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MUTUAL RECOGNITION – A BASIS FOR MARKET ACCESS AFTER BREXIT

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The International Regulatory Strategy Group

The International Regulatory Strategy Group (IRSG) is a practitioner-led body comprising leading UK-based figures from the financial and related professional services industry. It is one of the leading cross-sectoral groups in Europe for the financial and related professional services industry to discuss and act upon regulatory developments.

Within an overall goal of sustainable economic growth, it seeks to identify opportunities for engagement with governments, regulators and European and international institutions to promote an international framework that will facilitate open and competitive capital markets globally. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing industry views.

TheCityUK and the City of London Corporation co-sponsor the IRSG.

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1 EXECUTIVE SUMMARY

The IRSG Report on *Third Country Regimes and Alternatives to Passporting*, published on 23 January 2017, concluded that the preferable model for a future relationship between the UK and EU is to have a bespoke agreement under which mutual rights of access to each other's markets would be allowed.

The government's White Paper of 2 February 2017 and the Article 50 letter served by the UK on 29 March 2017 suggest that the UK's intention is to have the freest possible trade in financial services between the UK and EU member states (as similar in scope to the passporting regime as is realistic and possible), and a bespoke mutual access model (which would cover all aspects of financial services, including both retail and wholesale business) is seen as the best model for achieving that objective.

The purpose of this IRSG Report on *Mutual Recognition – A Basis for Market Access After Brexit* is to look in more detail at what mutual recognition would look like – i.e. to consider some of the key issues that would need to feature in any bespoke arrangement based on mutual recognition and which would form part of a wider free trade agreement ("**FTA**") between the EU and UK. The Report assumes that the UK would be looking for the widest possible rights of access, potentially including all four of the modes of supplying services that are typically covered by FTAs.[1]

As the UK and EU already have matching regulatory and supervisory frameworks and standards, a broad agreement for mutual access can be based on mutual recognition of each other's regulatory frameworks and standards. This will require a mechanism for regulatory alignment to be set down in the financial services chapter of a wider FTA.

This Report identifies the following issues as being key to agreeing a broad bespoke arrangement for mutual access:

(a) The criteria for access

There should be clear and transparent criteria which provide the basis for mutual access to each other's markets. A number of criteria have been used in free trade agreements and other similar arrangements and the details of these criteria are considered in the Report.

Where global standards are available and offer a sufficient degree of robustness and detail, the criteria for access could be based on those standards.

1 The four "modes" for providing services on a cross-border basis which commonly feature in free trade agreements (such as CETA) are:
(1) facilitating the provision of cross-border services from one territory to the other;
(2) permitting the sale of products in a territory for visitors from the other territory;
(3) the right to establish a physical presence such as a branch or a subsidiary in the other territory; and
(4) the right for individuals to visit the territory of the other in pursuit of financial service business.

Where there are no global standards, the relevant criteria should be based on the outcomes which the relevant regimes achieve. The bespoke arrangement should set out principles (e.g. consistency) which should govern the desired outcomes and how their achievement is measured. The International Organization of Securities Commissions ("**IOSCO**") has published some useful guidance in this area but the UK and EU should consider whether they need to develop their own principles.

(b) Mechanisms for assessing and maintaining regulatory alignment

Formal mechanisms for consultation and co-operation between the respective regulatory authorities of the UK and EU will be required in order to ensure ongoing alignment, particularly in the context of change. A number of examples of such mechanisms are considered in the Report.

The relevant forum should require the sharing of information. It should actively monitor the areas where divergence might arise and be empowered to make an assessment of the materiality of any divergence. The process should be transparent and based on a technical assessment of materiality.

Where there is material and adverse divergence, there should be processes to allow the parties to take steps to address the position without losing rights of access. If such divergence cannot be avoided, there should be agreed processes governing the withdrawal of the arrangement – which should give affected firms sufficient time to adapt to the loss of the relevant access right.

It may not be possible to have a "one size fits all" approach. It may be appropriate to have different hierarchies of fora, and for there to be different fora for different types of regulated business.

(c) Dispute resolution

A dispute resolution mechanism is necessary to deal with disputes that may arise between the UK and EU in relation to the bespoke arrangement.

A dispute resolution mechanism between the UK and EU is likely to have to consider regulatory divergence, and the terms of the FTA should spell out what the consequences would be if one of the parties ceased to meet the criteria for access.

There are numerous examples of dispute resolution mechanics associated with free trade agreements and similar arrangements. Some of these have elements that may be useful for a UK-EU arrangement.

It would also be open to the UK and EU to develop an entirely new model for dispute resolution.

This Report also considers a further question – namely whether mutual market access could in some situations be allowed without there being a mechanism for regulatory alignment. Some EU member states currently allow overseas firms to deal in certain areas or with certain categories of investor in that state without being authorised in that state. An example is the UK's overseas person exclusion. If such an approach was built into the bespoke arrangement, that could lead to a situation where access was allowed even where the respective regimes are not necessarily aligned.

Some of the issues raised by this Report (such as the criteria for access) relate specifically to financial services, but other issues (such as dispute resolution) may also apply in relation to other sectors of the economy that would be within the scope of any bespoke arrangement between the UK and the EU. We have not considered those other sectors in this Report.

Further work will now be undertaken to develop and evaluate the various options from current arrangements that could be adopted, to identify new solutions and to start to identify the components of a bespoke mutual access agreement.

This Report does not consider in detail all of the components that an FTA might contain. It focuses primarily on regulatory alignment, the mechanisms for the relationship and on dispute resolution. FTAs typically contain other standard provisions, such as most-favoured-nation clauses and prudential carve-out provisions, which would need to be considered in more detail in the context of a future EU/UK relationship.

It is intended that a further paper will consider all the issues raised in this Report, in relation to their place within a UK/EU FTA.

2 BACKGROUND

The White Paper of 2 February 2017 announced the intention of the UK Government to secure a comprehensive (i.e. multi-sector) and bespoke free trade agreement with the EU[2] that provides the greatest possible access to each other's markets. It is now clear that the UK will not seek membership of the Single Market, effectively ruling out market access via existing EU "passporting" or EEA models.

A number of models for the future relationship between the UK and the EU have been put forward, in particular:

(a) "Bespoke mutual access"

This would be a bespoke arrangement for mutual access for financial services, along the lines proposed by the UK Government in its White Paper. Under such an arrangement, the UK and the EU would allow access to each other's markets and set out the conditions for such access.

This is very much the approach preferred by the IRSG, and it was recommended in the IRSG paper, *The EU's Third Country Regimes and Alternatives to Passporting*, published in conjunction with Hogan Lovells, on 23rd January 2017 (the **"IRSG TCR Report"**).[3]

The bespoke mutual access agreement could potentially be made via an FTA negotiated and concluded in accordance with the process set out in Articles 207 and 218 of the Treaty on the Functioning of the European Union. Any such FTA would need to comply with the relevant WTO rules.[4]

As suggested by the IRSG TCR Report, bespoke mutual access should be based on the understanding that the two regulatory and supervisory regimes are broadly consistent with one another (in that they have consistent regulatory objectives and aim to deliver comparable outcomes) rather than strictly "equivalent" (in the sense used in the third country regimes or "**TCRs**"). The parties would also agree on a consultation mechanism should a change in law by either party call into question the fact that the regimes are broadly consistent.

