

Third Country Access and the Evolving UK Approach

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Context

- **Largest UK reform agenda in decades**
 - UK financial regulation at an inflection point
 - Major reform agenda: political and technocratic articulation of ‘take back control’
 - Regulatory Initiatives Grid/Financial Services Regulatory Initiatives Forum
 - Substantial deregulation (HM Treasury + Financial Conduct Authority (FCA))
 - Official Listing: Hill Review (2021) and subsequent FCA reforms
 - Already: dual class shares; increase in minimum market capitalization; reduction in free float
 - Currently: related party transactions
 - Prospectus: HM Treasury (2021) and (2022)
 - Secondary Capital Raising (Austin) Review (2022)
 - Wholesale Markets Review (2021)
 - Primary Markets Effectiveness Review (FCA) (ongoing)
 - 2022 Edinburgh Reform Agenda (large-scale across banking and financial markets)
 - Not just EU measures: ringfencing - HM Treasury (2023)

Context

- + Institutional reform: Financial Services and Markets Bill 2022 2023 (in final stages)
 - Future Regulatory Framework Review
 - Phased, system-oriented review
 - Implications of rule-making competence for financial markets reverting to UK
 - Mandates and accountability arrangements for UK regulators
 - Greater Parliamentary scrutiny; *competitiveness/growth* objective
 - This would be a new secondary FCA objective
 - Primary objective - ensure markets function well
 - When discharging its general functions, the FCA must, so far as reasonably possible, act in a way which, as a secondary objective, advances the competitiveness and growth objective

Context

- + Institutional reform: Financial Services and Markets Bill 2022 2023 (in final stages)
 - The competitiveness and growth objective is: facilitating, subject to aligning with international standards, the international competitiveness of the economy of the UK (including in particular its financial services sector); and its growth in the medium to long term
 - Obligation also to ensure competitiveness/growth embedded in operations, processes, and decision-making (and related reporting)
 - FCA working on how to ‘operationalize’ it

Context

- + Repealing of ‘on-shored’ EU financial regulation (the single rulebook)
 - Through Financial Services and Markets Bill
 - On-shored through European Union (Withdrawal Act) 2018 + correction of deficiencies (statutory instruments)
 - UK Prospectus Regulation/UK Short Selling Regulation/UK MiFIR
 - May be less radical than seems - current indications
 - No change for the sake of change
 - Much of EU law remains appropriate in substance

Context

- **Driving interests and incentives**
 - ‘Take back control’ and political context
 - + Competitiveness: public equity markets (since Kay Review (2012))
 - 2021 Hill Review: limited capacity to attract high growth issuers/low valuations
 - LSE (2022) (62% drop in IPOs); 2023 de-listings to US (CRH); 2023 Arm
 - Crisis in equity markets?
 - Response: new ‘secondary’ objective for FCA - competitiveness
 - + Large-scale liberalization/refinement of listing and prospectus regimes
 - Remains a political priority despite fragility in markets globally/financial stability risks
 - March 2023 Budget - Chancellor commitments on listing; May 2023 FCA proposals
 - And despite limits of regulatory levers (interest rate environment/macroeconomic policy/market structure - peer groups + valuations)
 - And despite some political wariness (Labour Party)

Context

- **Implications for third country access to the UK post Brexit**
 - Driving competitiveness objective
 - Reforms to international regime to secure attractiveness
 - Signal an 'open' approach
 - Shaped by outcome of Trade and Cooperation Agreement and related risk of frictions to UK access and drift to EU
 - Related reforms underway (ahead)

Context

- **Caution needed**
 - Third country arrangements usually technocratic; epistemic regulatory networks
 - Now - a deeply political space: third country arrangements a proxy for wider UK/EU political relations over and since Brexit
 - → Uncertain trajectory
 - Withdrawal Agreement and Northern Ireland Protocol
 - UK political context; Bill to suspend the Protocol
 - → Lack of progress on EU equivalence process; and failure to adopt TCA's proposed MoU on financial service cooperation
 - February 2023: Windsor Framework
 - Normalization of political relations
 - May 2023 and Commission draft MoU adoption
 - But: UK deregulation and competitiveness v. EU and CMU (Dec 2022 reforms)
 - Dynamism likely - but, regardless, so far equivalence largely irrelevant for UK access

