

Priorities for the EU-UK negotiations

Setting the right course

Recommendations of Deutsches Aktieninstitut on the future relations between the EU and UK with focus on financial services on the occasion of the third round of EU-UK negotiations, 11 May 2020

1. Introduction

On 23 June 2016, the United Kingdom (UK) voted in favor of leaving the European Union (EU). On 31 January 2020, the UK officially left the EU. The UK is now in a transition period, which will at least last until 31 December 2020. From 1 February 2020 until the end of the transition period, the UK remains within the EU internal market and is subject to EU legislation.

After two rounds of negotiations on an EU-UK free trade agreement, it is still largely unclear how the future relation between both parties will be designed after 31 December 2020.

The cross-sectoral Brexit Task Force of Deutsches Aktieninstitut has been contributing to the Brexit discussions both on national and on European level since 2016. The Task Force comprises non-financial companies, financial intermediaries, investors, rating agencies as well as stock exchanges. It therefore represents the entire spectrum of the financial markets ecosystem and is hence ideally placed to provide policy makers with a holistic view on economic issues post-Brexit. Against this background, Deutsches Aktieninstitut has drafted its fourth Brexit position paper, which reflects the views of its various members on the ongoing negotiations between the EU and the UK.

2. Executive Summary

In a nutshell, Deutsches Aktieninstitut suggests:

- ▶ Negotiations on a free trade agreement should focus on the right balance between financial and non-financial issues.
- ▶ The free trade agreement should include provisions on non-discriminatory treatment of financial market participants.
- ▶ It should also be addressed that none of the two parties imposes disproportionate bureaucratic hurdles on financial market participants active on their respective markets.
- ▶ In the field of goods and non-financial services, the prospective free trade agreement should include provisions on
 - a. the coordination on technical standards
 - b. rules of origin that are designed business-friendly as regards to the movement of goods
 - c. the simplified authorization for the delegation of workers
 - d. the non-discrimination of companies concerning public procurement and tax allowances. Furthermore, the legal framework needs to ensure a level playing field, which relates especially to state-aid and comprises dispute settlement mechanisms.

- ▶ In addition to the negotiations on a free trade agreement, equivalence regimes in the field of financial services need to be improved:
 - a. equivalence decisions should be taken reciprocally.
 - b. the scope of equivalence regimes should be extended.
 - c. the processes of equivalence decisions should be revised to provide predictability for market participants.
- ▶ The overall aim of strengthening financial market structures in the EU should be taken into account during the negotiations.

Negotiations between the EU and UK on a free trade agreement started on 2 March 2020. In June 2020, both parties plan to do a stocktaking to assess how far the negotiations have proceeded so far. The timetable shows that the parties do not have a lot of time to come to an agreement. The Corona crisis tightens the timetable even more and the negotiating parties decided in March 2020 to continue negotiations via videoconference. Against this background, the possibility of extending the transition period into 2021 could be considered.

3. Future Relation in Financial Services

It has been outlined by the EU Commission that the future relation between the EU and the UK in financial services could be based on three pillars:

- ▶ Conditions set out in a future free trade agreement

As outlined in the draft legal text proposed by the EU Commission on 18 March 2020, provisions on financial services in a future free trade agreement are envisaged. However, the provisions would be very limited in scope, since they would most likely entail a broad prudential carve-out.

- ▶ Close cooperation on regulatory and supervisory matters in international bodies

Both parties agreed in the political declaration that close and structured cooperation on regulatory and supervisory matters is in their mutual interest. The cooperation would be voluntary and be based on the principles of regulatory autonomy, transparency and stability.

- ▶ Assessment and granting of equivalence

After the UK withdrawal from the EU, both parties started assessing the equivalence frameworks in place with respect to each other. Both parties endeavor to conclude the assessments on equivalence before end of June 2020.

4. Proposals of Deutsches Aktieninstitut

The large majority of Deutsches Aktieninstitut's member companies are well prepared for the possible next steps regarding Brexit concerning the area of financial services. As companies had to prepare for the past Brexit deadlines, they have already been able to make internal arrangements, i.e. to transfer financial market related operations and contracts etc. In addition, alternative liquidity pools and market infrastructure have been established within the EU in the meantime, with the aim of catering for the need of European companies.