2 In this paper, the term "EU" means the EU and its member states excluding the UK.

3 https://www.thecityuk.com/assets/2017/Reports-PDF/The-EUs-Third-Country-Regimes-and-Alternatives-to-Passporting.pdf

4 The WTO's General Agreement on Trade in Services (GATS) requires WTO members to treat service providers from all other WTO members equally (the "most-favoured-nation" principle). This requirement is subject to certain exceptions – including, in the context of financial services, for measures taken for prudential reasons. As WTO members, the UK and the EU will be subject to this principle, which prevents them from affording each other special treatment in financial services, without granting the same treatment to all other WTO members. However, Article V of GATS provides a carve-out in relation to favourable treatment within the context of an agreement between WTO members that has substantial sectoral coverage and provides for the absence or elimination of substantially all discrimination in trade in services. The test for "substantially all" is not defined, but it is considered likely to cover the bespoke EU-UK arrangement (of the type described in the White Paper) given its proposed breadth and depth. A sector-specific deal that provided limited preferential treatment for financial services would be less likely to be covered by the exemption under Article V of GATS. The broader the agreement, the more likely it is to benefit from the exemption. It should be noted, however, that there is no existing precedent for negotiating a broad FTA covering passporting-like rights and mutual access.

Given that the UK has been a long-standing member of the EU, and given the long history of co-operation between the EU and its member states, the will may exist for each party to agree such arrangements.

(b) TCRs

This model would involve reliance on the EU's TCRs – whether in their current form or under an arrangement under the TCRs are enhanced.

The TCRs allow financial services providers from outside the EU to have access to some parts of the EU financial services market, subject to recognition being granted by the EU authorities. For the UK to rely on the TCRs, however, would mean that it accepts that its access to the EU will depend on whether its rules are equivalent to those of the EU – in effect, making the UK a "rule taker".

(c) "No deal"

This would be the situation where the UK has no long-term arrangement for market access with the EU. The Prime Minister has stated that, if the UK Government's objectives cannot be secured, then "no deal is better than a bad deal".

Under the "no deal" scenario, there would be no legal constraints on the ability of the UK to make changes to its own laws. Although this may technically permit a so-called "bonfire of regulations", it is thought unlikely that the UK will want to make extensive changes to its law. This is partly because of the UK's commitment to follow global standards, but it should also be noted that the UK has been something of an agenda setter in relation to many of the key regulatory changes, particularly since 2008. In addition, it is believed that much of the UK financial services industry would prefer to operate at higher standards and have the UK retain its position as a leading global regulatory regime. Nevertheless post-Brexit the UK will have the ability to design a regulatory framework that is appropriate for UK-based businesses.

If there was no deal, the UK would also lose its ability to influence EU law, except insofar as it had input to global standards which the EU agreed to adhere to.

As mentioned above, the IRSG's view is that the bespoke arrangement for mutual access is the preferable model. The purpose of this paper is to consider in more detail how that model might operate.

3 CONTEXT

Our review is informed by the perspective that any arrangement should be tailored to the unique relationship between the UK and the EU – including the fact that, immediately before the date of Brexit, their respective regulatory and supervisory regimes should be the same – and to reflect our integrated and interdependent markets. This requires both comprehensive mutual market access and robust governance arrangements to give market participants the transparency and predictability required for long-term business planning.

The interdependence of the UK and EU – and, in particular, the fact that the EU has a significant interest in having continued access to the UK market – has been highlighted in some recent statements. In an appearance before the Treasury Select Committee on 11 January 2017, the Governor of the Bank of England said:

> "there is tremendous capacity, depth and breadth of financial services resident here in the UK: people, capital, institutions, plumbing, wiring and regulatory constructs. At the point of leaving… capacity will be taken out because certain institutions are not authorised, people are not in the right place, capital liquidity is not in the right place…That is more likely to affect Europe than the UK. It will affect the UK as well, but in my view it is a greater risk for Europe"

A recent study for the Committee on Constitutional Affairs of the European Parliament[5] comments:

> "The UK is one of the largest Member States, and the first ever to withdraw from the Union, and it is doing so in difficult times. The UK is a political and cultural power, a Member State with a very relevant impact – for the better or for the worse – on numerous relevant EU policies. Its departure is a blow to the European integration project, and the lasting repercussions and ramifications will mainly depend, as with the economic consequences, on the degree of detachment or closeness of the future relationship."

It is in the economic interests of both the UK and the EU post Brexit to continue to provide, and have access to, the widest possible range of financial and related products and services. Mutual access would preserve notable benefits for businesses and individuals throughout Europe, enabling economic growth and job creation across the UK and the EU, as it gives corporates continued access to capital and liquidity, whether based in the UK or the EEA. The UK financial services industry is currently a significant source of direct funding for EU SMEs due to its ability both to attract global sources of investment and provide innovative services. Often firms in the EU benefit from the UK financial services industry indirectly too – see case study A overleaf.

Conversely, reduced access is likely to affect revenues, operating and financing costs, and hence employment and growth in Europe.

5 Brexit and the European Union: General Institutional and Legal Considerations; a study for AFCO, European Parliament: http://www.europarl.europa.eu/RegData/etudes/STUD/2017/571404/IPOL_STU(2017)571404_EN.pdf

The EU's Capital Markets Union, launched in spring 2015, is designed to diversify the sources of funding for companies and to address the barriers to cross-border capital flows. A recent paper by *New Financial*[6] illustrates the potential for growth in EU capital markets but also the significant dependence on the UK. The size, depth and growth of the UK's capital markets is about double that of the EU, and the UK capital market provides significant investment into EU firms. It is therefore important that there is a high degree of access between the UK and the EU to ensure the positive development of this agenda.

6 *New Financial*: "What Do EU Capital Markets Look Like Post-Brexit?" (September 2016)

CASE STUDY:

Why access to the UK's financial services industry matters to the EU – EU business requires capital

An industrial business in Germany wants to raise money to upgrade a factory in France and build a new manufacturing facility in an emerging market. A UK-based bank provides capital in a number of ways and often the business concerned may be unaware that the financial services it is accessing are provided by UK banks. For example:

- Fund raising advice and bank loan: A UK-based bank uses its CRD passport to both provide corporate advisory services on the financing arrangements and to help arrange a syndicated loan from a group of UK-based banks to the German business.
- Fund raising through a capital market bond: A UK-based bank uses its MiFID passport to assist the German business to sell bonds in the capital markets to secure additional money for the foreign expansion.
- Buy foreign currency: A UK-based bank uses its CRD passport to provide the foreign exchange services required to secure the immediately needed foreign currency for the emerging markets investment.
- Risk management of future currency and interest rate movements: A UK-based bank uses its MiFID passport to help the business hedge its foreign exchange exposure on the non-euro component of the new finance and to hedge its interest rate exposure on both the euro and non-euro components of the financings.

At the same time, global regulators are actively reviewing the coherence and calibration of the interaction of regulations, to avoid (amongst other things) different approaches to bank capital, which can have knock-on consequences for their customers and the global economy. The fragmentation of Europe's capital markets will drive up the cost of business.

As illustrated in the Oliver Wyman report on "*The Impact Of The UK's Exit From The EU On The UK-Based Financial Services Sector*", commissioned by TheCityUK and published in August 2016,[7] firms have different approaches for addressing increased costs of business, from increasing the price of products for end users, to shrinking the size of original business lines, or ceasing to serve certain client segments, to changing the structure of their firm.

European jobs and economic growth are likely to suffer if Brexit, on the one hand, slows the momentum towards reducing barriers to cross-border market finance, whilst, on the other, by increasing costs to banks, accelerates the fragmentation of bank finance in Europe. It is likely to be in the interests of the rest of the EU (as well as the UK) to minimise these potentially adverse consequences of Brexit.

