide a loan facility and related financing and risk management services



Commitments used

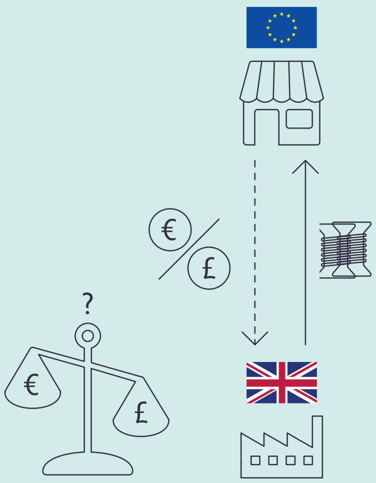
Professionals Commitment

Figure 5: An EU small, growing specialist clothing manufacturer wishes to protect itself against euro-sterling currency fluctuations

A small but growing specialist clothing manufacturer in the EU has placed a large order with a technical materials supplier in the UK to provide materials for one of its products over a period of two years. The company wishes to protect itself from the possibility that a sharp move in the euro-sterling exchange rate could change the economics of this important part of its supply chain. To do this, it can rely on the smaller commercial and retail commitment to contract an exchange rate derivative with a UK-based specialist provider of such exchange rate protection.

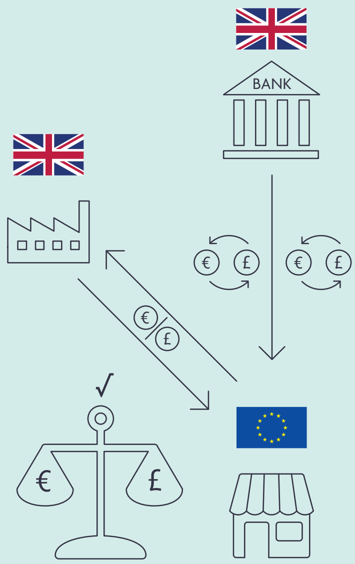
Scenario

An EU clothing manufacturer, purchasing materials (Harris Tweed) from a UK-based company, wishes to protect its cost base against fluctuations in euro / sterling foreign exchange rates



Opportunity

UK-based bank provides a currency swap



Commitments used

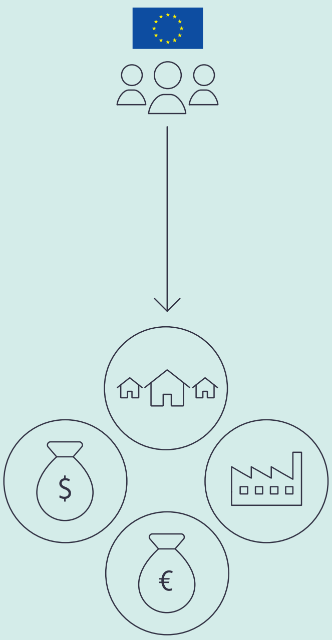
Smaller Commercial and Retail Commitment

Figure 6: A family which has inherited a large portfolio of assets wishes to obtain private wealth management services from a UK-based private bank

An EU-based family office manages a large portfolio of assets and wishes to contract private wealth management services including managed accounts, foreign exchange services and other personal banking services from a UK-based private bank. Managing this contract through its specialist advisers in the family office, it can rely on the professionals commitment to contract services from a UK-based bank. The family also wishes to raise a large loan for investment in a new business, secured against land and property. The professionals commitment would also enable the family office to consider the terms offered by the UK-based bank as well as EU-based banks for doing this.

Scenario

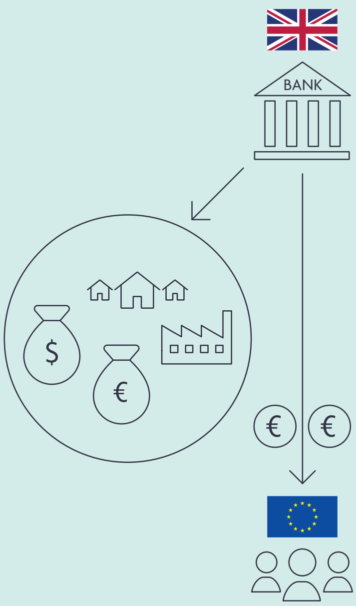
EU-based family office manages a large number of assets including cash, businesses and property



...and is seeking sophisticated asset management and private wealth management services to safely manage the portfolio

Opportunity

The family office contracts services from a UK-based private wealth management bank



The family office can also contract other financial services from the UK-based bank such as lending for investment and expansion of the family businesses

Commitments used

Professionals Commitment

4.4 Defining cross-border service rights and obligations

The fundamental basis for any cross-border framework on the model described above would be mutual recognition of the authorisations of firms seeking to provide services and regulatory and supervisory cooperation. This is to ensure the required confidence in the regulatory approach of the other party and to create adequate scope to withdraw trading privileges if regimes diverge or that underpinning confidence fails for any other reason.

However, having established that basis for trade, it is important that it is complemented by a set of protocols that ensure a level playing field for local and 'importing' providers. An EU firm providing services cross-border to a UK customer should be afforded regulatory and supervisory treatment that does not unnecessarily disadvantage it vis-à-vis a UK-based firm (of any national identity) – and vice versa.

For this reason, and to this end, each party would, as part of the qualified counterparties and professionals commitments described above, and the smaller commercial and retail commitment described below, agree six key protocols designed to create a genuinely cross-border framework and to reduce the scope for duplicative requirements that might render the rights and obligations created by the agreement nugatory. Some of these are established WTO principles of non-discrimination. All reflect the basic principle of a true level-playing field.

Protocol 1: National treatment

Both sides would agree to accord to regulated banks of the other party providing cross-border banking and capital market services for which they were authorised in the other party, and to those services, treatment no less favourable than the treatment it gives to its own banks and services in like situations:

- This commitment aims to provide a general assurance of non-discriminatory treatment for banks providing cross-border services under these commitments.

Protocol 2: MFN treatment

Both sides would agree to accord to regulated banks of the other party providing cross-border banking and capital market services for which they were authorised in the other party, and to those services, treatment no less favourable than it accords in like situations to third country institutions and suppliers:

- This may be subject to similar derogations as under the GATS for other comprehensive FTAs with third countries as well as for existing arrangements such as (in the case of the EU) the EEA agreement.

Protocol 3: No commercial presence requirement

Both sides would agree to allow regulated banks of the other party to provide cross-border banking or capital market services for which they were authorised in the other party, without the bank establishing a commercial presence:

- A requirement to establish a commercial presence, such as a branch or subsidiary, effectively negates the ability of the bank to provide the services on a cross-border basis.

Protocol 4: No authorisation or similar requirements additional to those already imposed by the other party

Both sides would agree not to adopt or maintain measures that prescribe authorisation or similar requirements for regulated banks of the other party providing cross-border banking or capital market services for which they are authorised in the other party:

- Authorisation requirements are the key barrier that prevents the provision of cross-border services. Even apparently non-discriminatory requirements can operate as an effective bar to cross-border services because of the practical difficulty of complying with multiple cross-border authorisation regimes and the related national rules that apply to authorised firms. For these purposes, the EU-UK FTA should define authorisation and similar requirements broadly to cover the full range of similar rules that impose qualification or similar formal requirements or preconditions on a qualified financial institution seeking to provide the services on a cross-border basis; and

- The FTA might allow a party to impose obligations on a bank of the other party intending to provide cross-border banking or capital market services to professional clients to notify basic objective information about the bank (as well as information on serious violations of law) to a competent authority of that party. However, it should not be necessary to impose such a requirement on a bank providing services to qualified counterparties.

Protocol 5: Limitation on duplicative rules

Both sides would agree not to adopt or maintain measures that prescribe requirements relating to capital or prudential regulation, internal organisation, the protection of customers or reporting to competent authorities with respect to regulated banks of the other party providing cross-border banking or capital market services for which they are authorised in the other party:

- These types of rules are closely linked to the authorisation of firms. Requirements on firms to comply with multiple sets of duplicative rules of this kind can operate as an effective bar to cross-border services in a similar way to authorisation requirements;
- However, this commitment should not restrict the right of a party to the EU-UK FTA to require a bank to comply with non-discriminatory requirements relating to market integrity, such as rules on reporting of large long or short positions in securities, registration of prospectuses, requirements relating to takeovers or mergers, restrictions on short sales or rules preventing insider dealing, market manipulation or fraud;[23]
- A party to the EU-UK FTA should also retain the right to bar a bank from supplying these services if the bank seriously and systematically infringes the laws of that party with respect to those services;
- In addition, the parties should agree that, notwithstanding their commitments, their competent authorities should have appropriate precautionary powers to address cases where reliance on home state supervisory or enforcement action is regarded as insufficient.[24] In particular, the agreement should recognise that competent authorities should be allowed to take proportionate measures against a bank of the other party in cases where the actions of the bank are clearly seriously prejudicial to the interests of clients in the party's territory, the proper functioning of markets in the party's territory or financial stability. The measures would include the ability to prohibit a bank from providing further cross-border services into the territory of the party. However, these powers should only be exercised after prior notice to the competent authorities in the bank's home state;
- The EU-UK FTA might also allow a party to impose obligations on a bank of the other party intending to provide cross-border banking and capital market services to professional clients to notify those clients that the bank is not authorised or registered in that party's territory (and the name of its home state regulator); and
- To the extent that the class of professional users includes individuals (natural persons) acting outside the context of a trade or business, the commitments might be calibrated to allow a party to apply some kinds of general consumer protection rules.

Protocol 6: No restrictions on volume or value of services via nominal limits or other tests

Both sides would agree not to adopt or maintain limits on numbers of services, total value of service suppliers or other quantitative limits, quotas or economic needs tests in relation to regulated banks of the other party providing cross-border banking and capital market services for which they are authorised in the other party, or those services:

- This is an established protocol in GATS practice, capturing the practical aspects of market access defined in GATS Article XVI. Such restrictions are not compatible with the principle of an open and competitive cross-border market for services.

[23] In relation to business with qualified counterparties, a party to the EU-UK partnership agreement may also want to be able to require the bank to comply with the party's own pre- and post-trade transparency requirements, unless the bank complies with comparable rules under the laws of its home state.

[24] Compare e.g., Article 86 MiFID II which gives similar precautionary powers to the host state.

4.5 Modal coverage and scope

...commitments should be expressed to cover the provision of cross-border services by regulated banks of a party to the EU-UK FTA, i.e., firms that provide any banking and capital markets services if they are regulated or supervised in respect of the provision of those services under that party's law.

These commitments (qualified counterparties, professionals and smaller commercial and retail) should be expressed to cover the provision by regulated banks of banking and capital market services both:

(a) From the territory of a party to the FTA into the territory of the other party (i.e., a Mode 1 commitment in GATS terminology); and

(b) In the territory of a party by a regulated bank to a person from the other party (i.e., a Mode 2 commitment in GATS terminology).[25]

The commitments should be expressed to cover the provision of cross-border services by regulated banks of a party to the EU-UK FTA, i.e., firms that provide any banking and capital markets services if they are regulated or supervised in respect of the provision of those services under that party's law. The commitments should not apply to services provided by unregulated entities. However, the commitments should also be structured so that, for example, a UK branch of an Italian bank would be treated in the same way as a UK bank when it is providing cross-border banking and capital market services to qualified investors and professional clients in Germany or another EU27 Member State. This should ensure that the FTA is neutral as between EU27 banks that operate in the UK through bank subsidiaries or branches. Similarly, EU27 branches of UK banks should be able to rely on the commitments given by the UK with respect to the provision of cross-border services into the UK. However, the commitments would not apply to a UK or EU27 branch of a third country bank.

The commitments should be expressed to cover the full range of banking and capital market services based on the list of banking and other financial services in the GATS. The list of these services should be aligned with the list of activities covered by MiFID II and the Capital Requirements Directive ("CRD") so as to be broadly aligned with the current MiFID II and CRD regimes, as well as the EU payment services legislation (see Box 6). It would be a matter for negotiation between the parties as to whether to include derogations to cover any cases where the list of banking and capital markets services may cover services that are not covered by the existing passport regimes, although some of these may not be subject to authorisation or similar requirements in any event (e.g., the provision and transfer of financial information).