Nonetheless, capital markets in Europe still need to be further developed in order to provide market participants with a broader range of services. Finally, companies require some notion of predictability as regards the future relations between the EU and the UK in the financial and non-financial markets area, since decisions on Brexit impact business processes and daily business.

Due to the time pressure of the negotiations, Deutsches Aktieninstitut pledges for an EU-only free trade agreement, which could be ratified swifter than a mixed agreement. It should thus be in the interest of both negotiating parties to focus on policy areas that fall under exclusive EU competence. A free trade agreement, which falls also under the competence of EU member states, would entail a longer ratification procedure, as also national parliaments would have to ratify the agreement.

Deutsches Aktieninstitut has compiled a list of issues that should be taken into consideration during the current negotiations.

4.1 Financial services in a free trade agreement

It is still unclear if provisions on financial services will be included in the future agreement. According to the EU Commission, if provisions were to be included, they would be limited as regards to market access. The provisions on financial services would most certainly also include a far-reaching prudential carve-out. Both parties would keep the ability to adopt or maintain any measure for prudential reasons.

The free trade agreement should however include provisions on non-discriminatory treatment of financial market participants. In the free trade agreement, it should also be addressed that none of the two parties imposes disproportionate bureaucratic hurdles on financial market participants active on their respective markets. It should rather include provisions allowing for business-friendly solutions. Especially against the background that this free trade agreement might be concluded by two negotiating parties that have been aligned in financial markets

regulation for a long time, the starting point is different compared to free trade agreements with other third countries.

Given the time constraints of the negotiations, Deutsches Aktieninstitut proposes to fairly balance the issues according to their significance in the negotiations. For example, market access for goods and non-financial services should deserve particular attention as they cover the core business relations between EU and UK market participants.

4.2 Equivalence and adequacy decisions

Equivalence regimes (adequacy decisions in the field of data protection) will become a major tool to allow market access both in the EU and the UK after the transition period expires.

In our opinion, the following guiding principles should apply to the procedure of equivalence assessment, decision taking and withdrawal of equivalence decisions in order to ensure predictability for market participants:

- ▶ Scope of equivalence regimes

Currently, equivalence regimes only cover a limited amount of financial services. The EU Commission should reflect on broadening the scope of equivalence regimes, especially in the field of licensable services.

- ▶ Transparency

There should be increased transparency regarding the process, progress and timing of equivalence decisions. Fostering the transparency of the process would provide increased confidence for market participants.

We believe that there exist various ways to foster transparency, notably by putting in place clear mechanisms for consultation between the EU and third country authorities, regular updates and dialogue with market participants to ensure that they are updated regarding the timing and progress of decisions to grant or withdraw equivalence, including the indication on the timing of decisions.

We also believe that beyond dialogue with market participants, private sector input in form of consultations would be advisable. This way, the process would gain structure and transparency would be further enhanced.

- ▶ Timeliness of the process

For the sake of predictability, equivalence assessments should be completed in a timely manner. This is particularly important where equivalence assessments have

significant implications for market participants. Therefore, adequate resources should be deployed to equivalence assessments to ensure a swift process. Also, clarifying in advance the information that would be required from the third country authorities and firms would accelerate the process even further.

▶ Withdrawal of equivalence

There is currently a lack of clarity over the process and timing of any potential withdrawal of equivalence. The unilateral withdrawal of equivalence should be viewed as a last resort and follow a clear procedure including dialogue with the relevant third country and affected market participants. Regarding the latter, the EU Commission has in practice included and informed relevant parties. Certainty would however be increased if such principles were stated in a clear and general manner.

In addition, mechanisms should be put into place to avoid abrupt withdrawal of equivalence where this would be likely to give rise to market disruption. For instance, a one-month notice would be insufficient for end-users and market participants to make adjustments to their business. This applies especially to areas such as access to important third country market infrastructure, or to provide certainty on continuity of existing contracts.