7 https://www.thecityuk.com/assets/2016/Reports-PDF/The-impact-of-the-UKs-exit-from-the-EU-on-the-UK-based-financial-services-sector.pdf

CASE STUDY:

Asset backed securitisation

A UK company is part of a supply chain that supplies parts to a German car company. Through the UK company, a UK bank receives an introduction to the German car company, which is looking for a bank to arrange an asset backed security (ABS) for its UK car lease portfolio.

In the post-Brexit world, the following considerations would affect this scenario:

- The UK bank could not offer to arrange an ABS deal for an EU corporate, because of the role of the MiFID/CRD IV passports. Structuring a securitisation would be complimented by EU regulated ratings agencies, EMIR and clearing and settlement mechanisms.

- A UK securitisation could attract withholding taxes and the asset would not fulfil requirements for central bank eligibility, EU bank liquidity (LCR) or leverage, insurers solvency regime (Solvency II), and asset management regulation (AIFMD), making it an unattractive investment for non-UK based investors (who are currently a significant investor group in European securitisations).

4 KEY COMPONENTS OF REGULATORY ALIGNMENT

In the UK's Article 50 letter dated 29 March 2017, the Prime Minister said that the UK proposes:

> "a bold and ambitious Free Trade Agreement between the United Kingdom and the European Union. This should be of greater scope and ambition than any such agreement before it so that it covers sectors crucial to our linked economies such as financial services and network industries. This will require detailed technical talks, but as the UK is an existing EU member state, both sides have regulatory frameworks and standards that already match. We should therefore prioritise how we manage the evolution of our regulatory frameworks to maintain a fair and open trading environment, and how we resolve disputes. On the scope of the partnership between us – on both economic and security matters – my officials will put forward detailed proposals for deep, broad and dynamic cooperation."

On this basis, the UK's preferred model is the bespoke arrangement. This paper analyses the building blocks for a financial services chapter of an FTA that provides for reciprocal market access based on mutual recognition of the respective regulatory and supervisory regimes.

The analysis covers:

(a) the criteria for allowing access – **SEE SECTION 5**;

(b) a process for granting access and mechanisms for assessing and maintaining alignment of the respective regimes on an on-going basis, as the respective regulatory frameworks evolve (including a predictable mechanism for the withdrawal of access) – **SEE SECTION 6**; and

(c) how disputes in relation to access can be resolved – **SEE SECTION 7**.

5 THE CRITERIA FOR ACCESS

- Many different forms of coherence exist for achieving market access. Most are based on comparable outcomes – i.e. setting out principles to determine whether the regulatory regimes are comparable.
- Clarity and transparency of criteria and process are important.
- Where global standards are available and offer a sufficient degree of robustness and detail, the criteria for access should use those standards.
- Where there are no global standards, the criteria chosen should be outcomes-based. This is particularly important, as it will allow some flexibility in the position as the respective regulatory regimes evolve over time.
- The bespoke arrangement should set out principles as to what the desired outcomes are and how their achievement is measured. IOSCO has provided useful guidance in the securities sector, which could be adopted more widely, but the UK and EU should consider whether they need to develop their own principles and, if so, how.

5.1 Introduction

It is likely that, if there is to be a long-term arrangement for mutual access, each of the respective parties will need to be satisfied that there is a sound conceptual basis for allowing mutual access and that the two regimes share common philosophies as to market stability and investor protection through appropriate rules and standards, as well as reliable enforcement.

As noted further above, the unique shared history of the UK and EU, the degree of interconnectedness between their respective economies and the fact that their regulatory frameworks and standards should be substantially the same at the date of Brexit, should create a basis for the grant of mutual access.

The approach proposed under the Transatlantic Trade and Investment Partnership ("**TTIP**") agreement provides a precedent for regulatory alignment that the UK/EU FTA could follow.[8] The requirement for a test is up for negotiation. The principal issues are likely to be having confidence that users of the other's markets and products will be adequately protected, that competition will be furthered and that market stability will be secured.

8 It is unlikely, however, that the TTIP approach would have been applied to financial services, as the the two sides had not reached agreement on regulatory coherence for financial services as part of TTIP by the time the TTIP negotiations fell into abeyance.

To date, the EU has not agreed to provide third countries with the same level of market access to its single market without the third country achieving equivalence with the EU's regulatory requirements (which is ultimately determined by the Commission or the Court of Justice of the European Union ("**CJEU**")). However, it is not inevitable that "equivalence" (as used in the TCRs) should be the standard; the test could provide for a less granular level of similarity – and instead allow access on the basis of "comparable outcomes".

In this section we consider:

(a) what the relevant criteria should be (e.g. whether the test should be that the regimes are "equivalent" or some other test);

(b) whether rights of access could be linked to global standards;

(c) on the assumption that the criteria are going to involve the assessment of outcomes, how outcomes can be assessed;

(d) the possibility of including, subject to parameters, an approach that does not involve a comparison of the respective regulatory regimes; and

(e) other relevant considerations.

5.2 What should the criteria be?

We have considered below some of the possible alternatives for the criteria that would underpin mutual access. In addition to the equivalence test under the TCRs, there are other alternatives under FTAs and similar arrangements.

5.2(a) "Equivalent" regulatory regimes

Under most of the existing TCRs, the relevant legislation states that the basis on which access is granted is that the regulatory regime of the third country is "equivalent" to that of the EU. The exact nature of the test differs as between the TCRs, but it usually requires that there is an "equivalent" regulatory regime in the third country and that the third country firm is authorised in its home state and subject to effective supervision and enforcement.

Market access does not arise as a matter of right, even if the third country has an equivalent regulatory regime; it requires the EU authorities to make a determination before market access is granted.

The IRSG TCR Report considered the TCRs in detail and noted that:

- there is a lack of clarity over what "equivalent" means. It appears that some divergence between the two regimes is permitted, but it is difficult to determine what level of divergence would mean that the regimes are non-equivalent;
- although certain TCRs were expressly stated to approach equivalence on an "outcomes" basis, the experience of actual applications under the TCRs suggested that the analysis was getting into a very high level of granularity;[9] and
- if "equivalent" required a high degree of similarity, it would mean that the UK would be something of a "rule taker" – i.e. in effect, having to follow EU law without having any direct input into the development of that law.

Matters such as these led the IRSG to conclude that TCRs do not provide an optimal long-term, sustainable solution for the UK-based industry as a whole to access EU markets, and that the most favourable solution for both the UK and the EU27 is likely to be for them to enter into a bespoke arrangement. The IRSG TCR Report specifically suggested that the test of having an "equivalent" regime should be avoided, because of the issues cited above, and that a different test (e.g. that the two regimes are broadly consistent) should be used instead.

5.2(b) "Regulatory approximation" – EU Enlargement and Neighbourhood Policy

As part of each phase of enlargement of the EU, the applicant country has had to meet certain regulatory standards to bring their laws into line with the EU's ***acquis communautaire***. In particular, the accession of the Eastern European countries followed a template process of "regulatory approximation", whereby the EU signed an association agreement with the applicant country as part of the acceding country's steps towards membership.