The TCA and Equivalence Arrangements

- **The Withdrawal Process**
 - EU regime: equivalence and deference (or subsidiaries/other routes (delegation))
 - 1 January 2021 (end of transition period in WA and application of TCA), UK access dependent on EU access requirements
 - Potential for friction well-signalled prior to 2021 given interdependencies
 - Loss of ‘passport’: contractual continuity/financial stability/liquidity risks
 - Complex and multi-faceted response, across two cliff edges (A50 TEU and 1 April 2019; WA and 1 Jan 2021)
 - Ex: NCAs and temporary permissions; market preparations (outsourcing/subsidiaries); two temporary equivalence arrangements (CCPs and CSDs)
 - Political negotiations?
 - UK: Lack of traction by financial services - late in the day - bespoke equivalence regime (dynamic alignment/outcomes based: Mansion House Speech (2018)/Chequers Framework (2018))
 - EU: no cherry picking and competition (CCPs v trading venues)

The TCA and Equivalence Arrangements

- The TCA
 - No bespoke UK arrangements for financial services
 - Classic EU FTA, based on WTO establishment and non-discrimination rights
 - Prudential carve out and ‘right to regulate’ (incl equivalence)
 - PM Johnson reaction: ‘perhaps does not go as far as we would like’
 - EU: UK firms to use standard EU access routes
 - Immediate impact: the MiFIR Share Trading Obligation January 2021 (no equivalence decisions for UK trading venues)

The TCA and Equivalence Arrangements

- **Equivalence**
 - Only one decision in place for UK (CCPs - to 2025)
 - Subsidiaries; and delegation/outsourcing
 - Legally stable routes (delegation (AIFMD)?)
 - But: advantages from equivalence passport, particularly MiFIR
 - UK posture on equivalence and alignment?
 - On-shored rulebook more-or-less identical; transaction costs
 - But regulatory autonomy and ‘take back control’ - political + technocratic - divergence in terms of ‘what is right for the UK’ - although no ‘bonfire of regulation’
 - ‘Rule-taking’ and risks to the City/UK taxpayer
 - CCP flashpoint (+ bankers’ bonuses)
 - EU posture on equivalence?
 - Oct 2019 Political Declaration conclude equivalence assessments by June 2020
 - Commission concern re signalled UK regulatory reform
 - Northern Ireland Protocol

The TCA and Equivalence Arrangements

- **2023 Windsor Framework and facilitation of equivalence?**
 - Normalization of political relations
 - May adoption by Commission of draft MoU: create an administrative framework for voluntary regulatory cooperation
 - Establishment of Joint EU/UK Regulatory Forum
 - Like US Forum
 - ESAs/ECB/SRB/Commission + US Treasury, Federal Reserve, Comptroller of Currency, CFTC, SEC, FDIC
 - Themes/sharing views (Feb 2023: financial stability risks/sustainable finance/regulatory developments in banking and insurance/operational resilience and digital finance/cooperation in capital market/AML and CTF)
 - Exchange of views
 - COM: MoU does not address single market access or ‘prejudge the adoption of equivalence decisions’

The TCA and Equivalence Arrangements

- Draft MoU 19 May 2023
 - Shared objective of preserving financial stability, market integrity, and investor/consumer protection
- Arrangements to provide for
 - -Bilateral exchanges of views and analysis on regulatory developments/issues of common interest
 - -Bilateral exchanges of views on market development/financial stability
 - -Enhanced cooperation and coordination in international bodies as appropriate
 - -*Transparency and appropriate dialogue in the process of adoption, suspension, and withdrawal of equivalence decisions*

The TCA and Equivalence Arrangements

- Draft MoU May 2023
- Joint EU-UK Financial Regulatory Forum: platform to facilitate structured regulatory cooperation
 - Including considering working towards compatibility of each other's standards
 - Exchanges of views on the respective policies, rules and processes concerning deference regimes, such as equivalence, or other tools used to address cross-border issues
 - Dialogue on the Participants' autonomous decisions to adopt, suspend or withdraw equivalence relevant to one or the other side

The TCA and Equivalence Arrangements

- Headwinds to equivalence
- Significant deregulation in the UK
- And will meet a less accommodating equivalence process given the changes to equivalence, since 2019 in particular
 - Less deferential (MiFIR)
 - More on-shored (ESMA as gatekeeper)
 - Scope of regime (MiCAR; securitization)
- But:
 - Synergies between UK and EU reforms? (Listing Act/unbundling)
 - Some signals of a more liberal approach to equivalence (benchmarks)
 - Greater technocratic engagement by ESMA as a moderating effect (MoUs with UK regulators)?
- Ultimately: interests will play out along the competition vector - UK (current agenda) and EU (CMU)
- + Open Strategic Autonomy
- + EU will act in strategic interests: CCPs v trading venues