▶ Reciprocity

We believe that for the proper functioning of financial markets and for smooth business processes, equivalence decisions should be reciprocal, i.e. not only allowing UK firms to have access to the EU single market, but instead being conditional on granting the same right to EU firms, too.

4.3 Independent financial market structures in the European Union

To ensure liquidity and a broad range of services for market participants after Brexit, strong capital markets in Europe should be envisaged.

Establishing stable financial markets in the EU also matches with the political objective and market need to strengthen the capital markets union of the EU. Strong and well-designed capital markets are the lifeblood of the European economy. Raising capital is crucial to enable companies to grow and provide jobs in Europe. Financial markets are also an essential prerequisite for innovation.

At the same time, policy makers should refrain to adopt measures that act counter to efforts to creating a capital markets union, e.g. the discussions on the Financial Transaction Tax (FTT). Deutsches Aktieninstitut firmly rejects the idea of a FTT, which would counteract the strengthening of Europe's financial markets.

4.4 Market access for goods and services in a free trade agreement

On goods and services, the free trade agreement should not only deliver on tariffs, but also on rules regarding customs administration. Time delays due to increased customs controls and increased bureaucracy must be avoided. The rules in the free trade agreement should allow for fast and uncomplicated processes at the borders. In an economy based on the division of labor, the time factor is central to the functioning of supply chains. Increased inventory cannot be the solution and companies cannot switch their suppliers easily.

Next to business-friendly rules that allow for fast customs checks at the borders, the following topics should be addressed in a future free trade agreement:

- ▶ Coordination on technical standards in view of alignment.
- ▶ Rules of origin and their usage should be designed business-friendly.
- ▶ The validity of product licenses has to be preserved and future licensing coordinated.
- ▶ Rules on public procurement should allow for discriminatory-free access to public tenders.
- ▶ The free trade agreement should include provisions on non-discrimination of companies regarding tax allowances.
- ▶ The legal framework needs to ensure a level playing field, which relates especially to state aid and comprises dispute settlement mechanisms.
- ▶ The absence of the free movement of workers jeopardizes the delegation practices in companies with sites in the UK. At least a simplified authorization is needed.

4.5 Legal and operational issues

- ▶ EMIR 2.2

Deutsches Aktieninstitut welcomes the final deal on EMIR 2.2 as it strikes the right balance between financial stability imperatives. As part of the finalization of EMIR 2.2 and the upcoming level 2 measures, the criteria to determine the systemic relevance of central counterparties is a crucial element. However, they will have to strike the right balance between addressing legitimate financial stability concerns due to Brexit and not creating unjustified tensions with other jurisdictions.

- ▶ § 9 of the Stock Exchange Admission Regulation

According to § 9 of the Stock Exchange Admission Regulation (*Börsenzulassungs-Verordnung*), the shares admitted to trading on the regulated market in the case of an initial public offering must be sufficiently diversified. This means that at least 25 percent of the shares must be purchased by investors from one or more member states of the European Union or the EEA. With Brexit, the free float requirement

becomes a problem, as it is regularly met by counting UK investors among the 25 percent. Due to Brexit, these investors can no longer be taken into account for the free float requirement, which then no longer has to be met in the form it takes. This contradicts the political will to make the stock exchange more attractive as a financing instrument, especially for growth companies.

In order to continue to make IPOs possible in the short term, at least a transitional period until the end of 2020 should be agreed. Until then the Stock Exchange Admission Regulation should be revised. The free float regulation is reasonable and should remain in place. However, the regional restriction must be dropped.

5. Summary and Outlook

Deutsches Aktieninstitut pledges for balanced and fair negotiations between the EU and UK. Talks should take into account the interests of financial market participants. Deutsches Aktieninstitut is in favor of a EU-UK relation that leads to as little market disruption as possible.

It is up to the negotiators to reach objectively substantiated and rational decisions, which achieve the best possible outcome for all affected parties taking into account all consequences. Deutsches Aktieninstitut and its members are available to act as competent discussion partners at any time.

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