The Deep and Comprehensive Free Trade Agreement ("**DCFTA**") with Ukraine is a current example of such an agreement. DCFTAs were listed as an example of a potential model for a future EU-UK relationship in the recent AFCO study

9 In one of the key case studies considered in the IRSG TCR Report (the TCR under which certain US central counterparties sought access to the EU market), it was reported that there had been a "line by line" comparison of the respective rule books. It has been suggested that such an exercise may have been undertaken in order to assess how aligned the two regimes were in terms of outcomes, but evidence from those who have been through an equivalence determination was that they felt that the process was extremely lengthy and required much detail for such an approach to be taken more widely – especially given the time frames. Nevertheless, the possibility of an equivalence process that is more outcomes-based and less focussed on detail may be worth considering as a basis for mutual market access. In relation to outcomes-based regulation, see below.

for the European Parliament which indicates that the mechanisms they use merit analysis.[10] (NB: Not all EU neighbourhood agreements contain "regulatory approximation" wording.[11])

The concept of regulatory approximation suggests a greater degree of possible divergence than a TCR-style equivalence test – and arguably establishes a precedent for the degree of alignment that the UK and EU may want to have with each other. It may be a structure which could also help manage evolution of the EU-UK relationship from membership to strategic partner. It should be borne in mind, however, that the concept has until now only been used in the context of an arrangement in which the parties anticipate that there will be regulatory convergence in the future, as opposed to the possibility of divergence.

5.2(c) "Regulatory coherence" under TTIP/TTP

Both the draft TTIP and draft TTP agreements use the concept of "regulatory coherence". The term is used to refer to the use of good regulatory practices in the process of planning, designing, issuing, implementing and reviewing regulatory measures in order to facilitate achievement of domestic policy objectives, and in efforts across governments to enhance regulatory cooperation in order to further those objectives and promote international trade and investment, economic growth and employment.[12]

The European Commission has stated that:

> "Making EU and US regulation more compatible is at the heart of the negotiations on a Transatlantic Trade and Investment Partnership (TTIP). It has the potential to contribute towards jobs and growth of any part of the negotiations. It will also deliver greater consumer choice and stronger, not weaker, regulatory outcomes."[13]

The relevant agreements each contained a chapter setting out mechanisms for establishing and managing regulatory alignment, expressly recognising that achieving this is critical to maximising market access.

In the context of TTIP, however, no agreement was actually reached during the

10 Brexit and the European Union: General Institutional and Legal Considerations; a study for AFCO, European Parliament: http://www.europarl.europa.eu/RegData/etudes/STUD/2017/571404/IPOL_STU(2017)571404_EN.pdf

11 For example, the European Common Aviation Area ("ECAA"), an aviation agreement between the EU, various Balkan states and Norway and Iceland, provides for detailed transitional provisions for certain signatory states, to allow them time to implement the EU's requirements. The ECAA does not provide for "regulatory approximation" but does make it clear that the EU alone will determine whether a signatory state's regulations are to an EU standard, and compliant with the ECAA.

12 See, for example, chapter 25 of the draft TTP.

13 http://trade.ec.europa.eu/doclib/docs/2015/february/tradoc_153121.pdf

negotiations about regulatory coherence in the context of financial services.

5.2(d) "Deference"

At G20 level, the concept of regulatory "deference" has been mooted. In 2013, in the context of OTC derivatives, G20 leaders agreed that "jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes." Deference of this nature could, in appropriate situations, form the basis of a relationship between two regulatory regimes.

In its report on allowing access in the context of OTC derivatives,[14] the Financial Stability Board ("**FSB**") included examples of criteria used to establish deference in other markets. The FSB also encouraged greater clarity and harmonisation in developing the criteria on which market access is permitted.

There are examples of the concept of deference being put into practice:

- In the USA, the Commodity Futures Trading Commission ("**CFTC**") uses a range of different approaches to assess "deference", depending on the activity being permitted access. These include assessing whether a country has a "comparable regulatory scheme" in respect of intermediaries or applying a narrower "substituted compliance" assessment in relation to swaps.

- According to a Progress Report published by the FSB in 2015, deference has also been applied by Australia, Canada and the EU in certain specific contexts.[15] The EU has applied deference to Australia, Hong Kong, Japan and Singapore in relation to the regulation of central counterparties.

5.2(e) "Mutual recognition" under Solvency II

Under article 175 of Solvency II, there is a regime for "mutual recognition" of reinsurance entities. Article 175 authorises the negotiation of agreements with third countries regarding the means of exercising supervision over third-country reinsurers that conduct reinsurance business in the EU and EU reinsurers undertakings which do likewise in a third country. It is effectively a mandate for the EU to make bespoke deals with third countries.

Article 175 specifies that any such agreements shall in particular seek to ensure,

14 The FSB Report on "Jurisdictions' ability to defer to each other's OTC derivatives market regulatory regimes" (September 2014): http://www.financialstabilityboard.org/publications/r_140918.pdf

15 http://www.fsb.org/wp-content/uploads/OTC-Derivatives-Ninth-July-2015-Progress-Report.pdf

under conditions of equivalence of prudential regulation, effective market access for reinsurers in the territory of each contracting party and provide for "mutual recognition" of supervisory rules and practices on reinsurance.

The question of equivalence of prudential regulation brings in considerations like those discussed in relation to the TCRs in section 5.2(a) above. However, the reference to "mutual recognition" of rules is a different approach to that used in most of the TCRs and may in itself constitute another means of approaching the criteria for mutual access under the bespoke arrangement.

The US-EU Covered Agreement for insurance – see section 5.2(f) below – is an example of an agreement entered into using the approach under article 175 of Solvency II.

5.2(f) "Substantially the same regulatory impact" – US-EU Covered Agreement for insurance

In January 2017, the US and EU announced that they had concluded the negotiation of a "covered agreement" relating to insurers and reinsurers. The terms of the agreement included arrangements which provide EU-based (re)insurers with relief from US collateral requirements, provide US-based (re)insurers with relief from EU local presence requirements, and free US insurance groups operating in the EU from EU worldwide group capital, solvency, reporting, and governance requirements under Solvency II.

The US/EU covered agreement does not itself include any criteria along the lines of "equivalence";[16] it simply disapplies the relevant specific provisions of US and EU law. The agreement does, however, say that the parties should refrain from maintaining or adopting any new requirement "with substantially the same regulatory impact on" the relevant reinsurer as the requirements which are being removed under the agreement. This is another concept which could be considered in the context of a bespoke arrangement.

In the event that the UK and EU agree to use one of the tests above, the UK should – as part of the FTA that will enshrine the future UK/EU relationship – seek to include provisions that reflect the very high degree of convergence that will exist between the UK and EU as at the date of Brexit and which expressly provide that the UK does need to go through any formal process in order to determine whether its regime is sufficiently aligned.

16 In order to get to the point where the Covered Agreement could be entered into, however, the EU would have had to consider whether the arrangement met the criteria under article 175 of Solvency II – see section 5.2(e) above.

5.3 The use of global standards

Certain elements of the regulatory regime that will apply in both the UK and EU after Brexit are derived from standards which are developed at a global level, such as the Basel Committee on Banking Supervision ("**Basel Committee**") prudential standards, guidelines and sound practices for banking, the standards for securities of IOSCO and the FSB standards.

The EU and certain of its member states, including the UK, contribute to setting these global standards, together with other G20 countries.

The global standards are primarily aimed at financial stability and preventing regulatory arbitrage, but could also form a sound basis for a mutual access regime founded on common approaches to key issues. The nature of these global standards is that they establish a framework and set out principles or minimum standards which need to be enacted in local regulatory regimes.

Andrew Bailey, the Chief Executive of the FCA, suggested in his speech to the Economic Council Financial Markets Policy Conference in January 2017[17] that the best approach for the global economy would be to base market access, in part, on mutual recognition of adherence to higher level global standards.