4.6 Remote access to securities and derivatives market infrastructure

The qualified counterparties and professionals commitments should be flanked by an additional commitment designed to ensure that banks retain the ability to access local securities and derivatives markets infrastructure, such as trading platforms, central counterparties and clearing and settlement systems. An important feature of the current single market framework under MiFID II is the rules facilitating access to market infrastructure and these rights and obligations are important to ensure the continued integration of EU and UK capital markets.

Accordingly, both sides should commit not to adopt or maintain measures that prescribe authorisation or similar requirements with respect to regulated banks of the other party as a condition of their becoming members of securities or derivatives exchanges or markets or securities or derivatives central counterparties and clearing and settlement systems.

[25] The commitments should apply to a bank providing cross-border services from the territory of one of the parties into the territory of the other party, even if the bank also maintains an establishment in the territory of the other party.

In addition, they should commit not to adopt or maintain measures that would restrict those banks having direct or indirect access to that infrastructure without establishing a commercial presence, except on terms that accord national treatment and that treat the other party's banks no less favourably than the most favourable treatment accorded, in like situations, to its own banks. In particular, these commitments should be structured to ensure that banks at least have remote access to regulated markets in a similar way to that guaranteed by MiFID II, i.e., without requiring the establishment of a commercial presence.

The parties may agree that this commitment on access to market infrastructure should be conditional on the parties' legal and supervisory regimes remaining sufficiently aligned in a similar way to the professionals commitment. This would reflect an assessment that a minimum level of regulatory and supervisory cooperation should be a condition for membership of significant infrastructure bodies.

4.7 A smaller commercial and retail commitment

The model described here has, to this point, focused on the provision of cross-border services to counterparties and clients with a high level of sophistication in the contracting and consumption of financial services.

Smaller commercial and retail users represent a different level of financial sophistication to those covered by the qualifying counterparties and professional commitments outlined above, and consequently attract a proportionally higher level of prudential and regulatory sensitivity. In order to maintain cross-border provision of banking services to smaller enterprises (including local governmental entities and municipalities) and/or households, it would be necessary to consider a range of possible ways to reflect the underlying imperatives of consumer or investor protection associated with these kinds of clients. As such:

(a) The underlying regulatory and supervisory cooperation requirement behind market access rights and obligations could be widened in scope to cover elements of consumer protection regulation, and involve an even higher level of comparability of approaches than the professionals commitment;

(b) Some differential approaches could be considered in the requirements for local authorisation and in the local standards directly applied to service providers in this area (as compared to the qualified counterparties and professionals commitments); and

(c) In addition, the regime might take into account the spectrum of users covered by this commitment by applying different commitments to different kinds of smaller commercial and retail clients. For example, the commitment might allow a party to apply local consumer protection rules to banks providing cross-border services to individuals but not to other users.

4.8 Commercial presence commitments

An EU-UK FTA should also include commitments relating to how banks can establish a (Mode 3) commercial presence to provide banking and capital market services through local subsidiaries, joint ventures or branches.

In relation to the establishment of local subsidiaries or joint ventures, it should be possible to build on the kinds of commitments envisaged by the GATS, the GATS Understanding and existing GATS Schedules and FTAs. The commitments to grant market access and national treatment should address the main issues faced by banks, at least if combined with other commitments of the kind included in existing FTAs, such as restrictions on nationality requirements for directors or management positions (perhaps supplemented by ancillary arrangements for mutual recognition of qualifications).

An EU-UK FTA should also include commitments relating to how banks can establish a (Mode 3) commercial presence to provide banking and capital market services through local subsidiaries, joint ventures or branches.

Commitments to grant market access and national treatment will also be important in relation to the establishment of branches. In particular, a commitment to grant market access includes, under Article XVI of the GATS, a commitment not to maintain or adopt measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service and thus precludes a party applying an outright ban on the other party's banks operating locally through a branch. In addition, a commitment to national treatment should ensure that an entity operating through a branch is, in principle, treated no less favourably than a locally incorporated firm (for example, as to its ability to participate in the local deposit or investor scheme or as to the types of business conduct or market integrity rules which the foreign bank is required to observe where conducting business in the jurisdiction through the branch).

However, in contrast to the passport regime that applies within the EU, these commitments would not prevent the state in which the branch is established from imposing authorisation requirements as well as duplicative capital or other prudential or organisational requirements on the bank or requiring the bank to participate in the local depositor or investor protection regime. These commitments do not require the "host state" of the branch to recognise or defer to the supervisory or resolution regime in the bank's home state. The UK Finance report, *Serving Europe: Navigating the legislative landscape outside the single market* (September 2017) gives examples of the kinds of requirements imposed on non-EU banks seeking to operate through local branches in the EU27 and illustrates that, at least in some EU27 countries, non-EU banks face significant obstacles to establishing and operating a branch.

In the UK, the UK Prudential Regulation Authority ("PRA") applies a policy which allows the establishment of local branches of non-EU banks, but it expects new UK branches of non-EU banks to focus on wholesale banking and to do so at a level that is not critical to the UK economy. The PRA's expectation is that non-EU banks will only generally conduct limited levels of retail banking activities unless there is a very high level of assurance from the bank's home state supervisor on how the bank can be resolved in the event of its failure.[26] However, the PRA will seek to agree a split of supervisory responsibility with the bank's home state supervisor which will usually involve some degree of reliance on home state supervision where the home state supervisory regime is regarded as equivalent to UK supervision and will not normally impose branch capital or similar requirements.

An EU-UK FTA could be structured to retain those elements of the passport regime that allow the establishment of branches without requirements for an additional local authorisation and disapplying host state prudential rules, at least for branches that are not providing deposit-taking or payment services to retail customers. In such an arrangement it would also be necessary to address the division of responsibility between home and host state for depositor and investor protection as well as other issues, such as the automatic recognition of home state resolution actions.

In any event, an EU-UK FTA could include additional specific commitments to facilitate the establishment and operation of branches, while addressing the supervisory concerns of host state supervisors (e.g., by having the foreign bank participate in the host state depositor and investor protection scheme). As with the professionals commitment, these additional commitments should be based on a continuing level of regulatory and supervisory cooperation between the EU and the UK (and subject to a similar mechanism to that described above to evaluate and address changes in the parties' legal and supervisory regime) and would be underpinned by the framework for regulatory and supervisory cooperation set up by the FTA.

[26] See Supervisory Statement SS10/14, *Supervising international banks: the Prudential Regulation Authority's approach to branch supervision* (September 2014).

They could also be calibrated such that the host state would be afforded a greater degree of supervisory discretion with respect to branches that provide services to smaller commercial and retail clients. The additional commitments might include commitments not to impose separate initial (endowment or donation) capital or risk based capital requirements on the branch or the bank as a whole and, subject to conditions, to waive localised branch liquidity requirements. The host state might also commit to allow the branch to rely on the intra-entity supply of services. However, it would need to be made clear that the host state is able to apply its business conduct rules (and pre- and post-trade transparency rules) to the operations of the branch.

In addition, a feature of the EU passport regime is that where an EU bank establishes a branch in another EU Member State, that branch can rely on the passport when providing cross-border services into a third Member State, whereas generally EU branches of third country entities do not benefit from the freedom to provide services into other Member States. However, MiFIR does include a mechanism under which a third country firm that has established a branch in one Member State can provide cross-border services from the branch to certain professional clients in other Member States (without additional local licensing rules applying) where its home state has been determined to be "equivalent", subject to compliance with the branch state's conduct and transparency rules. An EU-UK FTA should include commitments that seek to emulate this regime for all banking and capital markets services.

Box 7: UK based branch network

An EU bank operates a large network of branches in the UK serving both smaller and medium-sized enterprises and retail customers. These branches are an integral part of the UK smaller and medium-sized enterprises and retail banking landscape, providing valuable choice and competition for UK bank customers, not least in the rapidly evolving smaller businesses market. Under the current EU passporting regime, the UK regime for supervision of these branches largely defers to the home state, as the home state and the UK have closely aligned rules and supervisory practice through the EU mutual recognition regime.

This has material advantages that underpin the competitiveness of the branch network in the UK. It allows the EU bank to operate a branch network, rather than the less flexible and more onerous and capital-intensive option of establishing a full subsidiary in the UK. It limits the duplication in the UK of capital or other rules or obligations already applied to the branches via their home supervisor.

The branch commitment proposed here would use close regulatory alignment of branching and prudential frameworks between the EU and the UK to preserve some of these advantages. It would minimise the duplication of rules and supervisory obligations of UK branches of EU banks or EU branches of UK banks between branches and their home operations. This would materially reduce the impact on the branch network in the UK of the EU bank and help preserve the ability to maintain a presence in the UK without full subsidiarisation. The commitment would support its local competitiveness by ensuring that the EU bank's branches are treated in a comparable way to local equivalents. It would also ensure that the UK market retained a valuable source of diversity and choice.

4.9 Regulatory and supervisory cooperation

All of the commitments set out here rely on a high degree of regulatory and supervisory cooperation. This should be underpinned by appropriate arrangements in the EU-UK FTA for cooperation between the parties and their supervisors on new legislation and rulemaking, supervision and enforcement and resolution. As described on page 43, an EU-UK financial services committee should be the institutional core of this deep cooperation and collaboration.

...the FTA should put in place a general procedure under which the parties notify each other via the EU-UK financial services committee of prospective changes to their legislative and regulatory frameworks for banking and capital markets services and agree to consult each other on those changes in advance of their finalisation and adoption...

However, it will be essential that the parties make active use of the mechanisms established under the FTA for regulatory and supervisory cooperation (e.g., by having regular and frequent meetings). The parties will need to devote significant resources to ensure that these mechanisms are an effective way of managing the EU-UK relationship under the FTA and do not atrophy over time.

Legislation and rulemaking

In addition to the mechanism described above, the FTA should put in place a general procedure under which the parties notify each other via the EU-UK financial services committee of prospective changes to their legislative and regulatory frameworks for banking and capital market services and agree to consult each other on those changes in advance of their finalisation and adoption (subject to appropriate exceptions in cases where urgent action is required). Each party should have an opportunity to submit comments on any proposal and should be given feedback on those comments. However, neither party should have a veto on any proposed change to the other party's legislative or regulatory framework, subject to a party's rights to initiate the suspension process described above.

Supervision and enforcement

The two sides should agree in the FTA that their supervisors will agree regulatory and supervisory cooperation arrangements similar to those that are mandated under EU third country regimes. It is to be considered whether such arrangements should be non-binding regulatory and supervisory cooperation arrangements or legally binding commitments requiring the parties to cooperate in supervisory and enforcement tasks (similar to those in existing EU legislation), although under the EU-UK FTA, the European Supervisory Authorities could no longer play the role of providing binding mediation in relation to certain supervisory actions that they play today.

The arrangements will also have to address how the parties put in place supervisory colleges[27] to coordinate supervisory actions for particular banks or banking groups. These will have to dovetail with the colleges created under EU legislation and any colleges of global regulators.

Resolution

In addition, the parties should agree a framework for cooperation in resolution matters, either through non-binding cooperation agreements entered into by the parties or by more formal arrangements under the FTA. Again, there may need to be institution-specific arrangements for EU and UK resolution authorities to participate in resolution colleges.

The FTA should include appropriate commitments by the parties to protect supervisory information shared by the supervisors under the arrangements described above.

[27] In the EU, supervisory colleges enable close cooperation and information sharing but also have a decision-making role (e.g., joint decisions on an institution's internal model).

4.10 The prudential carve-out as applied to cross-border services

The EU-UK partnership agreement should recognise that the parties retain the "right to regulate" by including a "prudential carve-out" with respect to all of the commitments set out above. The carve-out would enable the EU or the UK to take regulatory measures, which may conflict with the commitments made under the FTA, for prudential reasons to ensure the stability of the financial system, market integrity and investor or customer protection of each jurisdiction. However, this should be limited in a manner similar to that in the EU-Singapore FTA[28] by restricting it to measures that are reasonable and proportionate which must not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on trade.