The UK Third Country Regime

- The UK approach
 - Pre Brexit, followed EU/equivalence arrangements, where applicable
 - EU Prospectus Regulation eg
 - + distinct UK requirements (treatment of branches/the ‘regulatory perimeter’: Overseas Persons Exclusion (OPE) and Financial Promotions Order)
 - Leaned towards a permissive, MS-driven approach in EU negotiations
 - Compare US as ‘great power’ in international financial relations (national treatment)
 - Longstanding concerns re competitiveness and openness
 - 2006 Investment Exchanges and Clearing Houses Act
 - Concerns to protect London Stock Exchange in a US takeover context and potential application of US rules
 - FSA veto power where rules ‘excessive’, not required under UK law, not justified as pursuing a reasonable regulatory objective, disproportionate to ends sought

The UK Third Country Regime

- UK and EU access post-Brexit
 - Temporary Permissions Regime (TPR)
 - EU/EEA firms operating in UK under passports could continue to operate while sought full authorization under UK law
 - Only available where firm sought to operate in UK long-term and committed to full authorization
 - Firms could be asked to stop undertaking new business/removed from TPR if they missed their 'landing slot' for authorization (all firms in TPR given a slot for authorization)/did not intend to apply for authorization/authorization refused by FCA
 - Run-off business facilitated by Financial Services Contracts Regime
 - Enforcement: Four cancellations by FCA
 - To end by Dec 2023
 - Temporary Marketing Permissions Regime (TMPR)
 - Facilitated marketing of funds under temporary permissions
 - Due to close in 2021, but extended to end 2025 while new regime (ahead) put in place

The UK Third Country Regime

- ‘FCA Approach’ to third country firm authorization/branches
 - Given significant increase in such activity by EU/EEA firms
 - 2021: ‘Approach to International Firms’ - not a reform; indication of approach
 - Commitment to open-ness and competitiveness
 - Important contribution made by such firms, commitment to ‘open and vibrant markets’ in UK, role played by international firms in supporting smooth functioning of UK wholesale markets
 - Authorization where relevant requirements met and firms have good risk mitigation in place
 - Not light touch; operates under FSMA 2000 on a case-by-case basis
 - Third country branches
 - More complex for FCA to take supervisory action/overlapping rules
 - Need for mitigation re retail harm/client asset harm/wholesale harm
 - Branch management (fit and proper’ requirements)/asset protection/FCA capacity to supervise conduct/potential outcomes in insolvency
 - If sufficient risk mitigations not in place - restrictions on business/require subsidiary (UK domestic regime with accommodations)

The UK Third Country Regime

- + Equivalence decisions re EU
 - HM Treasury (9 November 2020)
 - Large series of decisions, including re IFRS
 - Adopted before end of transition period to facilitate EU-based business
 - Also signal reciprocity

Reform

- (1) Prospectuses
 - Strong logic given relatively sophisticated state of international engagement (IOSCO) + bilateral mutual recognition (US/Canada; Australia/NZ)
 - Currently based on 2017 PR
 - 2021 Review - PR not optimal
 - A28 (UK rules; FCA approval): rarely used
 - A29 (TC rules; FCA finds these equivalent; FCA approval): never used
 - Regime narrow (use of international standards?)/requires FCA review/cumbersome
 - Limited impact given reliance on exemptions (qualified investors, eg)
 - More liberal regime could support TC retail offers and offer wider investment/diversification opportunities for retail investors

Reform

- **Prospectuses**
 - Three options
 - -Status quo
 - -Prohibition on all third country prospectuses
 - -‘Regulatory deference’
 - No FCA approval required for TC approved prospectus
 - Investor protection risks considered on a ‘holistic’ basis by a more general review of approach of the TC, including as regards issuer ongoing disclosures
 - HM Treasury to review the jurisdiction as regards adequacy of investor protection approach generally and its regulatory cooperation requirements
 - High level review supported by back-stop FCA powers to close an offer where detrimental to interests of investors in UK
 - Resonances with US SEC, pre-crisis: ‘substitute compliance’ experiment
 - 2008; opening of discussions with Australia (closed 2013)
 - Also with US/Canada and NZ/Australia - but wider reach