Sir Jon Cunliffe, in his evidence to the House of Lords' European Union Committee on "Brexit: financial services" on 15 December 2016, said:

> "Equivalence regimes are easier to establish when they are based on international standards. For example, while the EU and US treat prudential capital for banks differently, both regimes are equivalent as they are implementing a Basel international standard."

A focus on global standards, where appropriate, could potentially be done as an alternative means of satisfying an "outcomes-based" test. Parties could agree that compliance with the global standards for a specified activity will demonstrate that the "outcomes-based" test had been satisfied. This could be the case even where one party has decided to "gold plate" its laws and go beyond the minimum required by the international standard.

Recent EU legislative developments have indicated that the EU recognises the benefits of using global standards, such as those of IOSCO, when framing regulatory obligations. For example, under the Benchmarks Regulation one of the criteria for allowing certain forms of access for benchmark providers from third countries is whether the domestic regime in the third country complies with the IOSCO principles on benchmarks.

17 https://www.fca.org.uk/print/news/speeches/free-trade-financial-services-global-regulatory-standards-friends-not-rivals

Global standards covering prudential regulation of banks, recovery and resolution of systemic institutions, and critical market infrastructure are particularly robust and granular and could form the basis for mutual market access. There are other areas, however – such as insurance – where the architecture of global standards is less well-developed and so there may not be an applicable standard which could be used as the basis for mutual access, or the global standard may not in itself be sufficient for that purpose. For example, in relation to insurance, the International Association of Insurance Supervisors is currently (at the request of the FSB) devising an international capital standard. The intention is for high-level principles to be available by 2019, with a further version of the standards being introduced by 2022. However, it is clear that significant global differences in regulation and political appetite to change local jurisdiction requirements are significant, so undue reliance should not necessarily be placed on these measures.

It should be borne in mind that the existing global standards were not developed with the purpose of underpinning rights of mutual access between states.

The UK and EU would only want to rely on a global standard as the basis for a bespoke arrangement if it was sufficiently robust and detailed.

There is no mechanism for enforcement of global standards at a global level. Even where global standards could be used as the basis for a bespoke arrangement, it would still be necessary for each of the parties to agree mechanisms by which both parties can be held to those standards.

The Regulatory Consistency Assessment Programme of the Basel Committee (like the FSB assessments) may provide mechanisms to draw on to inform this process. It monitors the timely adoption of regulations by its members, assesses the consistency of implementation with the Basel framework and analyses the quality of intended regulatory outcomes. It considers that consistent implementation of the Basel framework is fundamental to raising the resilience of the global banking system, maintaining market confidence in regulatory ratios and providing a level playing field for international banking activities. These objectives may be well-served by an increased drive towards using global standards for market access. In addition, as the process of establishing global standards in the wake of the 2008 crisis is largely complete, global standard-setters may focus to a greater extent on the review of their implementation and peer review by the global standard-setting organisations.

There may also be areas where the UK and EU are not willing to defer to a global standard. The EU has not, for example, implemented all of the Basel III requirements, and the attempts to introduce global standards for insurance face with the challenge of there being significant differences in local regimes. In cases where a global standard is not appropriate, mutual access should be based on outcomes-based criteria defined in the FTA.

5.4 Outcomes-based assessment

Whatever criteria are used, it is likely that they will (at least to some extent) involve an assessment being made by reference to outcomes. Even in relation to tests such as equivalence, which are perceived as being more likely in practice to involve granular comparisons of respective rulebooks, the existing legislation suggests that an outcomes-based approach should be taken.[18]

When an outcomes-based approach is taken, the questions arise: what are the common outcomes that the parties are seeking to achieve, and how can they be measured?

The IOSCO Task Force on Cross-Border Regulation published a paper in September 2015[19] (the "**IOSCO Report**") which considered the question of cross-border regulation and alignment of regimes in some detail. Among the issues that the IOSCO Report considered was the challenge of assessing outcomes. The IOSCO Report suggested a four stage approach to this question:

5.4(a) Identifying regulatory outcomes

First, the parties would identify the outcomes that they were trying to achieve. The suggestions in the IOSCO Report for the outcomes were:

- domestic investor protection;
- maintenance of local market integrity;
- the reduction of regulatory arbitrage;
- the reduction of systemic risk, crime and misconduct in the domestic financial system; and
- effective AML and protection against financial crime.

5.4(b) Selecting measures to assess such outcomes

Once the outcomes themselves are determined, the parties need to agree how those outcomes can be measured. The IOSCO Report suggested eight common measures:

- general analyses of foreign securities laws, regulations, requirements, and standards;
- specific analyses of foreign securities laws, regulations, requirements, and standards, both as written and implemented, with respect to the cross-border

18 For example, MiFIR formally incorporates an outcomes based approach, stating that any assessment "should assess to what extent the respective third country regulatory and supervisory framework achieves similar and adequate regulatory effects and to what extent it meets the same objectives as Union law."

19 http://www.iosco.org/library/pubdocs/pdf/IOSCOPD507.pdf

activity considered under the proposed unilateral or mutual recognition arrangement;
- the level of investor protection in the foreign jurisdiction;
- enforcement capability of the foreign jurisdiction;
- the level of supervisory oversight in the foreign jurisdiction;
- legal framework for and implementation of international co-operation;
- analysis of results from standardized assessments by international organisations; and
- membership and status in international organisations, regional communities, or groups.

5.4(c) Gathering materials to evaluate comparability

Once the outcomes and the measures have been determined, the relevant regulator will need to gather materials for evaluation of whether or not the outcomes are comparable. This information is usually gathered by observing foreign regulatory and market developments, participating in international regulatory fora and other sources.

5.4(d) Evaluation and use of "benchmarks"

The IOSCO Report notes that regulators find it useful to set "benchmarks", where possible, to determine the extent to which the foreign regulatory regime meets the predetermined regulatory outcomes. These could be benchmarks that reflect international standards (of the types considered in section 5.3 above) or those that reflect domestic requirements.

The IOSCO Report is not, however, the only source of guidance in relation to the question of outcomes. For example, in the USA, the CFTC allows intermediaries and foreign brokers to directly solicit US investors without being registered by the US when they come from a country which is determined to have a "comparable regulatory scheme" to that of the CFTC. At a minimum, the CFTC will consider a jurisdiction to have a comparable regulatory scheme where there are the following features:

- registration, authorisation or other forms of licensing, fitness review or qualification of persons soliciting and accepting customer orders;
- minimum financial requirements for persons accepting customer funds;
- protection of customer funds from misapplication;
- recordkeeping and reporting requirements;
- minimum sales practice standards, including disclosure of the risks of futures and options;
- transactions and, in particular, the risk of transactions undertaken outside the jurisdiction of domestic law; and

- supervision, monitoring and enforcement by a regulatory authority for compliance.

Arrangements such as this could provide further thinking for any arrangement between the UK and EU. Although the IOSCO Report, containing global standards, has obvious appeal, the UK and EU should also look at other arrangements to help them devise the best possible framework of shared outcomes to use as the basis for a mutual access regime.

A framework of regulatory outcomes will become increasingly important over time as the UK and EU financial services regimes evolve, as they will help anchor considerations on outcomes rather than line by line assessments.