The FTA should also require that resort to the prudential carve-out must be subject to a declaration of the intent to rely on the carve-out, accompanied by a clear rationale, at the time that the measure is proposed for adoption. To the greatest extent possible the other party should be consulted on any measures and have the right to contest them under the dispute resolution framework applicable to the FTA. Where intended measures justified by the invocation of the prudential carve-out are related to a perceived change in policy, or policy deficiency in the other party, and not subject to financial stability, market integrity and investor or customer protection imperatives, scope for consultation and rectification should be provided.

4.11 Most Favoured FTA issues

In some recent FTAs, such as with South Korea and Canada, the EU has sought to ensure that it benefits from favourable terms in respect of services and investment granted to future FTA partners by South Korea and Canada (and vice versa).[29] This raises the question of whether the commitments offered to the UK in an EU-UK financial services agreement covering financial services according to the model set out above, would have to be extended by the EU to countries benefitting from a 'Most Favoured FTA' provision. If such clauses were reproduced in replacement bilateral agreements between the UK and these countries, this would also be relevant in that context.

The 'Most Favoured FTA' clauses in these two agreements distinguish between two forms of subsequent preferential commitment made to other trading partners:

(a) A general market access commitment. In all of these agreements such commitments, where they are more favourable than the terms agreed between the EU and the third country, are generally required to be made available to the other party on the same terms, unless they are deemed to create an internal market for services or establish a system of regulatory approximation. Clauses to this effect are included in the EU-Canada and EU-South Korea FTAs; and

[28] Article 8.50 states: (1.) Each Party may adopt or maintain reasonable measures for prudential reasons, such as: (a) The protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier; (b) The maintenance of the safety, soundness, integrity or financial responsibility of financial service suppliers; or (c) Ensuring the integrity and stability of the Party's financial system. (2.) These measures shall not be more burdensome than necessary to achieve their aim and shall not constitute a means of arbitrary or unjustifiable discrimination against financial service suppliers of the other Party in comparison to its own like financial service suppliers or a disguised restriction on trade in services. (3.) Nothing in this Agreement shall be construed to require a Party to disclose information relating to the affairs and accounts of individual consumers or any confidential or proprietary information in the possession of public entities. (4.) Each Party shall make its best endeavours to ensure that the Basel Committee's "Core Principles for Effective Banking Supervision", the standards and principles of the International Association of Insurance Supervisors and the International Organisation of Securities Commissions' "Objectives and Principles of Securities Regulation" and the internationally agreed Standard for transparency and exchange of information for tax purposes as spelled out in the 2008 OECD Model Tax Convention on Income and on Capital are implemented and applied in its territory. (5.) Subject to Article 8.6 (National Treatment) and without prejudice to other means of prudential regulation of cross-border trade in financial services, a Party may require the registration or authorisation of cross-border financial service suppliers of the other Party and of financial instruments.

[29] The EU-Vietnam FTA contains a similar provision. Although, this is limited to FTAs Vietnam was negotiating on 17 July 2015. The EU-Caribbean Forum Economic Partnership Agreement also contains a similar provision.

(b) A market access commitment based on mutual recognition. Where such subsequent commitments have been made, the other party must be given "adequate opportunity" to negotiate accession to such a framework, or one similar to it. For this right to be extended the other party must be able to show that the consequent market access would be underpinned by an equivalent level of regulation, oversight, regulatory implementation and information sharing between the parties. Clauses to this effect are included in the EU-Canada and EU-South Korea FTAs.

The market access commitments proposed in this section should be understood as based on mutual recognition arrangements between the EU and the UK, and thus captured only by the latter obligation. The commitments proposed above for the EU-UK FTA are extended contingent on:

(a) In the case of the qualified counterparties commitment, mutual recognition of the quality of prudential regulation in the other party, the robustness of its regulatory framework, and the authorisations that these regulators accord to firms providing cross-border services. This recognition is codified in the signing of the FTA and contingent on the FTA being in force;

(b) In the case of the professionals, smaller commercial and retail and Mode 3 branching commitments and related commitments on access to market infrastructure, regulatory alignment in key frameworks, on which market access is contingent, and the lapsing of which can result in market access commitments being withdrawn; and

(c) In all cases, a deep underpinning of regulatory and supervisory cooperation and information sharing.

In principle, and unless an EU-UK agreement was to meet the defined conditions of internal market creation or regulatory approximation, authorities in countries benefitting from a 'Most Favoured FTA' provision may be able to require that the EU or the UK at least afford to them an adequate opportunity to negotiate similar mutual recognition arrangements if they can show that they have equivalent regulatory and supervisory arrangements and information sharing procedures as are shared by the EU and the UK.

Box 8: Approaches to cross-border contracting with foreign firms

Chapters 2 and 3 of this report emphasised that WTO members have typically been very reluctant to make binding commitments to cross-border trade in banking and securities services. However, many jurisdictions nevertheless maintain "unbound" frameworks for cross-border contracting of some kind, in defined circumstances. The scope and nature of these permitted approaches differ from jurisdiction to jurisdiction.

EU Member States have a wide range of approaches to these rights at the national level, in the many areas where no EU-level framework for cross-border trade with third countries for banking and securities services has been established. In some cases, as in Germany, the Netherlands and Ireland, local regulators have developed a sophisticated approach to assessing the circumstances in which cross-border contracting provides valuable choice and diversity of service to local customers and should therefore be permitted. In parallel, they have developed a range of bases for such rights, generally based on assessments of the quality of regulation in the home market of firms providing cross-border services.

Across various EU markets, such permissions can cover cross-border contracting corporate banking services, including lending and deposit taking, and a wide range of securities and derivatives services. The types of customer entitled to take advantage of them vary from jurisdiction to jurisdiction. Some of these regimes are noted below, and they are explored in much greater detail in the UK Finance report Serving Europe: *Navigating the legislative landscape outside the single market* (September 2017).

The summary below describes some of the approaches currently used in the EU and more widely. Elements of these approaches are reflected in the three Mode 1 commitments proposed in this chapter. In particular, we have drawn on existing approaches from the EU and elsewhere that:

- establish the credibility and adequacy of the home regulator of a foreign firm as the basis for granting carefully delineated cross-border rights;
- calibrate local authorisation requirements to the nature of the products or services being procured and the jurisdiction from which they are being provided; and
- use the financial sophistication of the purchasing customer as a key criterion in determining the terms on which cross-border contracting might be conducted effectively and soundly.

Some of the frameworks described below place primary emphasis on the type of users procuring a service cross-border; some use the type of product or service as a core criterion. Most of the approaches use a mixture of both. Most are also based on some form of assessment of the quality of regulation in the home jurisdiction of the service provider.

What they all demonstrate is the important principle that in the right circumstances, with the right level of regulator-to-regulator trust and cooperation and/or the right level of alignment between regulatory and supervisory regimes, cross-border contracting by customers is feasible and can make an important contribution to the choice and diversification available to the users of financial services.

Right to contract based on close assessment of the home regulation of the provider

The EU itself has a regime that, in principle, provides the right to contract cross-border with a customer in the EU when the firm providing the service is subject to a regulatory regime "equivalent" to that of the EU. The new MiFIR will provide a framework under which a third country firm can provide cross-border services covered by MiFID II to 'per se' professional clients and eligible counterparties located in the EU, subject to registration with the EU authorities and without being subject to EU prudential, organisational and conduct rules, where the Commission has determined that the firm's home state has an equivalent regulatory regime. While regulations do not have to be identical to those of the EU, a very high level of comparability may be required. The EU regime is also conditional on the third country having an effective equivalent regime under which EU firms may operate and can be withdrawn without consultation if the EU concludes that equivalence has ceased to apply for any reason.

Right to contract without licensing based on deferral to the home state regulator

Some EU jurisdictions permit certain forms of customer to contract cross-border with foreign firms on the basis that they are authorised by regulators that the host authority recognises as operating to adequate standards. For example, the German licensing regime allows certain German corporate banking customers to contract with 70-80 third country banks from Australia, Singapore, Switzerland and the US subject to their having been granted a waiver from the German licence requirements for such business by the German Federal Financial Supervisory Authority ("BaFin") under section 2(4) of the German Banking Act. This deferral to the home regulator of these firms is based on an assessment of their regulatory regimes and a determination that the firms are effectively supervised by the home regulator according to internationally recognised standards and that the home regulator cooperates satisfactorily with BaFin. A similar approach is taken in the Netherlands, where the regulator can waive the requirement of local licensing for firms providing cross-border banking and investment services, provided the foreign firm in question can show that its home regulation sufficiently safeguards the Dutch interests involved.

The US Commodity Futures Trading Commission ("CFTC") similarly provides exemptions under its Part 30 regime allowing foreign firms to solicit and accept orders from US customers for transactions on non-US futures exchanges without registration with the CFTC, where the CFTC has made a determination that the applicable foreign regulatory requirements are comparable to the relevant US requirements. In these cases, the foreign person can "substitute compliance" with the applicable foreign rules for compliance with relevant US rules. The CFTC also limits the extra-territorial impact of US derivatives regulation on non-US firms that are registered with the CFTC as swap dealers when they deal with US counterparties by allowing those firms to rely on "substituted compliance" with their home state regulatory regime instead of complying with certain "entity level" requirements that would otherwise apply to them under US rules. These "substituted compliance" regimes place reliance on the sufficiency of the regulatory regime in jurisdictions with which the CFTC has established cooperative and closely aligned regulatory approaches.

Another example is found in Australia where financial services licensing laws allow non-Australian intermediaries to obtain an exemption from licensing requirements allowing them to conduct financial services business with wholesale clients in Australia where the Australian regulator recognises that the foreign regime provides sufficiently equivalent protections.

An example of regulators agreeing on mutual access based on the parties' assessment of the sufficiency of each other's regulatory regimes is the 2008 mutual recognition arrangement on cross-border trade in securities services between the US Securities and Exchange Commission ("SEC") and its Australian counterparts. The arrangement envisages that the SEC will provide exemptive relief to Australian broker-dealers seeking to do business with certain US qualified investors in certain Australian equity and debt securities, with the Australian authorities providing corresponding relief to US broker-dealers seeking to do business with certain Australian wholesale clients in certain US equity and debt securities. Broker-dealers relying on this relief have to provide risk disclosure statements to prospective investors disclosing their regulatory status.

Right to contract based on special "light" licensing regimes and deferral to home state regulator

The licensing regime in Luxembourg for corporate banking services and some investment and risk management services takes a similar approach; providing a "lighter" system with a high level of deferral to the home state regulator for firms from states with regimes recognised by the Luxembourg authorities as equivalent to those of Luxembourg. At present, banks from Australia, Canada, Switzerland and the US benefit from this regime.

Right to contract without local presence but subject to authorisation

Some EU jurisdictions permit local customers to contract with a foreign firm without that firm being required to establish a local presence, on the condition that the firm is locally authorised. The authorisation requirements will typically be similar to those for an entity with a local presence (e.g., the foreign firm will need to demonstrate that it is fit and proper and that it has appropriate systems and controls and sufficient resources to operate its business) and the foreign firm will need to comply with local law obligations relevant to its business (e.g., local conduct of business obligations and possibly also prudential obligations) and will be subject to supervision by the local regulator. One example of this in the EU is the Belgian regime for cross-border lending to smaller and medium-sized enterprises and cross-border financial leasing, neither of which require foreign firms to be locally licensed to provide cross-border services, but both of which require foreign firms to be authorised and, in some cases, subject to conduct of business and some other rules.

Right to contract with local presence but subject to registration

A variant of the above model involves the customer being able to contract with firms on the condition that they register with the local regulator. In this case, the provider is not subject to the full range of obligations of local authorised firms, but it would be required to comply with some local law obligations (e.g., local conduct of business obligations). In some cases, the right to contract with the foreign firm would be granted on the basis that the firm is authorised in its home jurisdiction to carry on the activities the customer is seeking to contract. The Belgian regime for cross-border provision of investment services permits foreign firms to provide a wide range of investment services to local institutional investors on the condition that the firm pre-notifies its intent to provide the service to the Belgian regulator.

Right to contract on the basis of access to a defined set of sophisticated customers

In some cases, local rules may permit customers of a certain type to contract with foreign firms for certain defined services. This could include locally authorised entities, institutional investors, large corporates or high net worth clients. There may also be other conditions; for example, requirements that the provider register with the local regulator or disclose to any local customer that the firm is not authorised in their jurisdiction. These rights to contract are not typically dependent on equivalent regulation or reciprocity, but rather reflect the competence of the local customer to contract with a foreign firm. For this reason, these exemptions are not usually available in relation to retail clients or individuals other than high net worth individuals.