Reform

■ Prospectuses

- Outcome (2022): regulatory deference approach
- Scope: securities listed on *certain designated overseas markets* (so ‘enrolling’ admission/venue rules)
- FCA not review the TC prospectus, once jurisdiction had met high-level equivalence-like benchmark re approach to investor protection (HM Treasury) - ‘assessment of overall effectiveness of the regulation of the overseas market’; exceptional intervention powers for FCA
- Significance?
 - Strong articulation of regulatory deference
 - Pivot from formal equivalence
 - Resonances with other bilateral arrangements for prospectuses, but much wider
 - Supported by gatekeeper function of trading venues (offer must be admitted to a designated overseas trading venue (not clear if equivalence arrangements would apply to designation)); not secondary offers only?
 - Operational detail awaited, but clear signal of intent
 - Open-ness; concern to widen retail market access

Reform

- Prospectuses
 - Progress?
 - Awaiting further indications
 - Not included in the series of May 2023 FCA engagement papers on review of the prospectus regime
 - Once FCA has new rule-making powers

Reform

■ (2) Investment Funds

- Reforms already adopted: similar, high-level equivalence regime + deference
- Overseas Funds Regime (OFR): Financial Services Act 2021
- Two outcomes-based regimes: retail funds; money market funds
- Not line-item equivalence, but overall assessment of jurisdiction
- Governing assumption: different approaches to regulation can achieve the same objective - exactly similar regulation not necessary
- + Competitiveness; retail investor access to wide range of funds (many funds, particularly ETFs, domiciled outside the UK)

Reform

- Retail funds:
 - Recognized by FCA once equivalence determination in place and marketing to retail market allowed
 - Equivalence? TC providing at least equivalent protection on an outcomes-basis, as compared to UK authorized funds, and supervisory cooperation arrangements
 - Exceptional power for HM Treasury to impose specific conditions on certain categories of funds (only retail funds) - and must avoid disproportionate regulation of TC funds
 - Equivalence process and recognition process now underway - estimate will take two years to process some 8,000 funds eligible

Reform

- (3) Overall design
 - Consideration of overall regime (exemptions for TC business (ie the OPE)/sector-specific equivalence arrangements)
 - Current FCA Business Plan: improve attractiveness and global reach of wholesale markets
 - HM Treasury, Overseas Framework. Response to Call for Evidence (2021)
 - Prompted by UK withdrawal and ‘opportunity to look at [the] overseas framework, and the regimes within it, to ensure that they continue to work effectively and support UK consumers, firms, and markets’ and as part of the process of ‘considering how we best move forward as an independent nation and as a global centre for financial services’
 - Regulatory perimeter (when financial services business within/without the UK)
 - Tilt towards liberalization - but: financial stability/investor protection imperatives
 - Impact of current market fragility?
 - Political economy?

Reform

- **The review is to consider (HMT, Overseas Framework Review, 2023):**
- ‘whether the operation of the regime appropriately balances openness while mitigating risks to the resilience and safety of financial markets, the protection of consumers, and market integrity, and the promotion of competition’
- The related governing principles include (alongside ensuring appropriately robust regulation; resilient and safe financial markets and the support of financial stability, market integrity, and consumer protection, supporting sustainable finance; transparency and predictability; stable and reliable arrangements for cross-border access; and enabling effective international cooperation) facilitating ‘the benefits of maintaining an open and globally integrated financial system, enabling international financial services business by reducing barriers and frictions where practicable’

Reform

- Ex: Crypto-assets (2023)
 - Idiosyncratic to UK context - but likely to contain equivalence arrangements
 - HM Treasury intends to pursue equivalence type arrangements whereby firms authorised in third countries can provide services in the UK without needing a UK presence, provided they are subject to equivalent standards and there are suitable cooperation mechanisms to help make this work
- Compare EU approach

Conclusion

- **A Modest Prediction**
 - International financial relations as much a creature of politics as of technocracy
 - → Highly dynamic and unpredictable context
 - + Acute political interests; mediated across competition vectors; market fragility
- **UK**
 - Regime under active review, framed by Brexit-related wider review of financial regulation + tradition of supporting openness
 - Prompted by UK withdrawal and coloured by it but also distinct drivers (UK equity markets)
 - Will benefit EU - reciprocity?
 - How radical is it?
 - Prospectus and international examples
 - Funds and deference to the EU regime (limited risks: UCITS/AIFMD)

Conclusion

- **EU**
 - Importance of a reversion to technocracy and away from politics
 - MoU
 - ESMA/UK regulators
- **Global financial governance**
 - UK influence at international standard setters
 - Current market context

■ THANK YOU FOR YOUR KIND ATTENTION