6 MECHANISMS FOR ASSESSING AND MAINTAINING ALIGNMENT

- Formal mechanisms for consultation and co-operation between the respective regulatory authorities of the UK and EU will be required.
- The forum or committee in question should share information and actively monitor the scope for the regulatory regimes to diverge (including through the regulators taking different approaches to enforcement).
- The forum should be empowered to make an assessment of the materiality of any divergence. The process must be transparent and based on a technical assessment of materiality, and should draw on expertise (from outside either of the participating regimes, where necessary) and on the experience of firms.
- Where there is material divergence, there should be processes to allow the relevant regime to address the position (including a means by which the forum assists in determining what steps need to be taken to address the position adequately).
- If divergence cannot be avoided or addressed, there should be agreed processes governing the withdrawal of the arrangement. These would include giving affected firms sufficient time to adapt to the loss of the relevant access right.
- It may be appropriate to have different hierarchies of fora, and for there to be different fora for different types of regulated entity (with, for example, a college of supervisors undertaking the role in relation to systemically important firms).
- Any mechanisms allowing for cross-border access should take into account the fact that one of the countries would ultimately be responsible for the failure of a firm that was exercising cross-border rights of access and should reflect the rights that the relevant regulators they are likely to want to exercise in relation to their firms.

6.1 Introduction

Once the relevant criteria for mutual access have been agreed, it will be necessary to have mechanisms for the respective parties to:

(a) assess whether those criteria are met in the first place; and

(b) maintain alignment of the respective regimes, by reference to those criteria, on an ongoing basis.

This section considers how those objectives might be achieved.

6.2 Consultation and co-operation

Co-operation and consultation mechanisms will be fundamental to the success of the agreement. In its Article 50 letter, the UK indicated that it will be putting forward detailed proposals for "deep, broad and dynamic co-operation".

The mechanisms for co-operation and consultation could, for example, be institutionalised by means of a forum or financial services committee – perhaps linking to the existing European System of Financial Supervision – supplemented by working groups of regulators and supervisors. The nature of the forum for such consultation and co-operation is considered in section 6.3 below.

Information sharing

Co-operation and consultation mechanisms that encourage sharing of information and best practices will be fundamental to the success of the bespoke arrangement. Consultation and co-operation activities might include:

(a) the promotion of timely and faithful domestic implementation of international standards;

(b) the sharing of information on intended new regulations;

(c) consultation if legislation is introduced which might lead to divergence; and

(d) exchanges of views on regulatory issues in a bilateral context.

The bespoke arrangement should include data sharing arrangements to ensure that EU regulators receive appropriate data on UK financial services firms accessing the EU markets and vice versa.

Co-operation on enforcement etc.

Divergence could occur as a result of the respective regulators taking different approaches towards enforcement in their own territory. If one regulator diligently enforced a rule against its firms, while the other did not enforce a corresponding rule against its own firms, the practical effect may be that the two regimes operate differently and produce different behaviours among their firms – which could amount to a form of divergence. Reliance on third country regulators is a concern that the EU authorities have publicly expressed.[20]

Any bespoke arrangement should agree an approach to enforcement. A co-operation arrangement on enforcement could be based on existing IOSCO Memoranda of Understanding, which ensure co-operation between both the UK and EU for enforcement against individual firms.

The forum that deals with consultation and co-operation should include approaches to enforcement as one of the areas that it is required to monitor.

Monitoring potential divergence

Although the UK and EU financial services regimes should be essentially the same as each other on Brexit (being derived from the same source), regulation is likely to evolve in both jurisdictions over time. Examples might include:

(a) the EU and UK seeking to implement new global standards that apply to them both;

(b) the EU seeking to further the European Banking Union and Capital Markets Union, and to provide for more consistent oversight of banks and of wholesale markets and enforcement of relevant regulation;

(c) the UK seeking to go further than the minimum requirements under EU law – which is what it has already done (within the boundaries of EU law) in areas such as the prudential regulation of banks, ring fencing, and benchmarks;

(d) alternatively, the UK seeking to diverge from provisions of EU law where rules could be better tailored to the specific nature of UK products and firms (such as certain specific provisions of the Solvency II Directive); and

(e) the UK seeking to develop specific new areas of regulation in response to developments, such as those relating to FinTech.

In some circumstances, it may be appropriate to allow divergence to occur but for cross-border access to continue – for example, where there are differences in approach

20 See, for example, the speech by Steven Maijoor, the Chair of ESMA: https://www.esma.europa.eu/press-news/esma-news/steven-maijoors-address-alde-seminar-review-european-supervisory-authorities

over prudential regulation. The GATS allows for a prudential override (the "prudential carve-out") and in many free trade arrangements, there are similar carve outs allowing departures from the normal operation of the agreement for prudential reasons. CETA specifically refers to prohibition of a particular service or activity for prudential reasons.[21] It may be appropriate to allow similar latitude under any UK/EU mutual access arrangement, subject to appropriate procedures.

Where divergence is a potential concern, however, the relevant forum or committee should be empowered to make an assessment of the materiality of any divergence, including the impact on the EU single market and on the UK.

It is critical that the scope of the assessment is properly defined to consider solely the impact of any amendments for that specific activity, service or entity.

The role of the forum or committee would be solely to determine whether, as tested against the provisions of the bespoke arrangement (and the agreed outcomes), the divergence is material and adverse to mutual access. It would not be empowered to require amendments to the financial services regulation of either the EU or the UK.

The process must be transparent and based on a technical assessment of materiality. Experts could come from members of the forum/committee, and the related working groups of regulators and supervisors. The UK and EU could each invite experts from third countries to participate, where appropriate.

In making its assessment, the forum/committee should be obliged to consult with market participants from the UK, EU and other countries outside the EU and with global standard setters such as the FSB and IOSCO. This is particularly important, as private firms may have technical data and market evidence to help judge the impact of the amendments. They might also suggest technical solutions that achieve the legislative objective of the amendment without undermining compliance with the UK and EU regulatory outcomes. Importantly, they should be asked to provide evidence of the consequences for businesses and individuals in the UK and EU were mutual access to be withdrawn in that particular sector, and to recommend the length of time required by firms to adjust before mutual access is withdrawn. (There would, however, be some practical questions to consider here, such as how firms could be assured that the information they provide remains confidential. It may appropriate for domestic regulators to act as conduits for information and ensure that the confidentiality concerns of specific firms are met.)

Addressing divergence

If both parties agree that regulatory changes have made UK and EU regulation materially

21 CETA, Article 13.16(3).

and adversely divergent in relation to a particular activity, opportunity should then be given for either party (usually the party that introduced the regulatory change that led to divergence) to address the divergence in order to retain consistency. There should be a clear and transparent process in relation to this.

As part of any exercise to try and remedy divergence, it may also be necessary to determine what level of further change would be necessary to restore matters to their normal equilibrium. In the first instance, this should be the responsibility of the forum or committee charged with consultation and co-operation. If that body cannot reach agreement, the matter could be referred to a dispute resolution mechanism (see section 7).

Withdrawal from mutual access
If it is decided not to amend the relevant regulations to avoid the divergence, the UK and EU could agree to withdraw mutual access rights in respect of the particular activity impacted by the relevant change.

Any withdrawal of mutual access should only occur after an implementation period designed to allow financial sector firms to adapt, to minimise the economic impact on businesses and individuals and to preserve financial stability.