Examples of such regimes in the EU include: the UK overseas person exclusion allowing foreign firms to provide cross-border investment services without local authorisation in defined cases, in particular where the local customer is a professional investor or high net worth company; the Irish "safe harbour" allowing foreign firms to provide defined investment services, without local authorisation, to Irish 'per se' professional clients and eligible counterparties (as defined in MiFID II); and the Dutch waiver from licensing requirements for the provision of cross-border deposit taking services to "professional market parties".

There are also a number of examples of these kinds of regimes outside the EU. Under the Financial Instruments and Exchange Act of Japan, certain non-Japanese brokers can conduct cross-border securities-related business with a defined class of professional investors in Japan without obtaining a licence. Under the Hong Kong Securities and Futures Ordinance, there is an exemption allowing non-Hong Kong firms to deal as principal in securities with a limited class of institutional professional investors, although there are also restrictions on marketing that would apply to such business. Canadian securities laws provide an exemption for certain international dealers transacting securities business with a category of institutional clients and counterparties in non-Canadian securities, subject to a filing with the Canadian regulators.

US rules also provide relief from compliance with US prospectus registration requirements under SEC Rule 144A for sales of securities to "qualified institutional buyers" and under Regulation D under the Securities Act, 1933 for private placements with "accredited investors".

In some cases, relief may instead be available subject to compliance with numerical restrictions on the number of local investors or clients. For example, Belgium waives licensing requirements for deposit taking where a foreign firm operating cross-border serves less than 50 local clients and the US Investment Advisers Act of 1940 provides an exemption for advisers with fewer than 15 clients.

Right to contract on the basis of involvement by a locally authorised entity

In some regimes, a local customer may be permitted to contract for services with a foreign firm where a local authorised entity intermediates in any transactions or provision of services. In these models the local authorised entity acts as an additional gatekeeper to ensure adequate protection of local investors or customers. These models can take a range of forms. The rules may require a local authorised entity to "chaperone" the activities of the foreign firm when interacting with local customers or require that the foreign firm contracts with local customers via the local authorised entity acting as an intermediary. In some cases, the local authorised entity may accept responsibility for a product provided to a local customer by the foreign firm, either by requiring the foreign firm to ensure compliance as a condition for endorsing the product or by itself "wrapping" the product to ensure compliance with local obligations such as required disclosures or risk warnings.

For example, in the German regime, a non-EEA provider of retail banking services is potentially eligible to provide cross-border services to German customers if they are introduced by an authorised local bank.

Similarly, the US SEC's rule 15a-6 enables non-US broker-dealers to engage in certain securities business with certain US institutional investors, subject to interactions with US investors being chaperoned by an authorised US broker-dealer and compliance with other requirements for the involvement of the US broker-dealer in the transactions with US investors.

Also, the Hong Kong Securities and Futures Ordinance provides an exemption where a non-Hong Kong firm deals in securities or regulated futures contracts with local investors through an entity with an appropriate Hong Kong licence, although there are restrictions on the extent to which the non-Hong Kong entity can receive remuneration for its services.

Some EU regulations envisage similar arrangements. For example, the EU Benchmarks Regulation allows EU firms to use a benchmark provided by a non-EU administrator if an EU regulated firm has been authorised by its national regulator to endorse the benchmark for use in the EU. In such a case, the EU firm must ensure that the provision of the benchmark complies with the requirements of the Benchmarks Regulation.

Right to contract on the basis of reverse solicitation

Some jurisdictions permit customers to contract services with foreign firms where they seek the service without any form of solicitation from the firm in question. Broadly, these jurisdictions allow the foreign firm to provide a service without local authorisation either on the basis that the initial contact with the client leading to the establishment of the relationship took place without any solicitation on the part of the foreign firm or, in some cases, on the basis that the customer has initiated every transaction in this way. Such models are very limiting for both the customer and the provider and do not facilitate effective provision of services or banking relationships. They often make it difficult for banks to provide customers with any form of advice around the provision of a service, or to customise a product or service offering in ways that go beyond the precise service initially sought by the client.

This reflects the fact that these approaches are generally not designed as a basis for contracting, but rather typically reflect the absence of a regulatory regime for the contracting in question, i.e., the fact that the customer's purchase falls outside the scope of local regulation because the foreign firm does not trigger licensing requirements by seeking their business. Many EU jurisdictions have a variation on reverse solicitation, although it is regarded with suspicion – and tolerated rather than endorsed – by many, if not most, EU national regulators. Many EU reverse solicitation regimes take a highly restrictive approach, setting tight benchmarks for when interactions with a customer are regarded as solicitation triggering consequent requirements for local licensing.

Case study: Manufacturing and the economic cycle

For European manufacturers and exporters, all elements of their business – from manufacturing, sourcing across the supply chain, distributing to wholesalers and retailers, and selling to businesses and private end-customers – will use a variety of financing tools to provide capital and financial resources in an efficient way. This enables faster growth and supports job creation and prosperity.

UK-based banks will frequently be among the key providers of financing solutions, either directly or indirectly. For illustrative purposes, we have imagined a large European-based global manufacturing company – a leading automobile producer, 'Euro Auto' – to provide examples of how the various financing solutions available at different stages of the manufacturing/distribution/sales cycle would make use of the commitments described within this report.

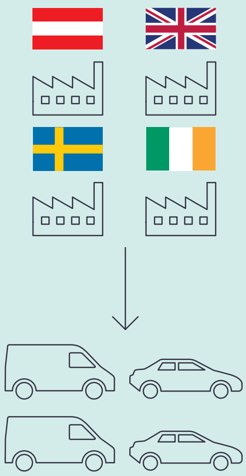
Figure 7: Step 1 – Financing manufacturing hubs

Euro Auto SARL ("Euro Auto") is one of the EU's largest automotive manufacturing companies. It has significant operations across Europe, including large vehicle manufacturing plants in a number of EU Member States and the UK with over 1,000 dealer groups in its distribution network. Euro Auto's vehicle range is manufactured with each plant responsible for certain vehicle ranges. Euro Auto sales volumes across Europe amount to over 5 million vehicles per annum.

Due to increasing sales and subsequent demand for its new models, Euro Auto has estimated it needs to produce an extra 1 million vehicles this year and is seeking additional capital to finance this production growth across its European manufacturing hubs. Euro Auto uses the qualified counterparties commitment to contract a suite of services from a UK-based bank to risk manage and finance the production of the new vehicles. With the UK-based bank, Euro Auto can now raise funding both from traditional bank finance via a syndicated loan and also, to diversify its funding sources, directly from the capital markets through a bond issuance programme. It can risk manage fluctuations in the foreign exchange markets by contracting a currency hedge and can obtain other risk management services to protect against future changes in interest rates or commodity prices.

Scenario

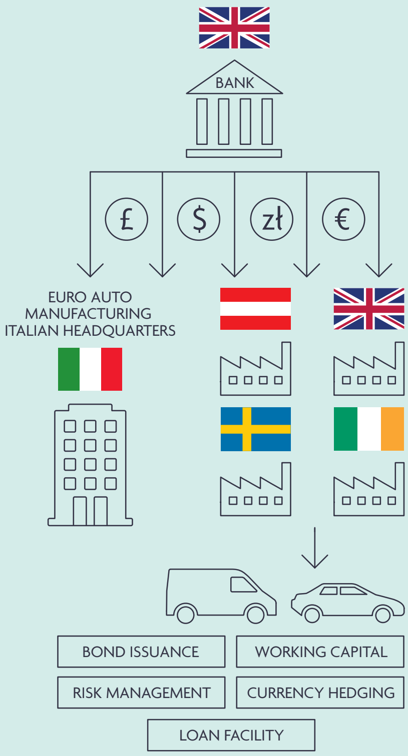
EU-based Euro Auto has manufacturing plants across the EU ...



... and needs to finance the production of 1 million new vehicles

Opportunity

UK-based bank provides a suite of financing solutions across the EU to Euro Auto to support its varied manufacturing needs



Commitments used

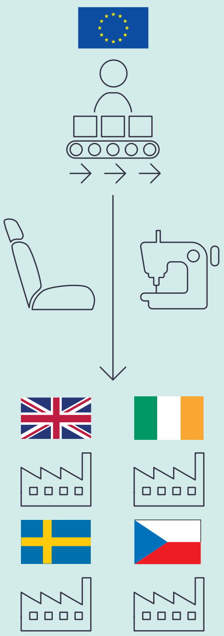
Qualified Counterparties Commitment

Figure 8: Step 2 – Financing the supply chain

As part of its supply chain Euro Auto has relationships with a number of small and medium-sized businesses across Europe. One of those businesses, Spare Parts SpA ("Spare Parts"), is supplying several million seats and other upholstery products to Euro Auto's manufacturing plants. For Euro Auto to deliver on its vehicle order commitments it will need timely delivery from Spare Parts. Spare Parts contracts a suite of financial services through the professionals commitment to enable it to commit and deliver on Euro Auto's order. For example, it contracts equipment financing to purchase new conveyor belts to manage the large order of seats and a currency hedge to manage euro / zloty foreign exchange rates where Spare Parts sources raw material from a Polish textile company. Where the supply chain financing services involve provision across several links in the chain and to Euro Auto then the qualified counterparties commitment and the smaller commercial and retail commitment may also be used.

Scenario

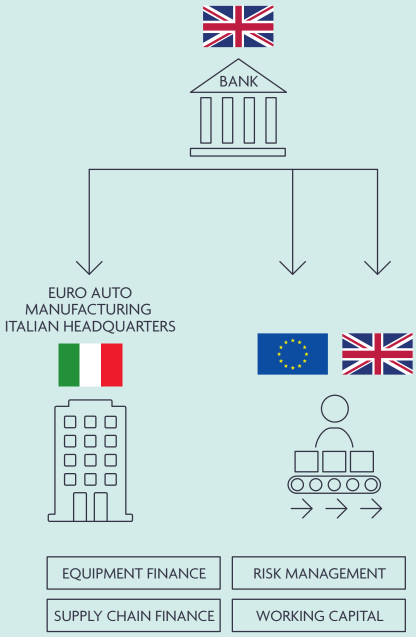
Key supply-chain partner, EU-based Spare Parts...



... needs to finance the provision of 1 million vehicle seats and upholstery material to Euro Auto manufacturing plants across the EU

Opportunity

UK-based bank provides range of supply-chain financing services across the EU to Euro Auto and key members of its supply chain



Commitments used

Qualified Counterparties Commitment

Professionals Commitment

Smaller Commercial and Retail Commitment

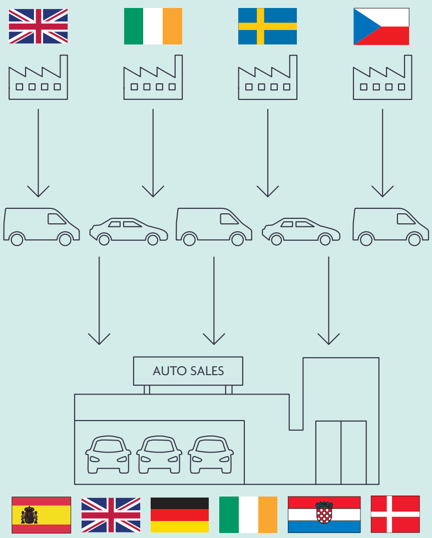
Figure 9: Step 3 – Financing the distribution network

To ensure that the vehicles have the best chance of being marketed and sold across the EU and the UK, Euro Auto wants to support its network of dealer groups by providing financing for the new vehicle inventory and dealership upgrades. The dealer network across Europe can use the professionals commitment to contract commercial and real estate financing to develop its dealer branch to better house the incoming vehicles and a lease financing product to bulk-buy cars and vans direct from the manufacturing plants in Germany and France. Where supply chain financing services are provided that include Euro Auto, the qualified counterparties commitment may also be used.

In addition, Euro Auto assists its dealer groups to assess the financing they require to optimise their individual business model given the economic circumstances of their national or regional market. Dealer groups vary in size but more often than not are medium-sized businesses employing a large number of staff across their local EU Member State operations. This type of support helps ensure the continuity and viability of Euro Auto's dealer groups in its distribution network through economic cycles.

Scenario

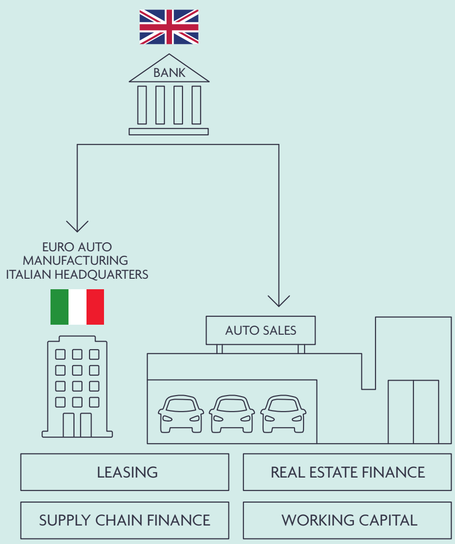
Euro Auto wants to support and build long-term relationships with its dealer network across the EU ...



... and provide capital and financing support for its dealers

Opportunity

UK-based bank, alongside Euro Auto's captive/owned 'in-house' bank, provides a suite of financing solutions across the EU to support Euro Auto's dealer network



Commitments used

Professionals Commitment

Figure 10: Step 4 – Sales Financing

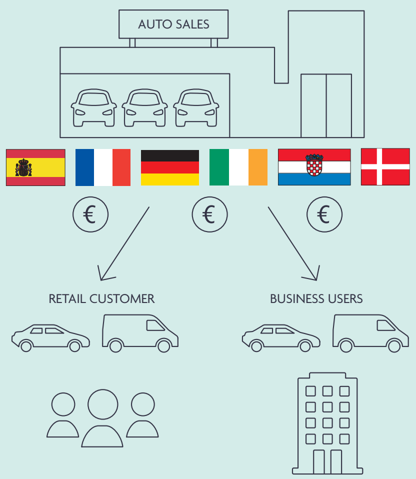
A small business in Spain, Fresh Foods SpA ("Fresh Foods"), is one of the first companies to place an order for Euro Auto's new models and wishes to purchase a fleet of specialist vans from a dealer in France. The Euro Auto dealer in France can use the smaller commercial and retail commitment to facilitate the contracting of fleet financing from a UK-based bank together with the finance arm of Euro Auto, allowing Fresh Foods to purchase and import the vehicles. The Euro Auto dealer can also use the smaller commercial and retail commitment to provide ancillary services such as drive-away insurance to Fresh Foods. Where the business purchaser involved is larger, then the professionals commitment may be appropriate.

Similarly, a dealership in the Republic of Ireland has an order for 25 of Euro Auto's new model of family carrier. The Irish dealer uses the smaller commercial and retail commitment to provide retail customer financing or leasing products on each of the vehicles enabling retail customers to finance and purchase the vehicles on the day.

Where the financing arm of Euro Auto accesses the wholesale markets via the UK-based bank to obtain wholesale funding for its sales financing services, then the qualified counterparties commitment will be used.

Scenario

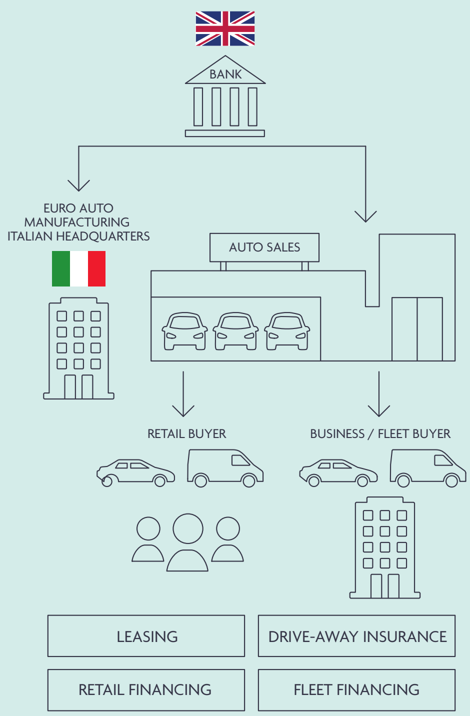
Dealer network wants to provide financing as an option for customers ...



... to offer customers additional service and assist in increasing volumes of auto sales

Opportunity

UK-based bank provides a diverse range of products and services to the dealership via relationship with Euro Auto HQ and Euro Auto's in-house bank



Commitments used

Qualified Counterparties Commitment

Professionals Commitment

Smaller Commercial and Retail Commitment

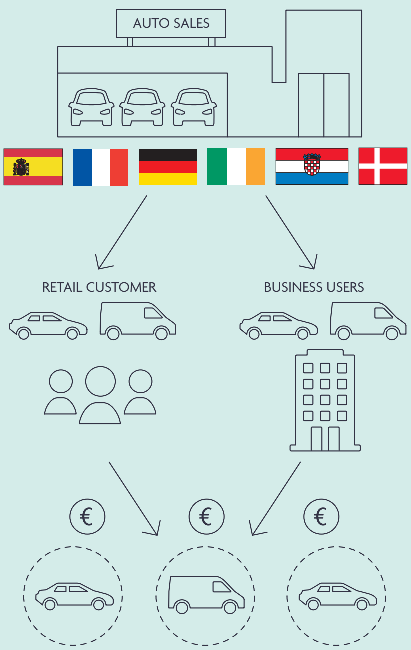
Figure 11: Step 5 – Capital management and creating additional capacity for Euro Auto

Euro Auto wants to securitise and sell the receivables from the new auto loans to provide additional diversified sources of investment capital and to fund further manufacturing production. Euro Auto together with its financing arm can use the qualified counterparties commitment to ask the UK-based bank to create a vehicle receivables securitisation programme to sell to EU investors (using the professionals commitment) and to international investors.

The use of the investor capital raised by the securitisation programme to assist in financing new manufacturing restarts the cycle of economic activity.

Scenario

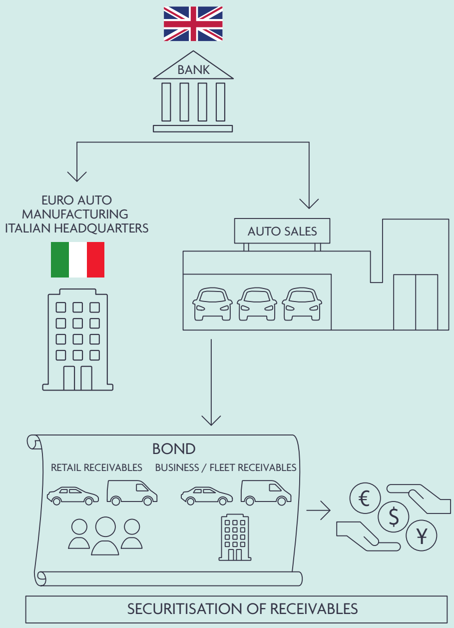
Euro Auto wants to securitise vehicle receivables ...



... in order to provide additional diversified sources of investment capital and to fund further auto production

Opportunity

UK-based bank and Euro Auto in-house bank create vehicle receivables securitisation programme to sell to EU and international investors



Commitments used

Qualified Counterparties Commitment

Professionals Commitment

Chapter 5: Temporary movement of financial professionals

5.1 Temporary movement and GATS

Combined with the fact that WTO members are free to define "temporary" as they wish, and link rights to enter their market to the kind of service they are providing, this has made the landscape for Mode 4 rights internationally uneven and subject to little consistency.

All services are delivered by people, and the freedom of people to move between countries will often be integral to realising the kinds of commitments to open trade described in the previous chapters. So, for example:

(a) A banking operation that establishes a commercial presence (Mode 3) in a market may want to be able to locate professional staff from its home market to the host market to set up the business, manage its operations or conduct key functions within it; and

(b) A banking operation that has the freedom to contract directly from its home jurisdiction with a customer in another jurisdiction (Mode 1) may want the freedom to dispatch experts to meet with and advise that customer.

In both cases, the movement of professional staff between the two markets is temporary and linked to an existing role in delivering the service in question. In both cases, the freedom to move financial professionals between the two markets can be integral to making liberalisations meaningful. At the very least, constraining these freedoms diminishes the value of the commitments made under Mode 1 and Mode 3.

As set out in chapter 2 above, in the conceptual approach of the GATS, this temporary movement of people for the purpose of supplying services is referred to as Mode 4, and is treated as a category of liberalisation in its own right. It has long been recognised as an important counterpart to liberalisation under Mode 1 and Mode 3, but states usually make very limited commitments in this area and often subject any freedoms to visa requirements, economic needs tests, quotas and pre-employment requirements. This will often reflect a range of policy objectives amongst WTO states:

(a) A desire to ensure that inward-investing businesses employ local professionals and that the skills they deploy in the local economy spill over into the local workforce;

(b) A general sensitivity over the conditions of any form of migration, although, as noted above, Mode 4 temporary movement is not migration for the purpose of seeking residency or any of the rights attached to it. Indeed, the GATS Annex on Mode 4 explicitly clarifies that Mode 4 does not cover any status conferring rights or future potential rights to permanent citizenship, residence or employment; and

(c) A general desire to maintain a high level of scrutiny of those who enter its territory, although the Mode 4 commitments do not remove the rights to document market entries and exits or subject those who cross a border to standard checks on travellers, provided these are done in a way that does not nullify a commitment made.

Combined with the fact that WTO members are free to define "temporary" as they wish, and link rights to enter their market to the kind of service they are providing, this has made the landscape for Mode 4 rights internationally uneven and subject to little consistency. As part of an ambitious FTA, this is something that the EU and the UK should aim to avoid. The symmetry of skills levels in their services markets means that many of the sensitivities that have often been a feature of Mode 4 negotiations between developed and developing countries need not characterise an EU-UK agreement. Nor should Mode 4 commitments be seen as undermining wider aims on migration or security policy.

The consideration of Mode 4 rights in an EU-UK FTA also needs to be treated in close coordination with the linked question of recognition of professional qualifications. As a highly regulated activity, in which professional qualification status is often integral to the right to deliver a service, financial services trade inevitably depends on a degree of willingness to recognise the professional qualifications of trading partners. In the same way that Mode 4 commitments might be seen as "realising" the liberalisation proposed under Modes 1 and 3, mutual recognition of professional qualifications can be seen as "realising" the commitments made under Mode 4.

Box 9: Who is a Mode 4 worker?

The GATS Annex on Mode 4 provides some guidance on what constitutes a Mode 4 worker. It must be a natural person (i.e., a human individual, rather than an entity with legal personality, such as a company) meeting the description of:

- a self-employed service supplier; or
- an employee of a service supplier, who is either sent to a country in order to supply a service, or seconded to a branch of the company in the host country.

There is also a categorisation for business visitors who receive no remuneration in the host country but have travelled in order to, for example, negotiate a service contract or negotiate the establishment of commercial presence.

WTO categories of Mode 4 workers

Category	Definition
Intra-corporate transferees	Work for a company established in one country and transferred to the enterprise's commercial presence in the territory of another country in the context of the supply of a service. This tends to apply just to senior employees.
Executives	Do not provide service directly but direct the management, have wide latitude in decision-making, and are supervised only by board of directors or stockholders.
Managers	Direct organisation or department and have responsibility for hiring and firing.
Specialists	Have essential knowledge at advanced level of expertise.
Business visitors	Are not engaged in supplying the service or making direct sales to the public, and do not receive remuneration from a source in host country. Sales business visitors negotiate the sale of a service, establish business contacts and attend business meetings. Set-up business visitors set up a commercial presence in another member, where their employer has none.
Contractual service suppliers	Employees of a company (which has no commercial presence in host country) who supply a service on the basis of a contract their employer has concluded with a consumer in host country. The employee receives remuneration from the employer while abroad, has appropriate educational and professional qualifications, and may not engage in other employment.
Independent professional	Self-employed person based in the territory of another country who supplies a service on the basis of a services contract with a consumer in the host country.