6.3 Fora for consultation and co-operation

Examples of fora for consultation and co-operation
There are several examples of models for consultation and co-operation which are currently used in international relationships and which the UK and EU may wish to take into account in devising their own arrangements. They include:

6.3(a) The Joint US/EU Financial Regulatory Forum

> The Joint US-EU Financial Regulatory Forum specifically links to the EU and US rule making processes and, taking into account the G20 agenda, provides a platform *"for enabling regulatory co-operation as early as practicable"*[22] to improve transparency, reduce uncertainty, identify potential cross-border implementation issues and work towards avoiding regulatory arbitrage and promoting domestic implementation.
>
> The Forum meets twice a year, with additional technical meetings and calls, as appropriate.

22 http://ec.europa.eu/finance/docs/160718-fmrd-enhancement_en.pdf

The European Commission recently extended this approach by launching an EU-Asia Pacific Forum on Financial Regulation in the second half of 2016.

6.3(b) Joint committees under EU-Swiss bilateral agreements

The EU-Swiss relationship is principally secured under an FTA agreement complemented by bilateral sectoral agreements.[23] The mechanisms for assessing and maintaining alignment in the EU-Swiss agreements are based on equivalence or simply the wholesale adoption of EU law (e.g. in relation to the Schengen/Dublin arrangement).

In cases of equivalence, joint committees of equal numbers of EU and Swiss experts are set up to exchange information and to act as initial reference point for resolving disputes (after which, disputes are referred to arbitration). Decisions of the joint committees must be unanimous.

As detailed in the IRSG TCR Report, equivalence decisions have been subject to long delays due to political considerations, some directly and some indirectly related to Switzerland's own relationship with the EU. Both Switzerland and the Commission are dissatisfied with the functioning of the Joint Committees, and the EU-Swiss model is not, therefore, considered a particularly helpful template for the UK-EU relationship.

One feature of the EU-Swiss arrangements that is noteworthy is that the implementation of new EU law in Switzerland is not automatic; where Switzerland fails to implement an EU law, there is a stalemate, which the agreements do not cover. This has the effect of pushing the issue into the political sphere rather than being subject to binding legal dispute resolution.

6.3(c) Technical working committees for EEA-EFTA states

States which are members of both the EEA and EFTA ("**EFTA-EEA States**") have fora in place to assist them in developing EU law – which EEA members become subject to. The EFTA-EEA States are involved in "proposal shaping" in consultation with the Commission, but they have no decision shaping authority and no veto. The process is intended to be consensus driven.

The high level diplomatic exchanges under this model are interesting in this context. However, the technical working committees are less directly relevant to the UK's position, as they are designed to ensure input into the development of EU legislation and their right of review before implementation. A UK/EU arrangement

23 In very limited areas, such as certain competition rules in the civil aviation sector, the Commission and CJEU retain direct supervisory and implementation rights in relation to Switzerland.

will be aimed more at ensuring on an ongoing basis that the respective regulatory regimes do not diverge.

There are elements of the different existing models that would potentially be useful in ensuring co-operation between the UK and EU after Brexit. However, each of the models has its own limitations, and they each reflect the precise political context in which they arise. In that regard, they can also act as examples of what not to do: the Swiss arrangement, for example, is not considered satisfactory by either side, and the UK and EU should therefore avoid developing a model which has the same problems.

The remit of the forum/committee

Given the breadth and depth of the relationship that the UK would seek to have with the EU, the forum or committee probably needs to be more than a forum for dialogue, like the arrangements with the US and Asia. Instead it should be a body with a fixed remit and with decision-making powers bestowed on it by the EU co-decision makers and the UK parliament. It could also act as the forum for dealing with disputes by consensus, before such disputes are referred onwards for final resolution – in relation to which, see section 7.

A forum for multiple sectors?

Any FTA between the UK and EU is likely to be broad in scope and is unlikely to be limited to financial services only.[24] Any forum or committee for co-operation and consultation established under the FTA may also need to consider issues relating to other sectors. Alternatively, separate mechanisms may be appropriate to provide the necessary expertise in relation to specific sectors.

Different fora for different types of firm?

Within the financial services sector, it may also be appropriate to have different approaches for different types of firm. For example, while in relation to most firms some kind of committee or forum established by the UK and EU (in the manner described in this section 6) might be appropriate, a different approach could be taken for systemically important firms. Such firms could be – and in many cases already are – subject to supervision and oversight by an international college of supervisors.[25]

24 If the FTA is not sufficiently broad in scope, it will run the risk of putting the UK and/or EU in breach of the most-favoured-nation ("**MFN**") provisions in GATS. The MFN principles provide that WTO members must grant to goods and services of other WTO members treatment no less favourable that that accorded to goods and services of any other WTO member. This does not apply, however, if the two parties agree to an FTA that eliminates substantially all duties and other restrictions on trade and has "substantial sectoral coverage". An FTA that covered only financial services would probably not satisfy this requirement. The UK/EU FTA is therefore likely to have to cover other sectors as well as financial services.

25 Colleges of supervisors are vehicles for the coordination of supervisory activities for cross border banking groups. Under EU law, colleges of supervisors have to be established for EEA banks with subsidiaries or significant branches in other EEA countries. They may include supervisors in non-EEA countries, where relevant. The colleges allow supervisory authorities to join forces, share knowledge and use skills and resources more effectively and efficiently, regardless of their individual jurisdiction. This requires determination and significant efforts to prompt coordinated approaches among competent authorities. To assist in developing a consistent and effective college framework, the EBA's predecessor, CEBS, published guidelines (i) on the operational functioning of colleges and (ii) on the joint assessment of banks' risks, and joint decisions on the adequacy of cross-border banks' capital within a college setting.

Although colleges of supervisors are currently used for regulating specific firms or groups, the model of a college of supervisors could be used to enhance co-operation between supervisory authorities and establish a mechanism by which the UK and EU could collaborate on developing a consistent regulatory response to new market developments or international standards. There may also be the opportunity, if it is considered desirable, to involve standard setters from other jurisdictions (i.e. outside the UK and EU).

Care should be taken to establish the guidelines for the operation of the colleges so as to maintain the long-established principle of mutual market access which is that the home market's regulatory framework is recognised as being adequate to rely on rather than control over a domestic regulatory agenda being ceded to the college.

Hierarchies of fora/committees

It would be possible to have a hierarchy of fora, each with different purposes. At the highest level, for example, that might be a committee at finance ministers/Commissioner level. Below that could be a committee composed of NCAs, and that could be supported by various sub-committees as appropriate.

An arrangement such as this could allow for efficient and effective consultation and co-operation, as dialogue can be held as often as appropriate and at the right level.

6.4 Responsibility for supervising cross-border services

A key factor in determining future cross-border arrangements is likely to be the question of which country's regulator has responsibility for the supervision of the firm that is seeking to use rights of cross-border access.

If a firm in one country provides cross-border services into another country, there will be a risk that the firm becomes insolvent and that investors in that other country suffer loss as a result. In that situation, it is important to determine which of the two countries will ultimately carry the risk of that firm becoming insolvent – for example, by having to cover the loss (through an investor compensation scheme or through government support) or by having to exercise rights of resolution and recovery (as exist across the EU, including in the UK, at present).

It is likely that the territory that is responsible for the firm will want to have ultimate control over how it deals with that firm – regardless of the deliberations of fora or committees which are designed to facilitate consultation and co-operation. This would be consistent with the approach that is generally taken in the EU as part of the passporting regime – the responsibility for the prudential supervision of a firm (e.g. its capital and its systems and controls) generally rests with the member state in which the firm is incorporated.