5.2 The EU approach to Mode 4

Relatively speaking, the EU approach to Mode 4 is amongst the more liberal between WTO members, in part because it accepts the principle that Mode 4 commitments underpin Modes 1 and 3 commitments. The EU's GATS services schedule has the majority of its Mode 4 commitments in the horizontal section that applies to all sectors. However, it does have specific additional commitments for financial services, where commitments on national treatment and market access are given for:

(a) Senior managerial personnel possessing essential proprietary information;

(b) Individuals linked to the establishment, control and operation of the services of the financial service supplier that is establishing or has established;

(c) Specialists in the operation of the financial service supplier that is establishing or has established;

(d) Specialists in computer services, telecommunication services and accounts of the financial service supplier that has established, subject to availability of qualified personnel; and

(e) Actuarial and legal specialists associated with a commercial presence of a financial service supplier, subject to availability of qualified personnel.

However, some EU Member States have specific restrictions that can derogate from these general principles. For example, in Austria, the management of a branch office of a financial services business must consist of two natural persons resident in Austria, and a majority of the members of the board of directors of a company established in Greece must be nationals of an EU Member State.

FTAs and other regional economic integration agreements do grant some advances over GATS commitments on Mode 4 trade in services. The EU does technically offer Mode 4 access in its trade agreements but its commitments generally do not go further than those given by the most ambitious countries in the last WTO round. In its trade agreements, the rules distinguish between five different categories of personnel, roughly similar to those set out under the GATS (see above). The broad baseline for Mode 4 established by the EU's existing preferential trade agreements is set out in Box 10.

The EU-Singapore FTA provides for the temporary presence of "key personnel, graduate trainees and business service sellers". Key personnel is defined as persons responsible for the setting up or the proper control, administration and operation of an establishment. Graduate trainees and key personnel are granted temporary entry and stay for a period of up to three years for intra-corporate transferees, 90 days in any 12-month period for business visitors and one year for graduate trainees. The parties are still able to impose licensing and qualification requirements (such as visas), but the FTA provides that decisions must be made within a reasonable timeframe, and the formalities should be as simple as possible, so as not to unduly complicate or delay the supply of the service.[30]

[30] However, even in this context there are a range of specific limitations placed on the temporary movement of persons, varying depending on the specific country, e.g., Bulgaria and Hungary require economic needs tests for graduate trainees. In addition, for the Union as a whole, mutual recognition only applies to EU citizens. The right to practice a regulated professional service in one Member State of the Union does not grant the right to practices in another Member State.

Box 10: Typical EU Mode 4 coverage
(NB some variations apply to these categories across different EU trade agreements)

Category of person	Main Criteria	Length of Stay
Key Personnel (Business Visitors)	Persons responsible for setting up a commercial presence and paid by a source outside the host territory.	90 days per 12-month period
Key Personnel (Intracorporate Transfers: Managers and Specialists)	Persons employed by a company in the sending country at least a year before entry to the host country to work within a partner company there.	Up to 3 years
Graduate Trainees	University graduates, employed by a company for at least a year and entering either Party for career development or training in a branch or parent company.	Up to 1 year
Business Services Sellers	Persons entering to negotiate a sale or an agreement but who receive remuneration from a source outside a Party and do not make direct sales.	90 days per 12-month period
Contractual Service Suppliers	Professionals with three years' experience employed by a company in the sending country, which does not have a presence in the other Party but has a service contract with a client in the other Party.	Up to 6 months per year
Independent Professionals	Self-employed professionals with six years' experience and service contract.	Up to 6 months per year
Short Term Visitors for Business Purposes	Persons that are not selling services can enter either Party to perform a range of activities such as: research and design, marketing research, training, trade fairs and exhibitions, sales, purchasing and tourism, services contract with a consumer in the host country.	90 days per 12-month period

5.3 Mode 4 and recognition of qualifications in an EU-UK FTA

An EU-UK FTA should provide for comprehensive agreements on temporary movement between the two markets for business purposes, unless such short-term travel to, and temporary presence in, the other market is covered by a wider agreement between the EU and the UK on freedom of movement of persons between the two sides.

Transparent, clearly defined arrangements to cover temporary relocation for professionals to the other market are an integral part of providing both cross-border services and the effective operation of businesses established under an FTA. Creating a right to establish a business, or serve a customer or client in the other market, and then imposing restrictions on the ability of employed representatives or contractors of that business to travel temporarily to that market to support that activity diminishes, or even potentially nullifies, the right granted.

These arrangements should not be seen as compromising the exercise of general labour market or migration policy on either side. Rather, they should be seen as a way of fully realising the opportunities for cross-border trade agreed in both directions. They should cover only workers posted to serve established enterprises or investments or conduct contracted services on a temporary and time-limited basis. They should not create rights and obligations to enter a labour market without prior contracting for services. They should apply only to individuals who in all general respects comply with the migration criteria of the market to which they seek temporary entry. They should create no rights of residency, constitute no contribution to establishing rights of residency or other rights except as explicitly granted.

These arrangements should not be seen as compromising the exercise of general labour market or migration policy on either side. Rather, they should be seen as a way of fully realising the opportunities for cross-border trade agreed in both directions.

As a minimum commitment, both the EU and the UK should agree to:

(a) Allow temporary entry to a defined and limited category of professional financial services worker covering senior, supervisory or specialist staff responsible for servicing an investment or setting up or operating an enterprise in the other market;

(b) Allow the temporary transfer of financial services staff between entities in the two markets, subject to defined levels of minimum seniority and specialism and minimum periods of employment by the enterprise in question;

(c) Allow the temporary transfer of financial services graduate trainees between entities in the two markets for the purposes of career development;

(d) Allow the temporary entry and stay of contractual service suppliers carrying out similar financial services functions to those above, also subject to minimum requirements with respect to their previous provision of that service, and maximum duration limits for their contracting period; and

(e) Allow, without the requirement for a work permit, the temporary entry and stay of short-term financial services business visitors that are not employed by an entity within the market they are visiting and are not providing a service to the public.

Temporary stays should be defined as periods not more than three years for senior staff and specialists and one year for contractual service suppliers and graduate trainees. Short-term business visitors should be limited to 90 days. However, in all cases, extensions should be possible at the discretion of the local authorities.

To the greatest extent possible, such commitments should not be subjected to individual EU Member State caveats. Although subject to clear and transparent limitations on length of stay and definitions of the skills and seniority required of temporary workers, these commitments should not be capped numerically and should not be subject to economic needs tests. Except for short-term business visitors, they should, however, not remove the need to hold a permit, visa or other form of documentation if required, although the process of applying for these should be as simple, transparent and rapid as possible.

The EU and the UK should grandfather all existing mutual recognition of professional qualifications in the fields of financial services and encourage authorities and professional bodies on both sides to develop and maintain a high level of mutual recognition of qualifications. A joint committee on mutual recognition of professional qualifications should be maintained for this purpose. Non-binding guidelines on how to maintain a high level of mutual recognition should be agreed by the EU and the UK.

Chapter 6: Seven further key elements of an EU-UK free trade agreement for financial services

6.1 Overview of framework of an EU-UK FTA for financial services

This report has focused on the elaboration of a framework approach that the EU and the UK might develop for commitments on cross-border trade in financial services as part of a wider FTA. It has also elaborated a set of commitments on the temporary movement of financial professionals designed to support and make meaningful these rights to trade and invest. The focus on this cross-border dimension of a future relationship and how it might be codified in commitments between the two sides simply reflects the fact that this is the area in which the status quo will potentially be most sharply changed by a UK exit from the single market. It is here where a new approach will be most required to preserve some of the choice currently available to EU and UK customers.

However, there are a wide range of additional areas where the nature of the commitments between the EU and the UK will be relevant for financial services. These commitments will protect firms on both sides from discriminatory treatment; deepen and help realise the full potential of cross-border trading rights and provide clear routes to settle disputes arising from the operation or interpretation of the agreements. This chapter identifies seven additional areas where EU-UK commitments will be especially relevant for financial services:

(a) In the use of *standstill and ratchet clauses* to lock in minimum market access terms on both sides both at the time an agreement is signed and in the future;

(b) In a framework for *new financial services* that anticipates innovation in the delivery of financial services and ensures that commitments made in an EU-UK agreement have the scope to cover new services in the future;

(c) In the area of *payments systems*, a commitment to close alignment and mutual recognition of payments frameworks to facilitate their integration;

(d) In the development of a framework for moving and storing *personal data* between the two markets while maintaining the highest shared standards of data protection;

(e) In clear commitments to non-discrimination in the levying of *taxes* on importing firms and attention to ensuring that the new agreement integrates effectively with existing double taxation treaties;

(f) In an agreement that ensures the continued *recognition of court judgments* on both sides, ideally through UK participation in an existing mutual recognition framework for court judgments; and

(g) In the design of *dispute resolution mechanisms* that provide clear recourse both for the EU and the UK as parties to the FTA and for firms impacted by non-compliance with the terms of the agreement while respecting the legal autonomy of both sides.

6.2 Ratchet and standstill clauses

Standstill clauses are included in bilateral and multilateral trade agreements in order to guarantee and lock in existing levels of liberalisation in respect of market access or national treatment obligations. As a result, depending on the wording of the standstill obligation, once the parties agree a set of commitments and outline specific reservations to each, they cannot introduce any new barriers afterwards.

Although the GATS is silent with respect to standstill obligations, the GATS Understanding envisages a limited standstill obligation according to which "any conditions, limitations and qualifications to the commitments made must be limited to existing nonconforming measures at the time of making those commitments".[31]

Ratchet clauses have a similar intent to standstill clauses but focus instead on locking in future unilateral liberalisation by the parties. Because commitments under an FTA – including those under standstill clauses – usually reflect existing levels of market openness, a ratchet clause ensures that the FTA "updates" the baseline of the trading relationship if either side unilaterally liberalises its market access regime.

The EU has not consistently pursued standstill and ratchet clauses in its preferential trade agreements, or has applied them narrowly to maintain scope for prudential regulators to reverse future liberalisation if they wish. Objectively, both kinds of mechanism in an EU-UK FTA would provide financial institutions on both sides with greater legal certainty with respect to commitments agreed to under the FTA, minimum applied conditions in place at the time of the FTA and any future liberalisation undertaken by either party that goes beyond the initial commitments in the FTA.

As a minimum, the EU and the UK should agree a clear standstill mechanism for an EU-UK FTA that contains the explicit obligation to "maintain the conditions of market access and national treatment applicable at the time of the signature of the Agreement". In addition, the EU and the UK should agree not to adopt measures that restrict any type of cross-border trade in financial services that a party permits at the time of signature. These commitments should bind both the EU itself and the individual EU Member States with respect to the conditions of their national licensing regimes for treatment of non-EU banks. Ideally, the EU and the UK should also agree a ratchet clause having a similar effect for future evolutions of either party's market access regime. While this has not been a feature of past EU FTAs, the close linkages between the regulatory and supervisory systems of the two sides envisaged here would make it much easier to agree such a principle.

6.3 New financial services

Any agreement between the EU and the UK on financial services would need to address the treatment of new financial services that are not subject to regulation at the date of the agreement. This may include new services that did not exist at the date of the agreement as well as services that did exist but that were not regulated as financial services. The agreement should also address the position of service providers that were not already engaged in the supply of financial services in the EU at the date of the agreement, but that may wish to provide financial services in the future. GATS and FTA practice establishes that such new financial services should not fall outside existing commitments simply because they postdate them.

[31] Clause A, GATS Understanding.

The EU-Singapore FTA contains a specific provision on new financial services…

The EU-Singapore FTA contains a specific provision on new financial services,[32] which provides that: *"Each Party shall permit a financial services supplier of the other Party to supply any new financial service that the first Party would permit its own like financial services suppliers to supply without additional legislative action required by the first Party. A Party may determine the institutional and juridical form through which the new financial service may be supplied and may require authorisation for the supply of the service. Where such a Party requires such authorisation of the new financial service, a decision shall be made within a reasonable time and the authorisation may only be refused for reasons justified by the [prudential carve-out]."* This would enable EU financial services suppliers to provide any new financial services to clients in Singapore where Singapore permits its own financial services suppliers to provide those services. CETA also contains specific provisions on new financial services along similar lines to those in the EU-Singapore FTA.[33]

An EU-UK FTA should extend such national treatment requirements to new financial services, including cross-border financial services on the basis of the principles set out in chapter 4 above, including an obligation that the provision of a new financial service not be made conditional on local establishment, except where such requirements have been agreed by the two sides in a way that reflects, for example, the retail nature of the service. Where the treatment of new financial services is not subject to harmonised rules or practice at the EU level, individual EU states should be required to observe corresponding obligations.

6.4 Payments systems

As noted above, an EU-UK FTA should explicitly protect the right of EU and UK firms with a commercial presence in either market to access the payments and settlement systems of that market on a national treatment and MFN basis. No conditions should be applied to commercial entities established in either jurisdiction that act as a discriminatory check on their ability to access these systems or participate in industry-led institutional cooperation systems such as SEPA that confer market advantages on the participating firms.

As a general principle, the EU and the UK should recognise the value and importance of maintaining close alignment in regulatory frameworks for payments in a way that facilitates continued UK participation in payments systems and schemes such as SEPA.

[32] Article 8.53, EU-Singapore FTA.

[33] Article 13.14, CETA.

6.5 Privacy, data protection and data localisation

...the ability to move data under carefully managed conditions of privacy protection between parts of a business can be as integral in many respects as the freedom to support cross-border operations through the movement of professional staff...

Divergent regulatory approaches to data privacy and data protection can significantly impact the provision of cross-border banking and capital markets services by financial institutions. With many modern services businesses built on the effective analysis and synthesis of data both in fintech and more widely, the ability to move data under carefully managed conditions of privacy protection between parts of a business can be as integral in many respects as the freedom to support cross-border operations through the movement of professional staff (see chapter 5). For this reason, commitments in this area are often closely linked to the consideration of the treatment of new financial services (see above).

Article XIV(c)(ii) of the GATS acknowledges the primacy of data protection in trade policy, provided it is designed and implemented proportionally. It permits trade restrictions that are necessary for "the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts", specifying that "such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services".

The GATS Understanding specifically addresses the question of cross-border transfer of data in a provision on the Transfers of Information and Processing of Information, which requires parties to permit a foreign financial service supplier established in its territory to transfer information into and out of its territory for data processing, where such processing is required in the ordinary course of business of such financial service supplier. The provision included in the GATS Understanding has been replicated in some form in the EU's most recent FTAs along with positive obligations in some FTAs not to impose forced data localisation requirements unless they are required by legitimate public policy aims. The proposed Annex on Financial Services in TiSA[34] contains similar clauses, as does the e-Commerce chapter of the Trans-Pacific Partnership Agreement ("TPP").

An EU-UK FTA should contain comprehensive commitments on e-commerce and cross-border transfer of data. This should be based on a reciprocal recognition that the data protection standards of the two parties that apply to personal data transferred between them are aligned and "adequate" for the protection of their nationals' personal data. Such a determination can be expected to be generated on the basis of the recognition regime established by the EU General Data Protection Regime, which will be in force in both the EU and the UK at the point of exit. On this basis there should be established a general prohibition on data localisation requirements and a clearly defined set of rights to move personal data between entities in the EU and the UK, subject to clear data privacy and protection standards. It will be a matter for negotiation between the parties whether any of these commitments are subject to arrangements to address the possible future divergence of the parties' respective data privacy and protection standards similar to those set out in chapter 4 above which might lead to a suspension of those commitments (after an appropriate transition period) if the two regimes cease to be sufficiently aligned. However, any negotiation on these issues would have to address EU opposition to the negotiation of EU data protection rules in FTAs, which sees adequacy decisions as unilateral measures which complement other commitments in trade agreements.

[34] Andrew Lang, Leonie Amarasekara, European Parliament, Directorate-General for External Policies, Policy Department, *Financial Services liberalisation and TiSA: implications for EU Free Trade Agreement* (July 2016).

6.6 Tax

Tax potentially creates non-tariff barriers to cross-border trade in services. Any tax rule which treats foreign services providers differently to local providers or which acts as a restriction on trade in services, even if not overtly, can represent such a barrier.

Within the EU, taxes such as these are generally prohibited on the basis that they infringe the EU fundamental freedoms, particularly the right to freedom of establishment and free movement of capital. The WTO framework is more permissive. For example, the GATS recognises that discriminatory tax treatment may be justified where it is "aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members". This would seem to cover, for example, requirements for non-residents to pay taxes in advance (e.g. by gross withholding taxes), complete registration formalities and/or appoint local agents, all of which can materially impede the provision of cross-border services. While double taxation treaties in the standard OECD form also contain a prohibition against discriminatory tax treatment, this is relevant only to direct investment, and not to the cross-border provision of services.

An EU-UK FTA should go further than either the WTO or OECD tax treaty norms, and generally prohibit all discriminatory tax treatment.

If it is necessary to include a general statement in the FTA which recognises that certain tax rules are justifiable, and therefore permitted, that statement must set out the circumstances in which (or principles to be applied in determining when) discriminatory rules are justified. To avoid uncertainty, including for the financial services sector, it will be important that any such provision is as clear in scope as possible.

The other issue for the financial services industry is likely to be the relationship between the EU-UK FTA and double taxation treaties which have already been entered into (and/or which might be amended, or entered into in the future) between the UK and other EU countries. Double taxation treaties are particularly important for the provision of cross-border financial services, because cross-border payments under loans, derivatives and other financial instruments are in many cases subject to withholding tax unless a double taxation treaty applies to eliminate that tax. In practice, any such withholding tax would often represent an absolute, and therefore potentially prohibitive, cost. The existing experience within the EU is that companies in those jurisdictions which do not have appropriate exemptions in their double taxation treaties or domestic law (e.g. Portugal, Greece and, until recently, Italy) have found it more difficult to access cross-border financial services.

It will be necessary to ensure that the EU-UK FTA interacts effectively with any relevant double taxation treaties. This is particularly important as the EU-UK agreement will be entered into by the EU on behalf of the Member States, while all relevant double taxation treaties will have been, or will be, entered into between the UK and individual Member States, as tax remains a national competence in the EU. To minimise the impact on taxpayers, the EU-UK FTA should make it clear that:

(a) Nothing in the FTA restricts the rights of, or imposes any obligations on, any person under a relevant double taxation treaty; and

(b) If there is any conflict between the FTA and any double taxation treaty entered into between the UK and a Member State, the treaty shall prevail.

6.7 Judgment enforcement

A judgment of the UK courts is currently enforceable in other EU Member States under article 39 of the Brussels I Regulation (Recast). The Regulation provides that a judgment given in one EU Member State must be recognised and enforced in all other EU Member States without any special procedure or declaration of enforceability being required. As a result, a wide range of judgments are enforceable across the EU, subject only to limited exceptions.

After the UK has withdrawn from the EU, the enforcement of a UK court judgment in EU Member States (or an EU Member State court judgment in the UK) will be subject to greater uncertainties and procedural obstacles and it is in the interests of both the EU and the UK to reach an agreement regarding the enforceability of judgments. This could be done via a number of routes:

(a) The EU and the UK could seek to maintain the status quo by agreeing to continue to apply the *Brussels I regime* through an equivalent EU-UK bilateral arrangement. However, it may be difficult to negotiate such an arrangement because of the possible requirement for the CJEU to police the parties' obligations.[35]

(b) The UK could, as of right, join the 2005 *Hague Convention* on Choice of Court Agreements, which currently applies to EU Member States (excluding Denmark), Mexico and Singapore. The Hague Convention sets out rules establishing the validity of exclusive jurisdiction agreements, and provides for the enforceability of judgments given by the courts of contracting states if those courts were chosen by the parties. The Convention only applies to choice of court agreements concluded after its entry into force in the state of the chosen court. The Hague Convention is more limited in scope than the Brussels I Regulation and the Lugano Convention (see below), but joining it would potentially allow certain UK judgments to be enforced in EU Member States and vice versa.

(c) The UK could sign and ratify the *Lugano Convention* if the UK became a member of EFTA or with the agreement of all other participating states, if this could be obtained. The Lugano Convention would provide EU-wide enforceability of UK judgments in civil and commercial matters, and vice versa, on substantially the same basis as is presently the case (though, so far as EU Member States are concerned, without the generally helpful amendments to the Brussels I Regulation implemented via the recast version in 2015).

6.8 Dispute resolution

Any EU-UK agreement in the future should have transparent and effective dispute resolution procedures.

Any EU-UK agreement in the future should have transparent and effective dispute resolution procedures. The precise form such a dispute resolution mechanism might take will inevitably reflect the nature of a wider agreement between the two sides. However, as a minimum it should comprise:

(a) A state-state dispute mechanism for trade disputes; and

(b) An investor-state dispute mechanism for investment disputes.

It is recommended that the parties agree to empower an interpretative body (e.g. a Trade Committee comprising representatives of the EU and the UK) to make binding decisions regarding the interpretation of the EU-UK agreement. This would avoid issues of inconsistency or inaccuracy in interpreting the terms of the agreement, and the interpretations would be binding on the arbitrators adjudicating the disputes. Examples of such bodies include the North American Free Trade Agreement ("NAFTA") Free Trade Commission, and the CETA Joint Committee, which resolve disputes arising from the interpretation or application of those agreements. It may also be advantageous to have a separate Committee

[35] As an alternative, the UK might seek to rely on the 1968 Brussels Convention, which was, in the main, superseded by the Brussels Regulation in 2001. The UK remains a party to the Brussels Convention. However, this Convention has very limited continuing relevance, and it seems very unlikely that the UK's withdrawal from the EU would revive the Convention.

on Financial Services which would oversee the interpretation and implementation of the financial services chapter, and play a role in the resolution of disputes, if appropriate.

For disputes concerning cross-border services (discussed in chapter 4 above), the key protections are generally those afforded by the state-state dispute resolution mechanism. On the other hand, for investment disputes, the focus is on the protection of investments, which will not apply to most of the rights and obligations contemplated by the commitments relating to cross-border services. An investor-state dispute mechanism would be critical to fully enforce the investor protections under a future EU-UK FTA.

State-state disputes

A future EU-UK FTA would benefit from an arbitration-based inter-state dispute resolution process, with a structure that draws upon and elaborates some of the elements in frameworks such as the EU-Switzerland, EU-Canada and WTO dispute settlement mechanisms. Some of the core protocols that should be embedded in the EU-UK approach are:

(a) An initial consultation process based on a clear machinery of *notification, engagement and escalation*. The two parties should be obliged to notify issues and consult in good faith on solutions within a fixed timeframe before escalating the issue through different levels of seniority;[36]

(b) A *formal dispute mechanism of inter-state arbitration* to which recourse is available if the parties do not resolve the dispute through consultations. This should involve the appointment of a tribunal including its chair, ideally from an agreed list of arbitrators.[37] This tribunal would then hear evidence in accordance with a pre-agreed protocol, and reach an objective assessment of the matter within an established timeframe;

(c) *Effective remedies* should be available to the tribunal, particularly, the power to order the offending party to bring inconsistent measures into conformity with the FTA and possibly, the power to require compensation (such as, damages during the period in which the offending measures were in place);

(d) A *protocol for assessing compliance with tribunal judgments* that allows reasonable time for compliance, but clear mechanisms for a claimant to contest perceived inadequate action and a remedy process that provides scope for authorised retaliation by the claimant state if non-compliance is determined; and

(e) A *parallel mediation mechanism* available before and throughout the course of the dispute to run in parallel with the arbitration process, using mediators who are separate from the arbitration panel, and providing clear access to an "off ramp" for disputes from formal arbitration.

[36] Consultations could also take place among, or at a minimum include the parties' respective regulators.

[37] Where a dispute concerns financial services, the arbitrators should have expertise in financial services. See e.g., Article 11.21(3), TPP, where the dispute settlement provision in the financial services chapter envisages that a panel be comprised of individuals who "shall have expertise or experience in financial services law or practice, which may include the regulation of financial institutions".

[38] "Investment" could be defined to mean "every kind of asset, owned or controlled directly or indirectly" with a list of non-exhaustive examples including shares, stocks or other forms of equity participation, bonds, debentures, loans and other forms of debt, and any rights derived from such equity or debt instruments.

Box 11: State-to-state dispute settlement mechanisms	
EU-Switzerland	The EU-Swiss network of bilateral agreements does not provide a legal framework to adjudicate disputes between the parties. Instead, each bilateral agreement has its own dispute resolution mechanism, and establishes its own "Joint Committee". Each Joint Committee is made up of representatives from both the EU and Switzerland. The Joint Committees have the responsibility for managing, and applying, the agreement. If a dispute under the bilateral agreements cannot be resolved by a Joint Committee, either party has the right to terminate the agreement. As some of the agreements are linked, when one agreement is terminated so are the other agreements. There is not usually an option to refer the dispute to a court or tribunal.
CETA	CETA contains provisions for dispute settlement between the parties. If a dispute arises between the parties to the treaty, in the first instance, it is to be resolved by consultation and voluntary mediation. If this fails, the dispute can be referred to an arbitration panel, the composition of which combines EU, Canadian and international qualified arbitrators and the ruling of which will be binding. Alternatively, CETA permits the parties to opt to use the process for dispute settlement under the WTO.
The DSB	Dispute resolution is one of the core functions of the WTO and is the responsibility of the DSB, comprising all WTO members. It establishes a process of consultation followed – if an issue cannot be resolved – by binding arbitration by a panel composed of well-qualified governmental and/or non-governmental individuals. Panels' reports are subject to appeal before a standing Appellate Body and a mechanism for assessing the compliance of the parties with the recommendations of the DSB. The DSB also has the power to authorise WTO members to take retaliatory action against those WTO members that fail to comply with recommendations of the DSB.

Even where certain financial services activities may not qualify themselves as "investments", there is still an indirect benefit as the foreign investments the financial services industry so often supports will benefit directly from the protections and the right to arbitrate if necessary.

Investor-state disputes

Conventionally in international investment policy, recourse for investors (whether individuals or firms) against unfair treatment by a state is provided through the ISDS mechanisms that enable an investor from one contracting state to bring a claim directly against the government of another contracting party (the "host state") in the event of a breach of the substantive terms of an investment treaty or an investment chapter in an FTA. Critically, this remedy cannot be replicated in national law. ISDS provides a remedy that is distinct from remedies under contract or under national laws, and that remains available even if the host state changes its national laws. Financial services firms will benefit directly from ISDS provisions in an EU-UK FTA provided there is a broad definition of "investment".[38] Even where certain financial services activities may not qualify themselves as "investments", there is still an indirect benefit as the foreign investments the financial services industry so often supports will benefit directly from the protections and the right to arbitrate if necessary.

Such mechanisms are very common. They are embedded in bilateral investment treaties ("BITs"), multilateral investment treaties such as the Energy Charter Treaty and the investment chapters of some FTAs such as NAFTA.[39] There are more than 2,500 such agreements globally; and almost all of the UK's 90+ BITs contain such provisions. These are widely recognised by business as extremely valuable mechanisms, supporting foreign direct investment valued at around US$1.75 trillion annually. They are designed to encourage investment, and to enhance the protection of investments abroad.

Such a mechanism can and should be part of a future EU-UK FTA. The UK already has BITs with 12 EU states – all of which provide for the ISDS mechanism described above.[40] These BITs were all entered into before these states joined the EU.[41] An investment chapter in a future EU-UK FTA could replace these 12 BITs, and provide similar rights and obligations in respect of investment uniformly across all EU states.

[39] In the EU-South Korea FTA, these provisions are incorporated by reference from the dispute settlement chapter to the trade in services, establishment and electronic commerce chapter.

[40] Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia.

[41] The European Commission has for several years now made clear its position that intra-EU BITs are incompatible with EU law, and in June 2015, it launched a first stage of infringement procedures against five Member States (Austria, the Netherlands, Romania, Slovakia and Sweden) to bring the intra-EU BITs between them to an end. Two other Member States – Ireland and Italy – already ended their intra-EU BITs in 2012 and 2013, respectively. On the other hand, the opinion issued by Melchior Wathelet (an Advocate General of the CJEU) in Slovak Republic v Achmea BV suggests that intra-EU BITs concluded before the accession of a Member State to the EU may not be incompatible with EU law (Case C 284/16, 19 September 2017).

Box 12: EU Competence to agree FTAs with ISDS

In its recent Opinion on whether the EU has exclusive competence to sign and conclude the EU-Singapore FTA, the CJEU stated that the EU does not have exclusive competence with respect to ISDS mechanisms. As a result, this matter, in particular, will require the approval of each of the EU's Member States.

If this matter is included as part of the EU-UK FTA, for the EU, the FTA would have to be agreed by the European Council and European Parliament, and also ratified by the Member States according to their national procedures. In practice, this means that 38 national and regional parliaments must separately approve the agreement, a process which could entail a significant stumbling block to finalising the agreement.

One way to avoid the delay of Member State ratification and the risk that the entire FTA could be vetoed would be to include ISDS in a separate agreement. Senior EU officials have suggested that the ISDS mechanism in the EU-Singapore FTA could be dealt with in a separate BIT. This approach, however, may not be entirely straightforward. Careful consideration will need to be given to this issue if the entry into force of the EU-UK FTA is conditional on the approval of the ISDS mechanism.

Under such agreements, and their likely variant in an EU-UK agreement, each state commits to promote and protect investments made in its territory by investors of the other state. As they are individually negotiated, each treaty is slightly different, but the substantive protections are significant, and typically provide for:

(a) Protection against expropriation/nationalisation without compensation and observance of due process;

(b) Fair and equitable treatment (including abstaining from any discriminatory measures, protecting legitimate expectations of investors);

(c) Full protection and security (i.e., physical protection of the investment);

(d) Non-discrimination and national treatment, being the same treatment as that given to nationals of the host state;

(e) MFN treatment, namely, treatment no less favourable than that given to nationals of any other countries not party to the BIT;

(f) Guarantee of repatriation of investment and returns; and

(g) A commitment by the host state to observe all obligations it has in relation to that investor – whether those be in the treaty, in a contract or otherwise.

The breach of any of these standards of protection may entitle an investor to compensation.

The design of ISDS mechanisms has been subject to intense debate in recent years and best practice is an evolving picture. An EU-UK variant will need to give due consideration to:

(a) The conditions under which disputes can be brought, and with respect to what forms of perceived injury;

(b) The mechanism for creating arbitration tribunals from a fixed group of tenured arbitrators in a way that respects the sensitivities of both sides while guaranteeing objectivity and impartiality – supported by a properly resourced secretariat;

(c) The procedural processes for tribunals, including the scope for third party amicus briefs. Here, the EU and the UK will want to draw on, or refer to, established protocols such as those set down by the ICSID Convention[42] or the United Nations Commission on International Trade Law ("UNCITRAL") Arbitration Rules[43];

(d) The potential establishment of a separate appeals process for first instance awards (as proposed in the EU-Vietnam FTA, CETA and through the European Commission's multilateral investment court proposal); and

(e) The enforcement mechanism for tribunal awards. An arbitral award can generally be enforced more easily than court judgments, particularly for awards made under the ICSID Convention, or where enforcement of a non-ICSID award takes place in one of the 156 states that are party to the New York Convention.[44]

One issue in the context of financial services is the compatibility of prudential measures with treaty commitments. There remains a balancing exercise between the right to regulate for a host state against the right to provide effective redress to investors. As a result, the ISDS provision in trade agreements has sometimes been modified in its application to financial services, e.g., to accommodate a determination on the validity of prudential measures as a defence to a claim, either jointly by the authorities of the host state and the claimant's state, or by a financial services committee established by the treaty.[45]

[42] The International Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID Convention"), entered into force on 14 October 1966.

[43] The ICSID Convention and UNCITRAL Arbitration Rules are established international processes for the management of international arbitration.

[44] The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958, entered into force on 7 June 1959.

[45] See e.g., Article 11.22, TPP. See also, Article 13.21, CETA and Article 1412, NAFTA.

Box 13: Recent EU approaches: EU-Vietnam FTA and the multilateral court proposal

EU policy on ISDS has evolved materially in the last five years, both as a result of a shift of the locus of investment policy to the European Commission in certain respects and an active public debate about the role of investment protection, especially in the TTIP and CETA negotiations. This has prompted a set of changes in the EU approach that can be expected to be applied in an EU-UK agreement. In particular, the EU has sought ways of institutionalising the dispute resolution process, maintaining a standing body of judges and providing clear and transparent rights of appeal.

The EU-Vietnam FTA

The EU-Vietnam FTA establishes an investment tribunal system between the two parties constructed around a two-tier standing tribunal. The first tier of the standing tribunal shall comprise nine members drawn equally from among nationals of the EU, Vietnam and third countries. Within 90 days of the submission of a claim, a three-member tribunal shall be created on a rotation basis from within the standing tribunal, with one national each from the EU, Vietnam and a third country.

Any appeals from the awards issued by the tribunal shall be heard by the appeals tribunal. The second tier of the standing tribunal comprises an appeals tribunal with six members, drawn equally from among nationals of the EU, Vietnam and third countries. Appeals shall be heard by a three-member tribunal with one national each from the EU, Vietnam and a third country.

CETA

A similar approach had been previously proposed in CETA, with a 15 member standing tribunal. Members to the standing tribunal are to be appointed for a fixed term (typically, four or five years) and can serve up to two terms. There are clear criteria for the qualifications and necessary experience of tribunal members.

Belgium has submitted a request to the CJEU for an opinion on the compatibility of the CETA investor-state dispute mechanism with EU law.[46]

The multilateral investment court proposal

The European Commission has proposed to "multilateralise" this approach via a new investment court system built around a permanent body to resolve investor-state investment claims.[47] The EU-Vietnam FTA requires the treaty parties to enter into negotiations for an international agreement providing for a multilateral investment tribunal. The CETA also contains a provision requiring the treaty parties to pursue the establishment of a multilateral investment tribunal with other trading partners. Despite having met with mixed responses, the European Commission has continued to develop its proposals in this area, including at the World Economic Forum in Davos in January 2017[48] and at the 50th Session of UNCITRAL in July 2017.[49]

[46] See Kingdom of Belgium Foreign Affairs, Foreign Trade and Development Cooperation Press Release, *Minister Reynders submits request for opinion on CETA* (6 September 2017).

[47] In this regard the European Commission appears to be working together with the Canadian Government, European Commission Press Release, *European Commission welcomes Parliament's support of trade deal with Canada* (15 February 2017); see also, Steffen Hindelang, Teoman M. Hagemeyer, European Parliament, Directorate-General for External Policies, Policy Department, *Study – In Pursuit of an International Investment Court. Recently Negotiated Investment Chapters in EU Comprehensive Free Trade Agreements in Comparative Perspective* (July 2017).

[48] Kimberley Botwright, *What now for global trade? 8 things we learned from Davos 2017* (27 January 2017); Cecilia Malmström, *In Davos, discussing investment disputes* (19 January 2017).

[49] UNCITRAL, Investor-State Dispute Settlement Framework, Compilation of comments, A/CN.9/918 (31 January 2017).

Glossary

BaFin	German Federal Financial Supervisory Authority
BBA	British Bankers' Association
BITs	Bilateral investment treaties
CETA	EU-Canada Comprehensive Economic and Trade Agreement
CFTC	US Commodity Futures Trading Commission
CJEU	Court of Justice of the EU
CRD	Capital Requirements Directive
DSB	WTO Dispute Settlement Body
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATS Understanding	Understanding on Commitments in Financial Services
GATT	General Agreement on Tariffs and Trade
ICSID Convention	International Convention on the Settlement of Investment Disputes between States and Nationals of Other States
ISDS	Investor-state dispute settlement
MFN	Most favoured nation
MiFID II	EU Markets in Financial Instruments Directive
MiFIR	EU Markets in Financial Instruments Regulation
MRA	Mutual recognition agreement
NAFTA	North American Free Trade Agreement
PRA	UK Prudential Regulation Authority
SEC	US Securities and Exchange Commission
SEPA	Single Euro Payments Area
TiSA	Trade in Services Agreement
TTIP	EU-US Transatlantic Trade and Investment Partnership
TPP	Trans-Pacific Partnership Agreement
UNCITRAL	United Nations Commission on International Trade Law
WTO	World Trade Organisation