Any mechanisms that are developed for future access should therefore take into account who is ultimately responsible for the supervision of an entity and what rights they are likely to want to exercise in relation to their firms. In certain circumstances, mechanisms for shared oversight/supervision may be appropriate and should be considered in more detail. This is a matter of great importance for both the UK and the EU. In the draft EU Council guidelines following the UK's Article 50 notification, the EU noted that for a transitional arrangement to be considered, "existing Union regulatory, budgetary, supervisory and enforcement instruments and structures" would have to continue to apply. The guidelines also suggested that this principle should apply to any preliminary and preparatory discussions on the framework for a future relationship. These will obviously be key considerations for the long-term deal.

The next IRSG report will address these matters in more detail.

7 DISPUTE RESOLUTION

- A dispute resolution mechanism is necessary to deal with disputes that may arise between the UK and EU in relation to cases of regulatory divergence.
- A dispute resolution mechanism between the UK and EU is likely to have to consider regulatory divergence, and the terms of the FTA should spell out what the consequences would be when divergence occurs.
- There are numerous examples of dispute resolution mechanics associated with free trade agreements and similar arrangements. Some of these have elements that may be useful for a UK-EU FTA.
- It would also be open to the UK and EU to develop an entirely new model for dispute resolution. This might include involving global standards setters in appropriate circumstances or appointing a panel of experts predominantly from outside the UK and EU to resolve disputes.

7.1 Introduction

If the members of the relevant co-operation forum or committee fail to agree on an important matter – in particular the materiality of any regulatory divergence – they would turn to a third party dispute resolution body composed of independent financial services experts.

The UK Government has recognised the need for a UK-EU bespoke arrangement to provide for a dispute resolution mechanism. On 26 January 2017, David Davis, the Secretary of State for Exiting the European Union stated that:

> "The dispute resolution mechanisms adopted as part of our future trading relationship with the EU and other international parties will be a matter for negotiation."

When pressed whether this would amount to the CJEU retaining influence over UK laws as part of a trade agreement with the EU, Davis suggested that the Government was instead looking at *"agreed arbitration mechanisms"*.

In its White Paper, the UK Government set out its plan to devise a dispute resolution mechanism governing its future trading relationship with the EU. The White Paper makes reference to a number of existing systems included in both EU-third country FTAs and other regional and bilateral FTAs and provides detail on their operation in an annex.

The government White Paper indicates that the UK will be seeking a broad free trade arrangement with the EU, which would not be limited to specific sectors (such as financial services). It is likely that a wider deal of this nature would itself have to contain dispute resolution procedures, and it is possible that disputes relating to financial services may be resolved through the same mechanisms as is used in other sectors.

7.2 The nature of a dispute resolution mechanism

There are a range of models for trade dispute mechanisms that will need to be assessed when developing a system as part of the UK-EU deal. A dispute settlement mechanism could be either largely political and diplomatic in nature or more legalistic and judicial. Existing models that are more diplomatic usually provide for negotiated settlement between the disputing parties or require the consent of both parties for any referral to an independent tribunal. More judicial mechanisms provide for either party to have an unqualified right of referral to an adjudicative tribunal. For example, the model used in EU-Swiss bilateral agreements is largely diplomatic, in that it envisages the resolution of disputes by political representatives from both parties and a termination of the treaty where dispute resolution is not achieved. In contrast, CETA provides for a more legalistic model, relying on a permanent arbitral tribunal to adjudicate on disputes, and on resolving a dispute without the arrangement being terminated.

Dispute resolution tribunals can be ad-hoc or standing. Under the WTO dispute settlement system, an ad-hoc tribunal is convened in relation to each dispute. In contrast, the CJEU represents a standing tribunal which is comprised of judges nominated by the parties for a fixed term.

It is likely to be in the interests of both the UK and the EU to have an independent system for resolving disputes, and for the system to be transparent and underpinned by agreed values.

Some of the existing fora for disputes considered in this section 7 also include provision for resolving disputes between investors and states – for example, where the investor considers that it has suffered loss because the state is not complying with its obligations under an FTA. Disputes of this nature are not the main focus of this paper (although any long-term bespoke arrangement between the UK and EU may benefit from having a mechanism for resolving such disputes). Nevertheless, we have referred to certain mechanisms of this nature, as they offer example of mechanisms that could be considered by the UK and EU in the context of resolving disputes at a state level.

We anticipate that a dispute resolution mechanism for a bespoke agreement between the UK and EU would have the following characteristics:

(a) The resolution body could be composed of independent financial experts – possibly selected from a panel of experts who take part in the global standard-setting bodies.

(b) The role of the resolution body would be to determine, whether or not, benchmarked against the provisions of the FTA, the divergence is material and adverse to mutual recognition. It would not be empowered to require amendments to the financial services regulation of either the EU or the UK and neither the UK nor the EU would have a power of veto over the other.

(c) If the third party resolution body determines that the regulatory divergence is material, the party to the FTA that has alleged regulatory divergence may withdraw mutual recognition of the other party, subject to the transition period set forth in the agreement.

(d) If the third party resolution body determines that the regulatory divergence is not material, the party that has alleged regulatory divergence may:

   (i) withdraw the allegation and maintain mutual recognition of the other party; or

   (ii) insist on the allegation and withdraw mutual recognition of the other party, in which case the FTA could provide for the following consequences:

      1. the party that withdrew mutual recognition could pay "compensation" (in the form of offsetting trade benefits or as otherwise agreed) to the other party; or

      2. the party that did not withdraw recognition could retaliate by introducing measures that affect an equivalent value of trade.

(e) Ultimately, the parties may need to consider in what circumstances the appropriate outcome would be for the FTA to fall away altogether or for a party to withdraw rights of access in a particular area (as discussed in section 6.2 above). The possibility of this outcome should be taken into account in developing the dispute resolution process.

7.3 Existing forums for resolution of disputes

Appendix 1 contains a summary of a number of existing models for dispute resolution, including details of how they are formed and how they operate. In relation to these models:

(a) The CJEU is the forum in which disputes around equivalence under the TCRs would ultimately be resolved.[26] However, one of the objectives in the White Paper

26 There are, however, some agreements between the EU and third countries which do not involve the ECJ as the ultimate arbiter of disputes. In the context of aviation, for example, the EU has entered into agreements with third countries which involve equivalence-like concepts and where the ECJ does not have jurisdiction (and which, in at least one instance, involved a separate joint body being created for consideration of disputes and an appeal to an independent tribunal).

is to bring an end to the jurisdiction in the UK of the CJEU.

(b) The EFTA Court provides a possible model, as it is a judicial forum comprised of representatives of the four countries making up EFTA (i.e. Norway, Iceland, Liechtenstein and Switzerland). However, it has a very specific and limited focus and may not be suitable for a wide-ranging bespoke arrangement such as that that the UK would be seeking with the EU.

(c) In relation to FTAs, a typical dispute resolution mechanism (and that referred to by David Davis in section 7.1 above) is that provided for in chapter 29 of EU-Canada CETA. This provides for state-to-state procedures for resolving any disputes between the EU and Canada about the way in which they apply or interpret CETA. If differences arise, the two sides must first communicate clearly and promptly with each other to try and resolve them quickly. They must also make available their government agencies or other regulatory bodies who have expertise on the issue. Only if those efforts are fruitless can they resort to the formal procedures set out in chapter 29. Chapter 29 also sets out the procedures that both sides must follow to resolve a formal dispute – which includes the option of using an independent mediator to oversee the process. The CETA dispute resolution and arbitration panel procedure is interpretative only. Article 29.18 specifically states that *"The rulings of the arbitration panel cannot add to or diminish the rights and obligations provided for in this Agreement."* This means, for example, that it cannot make incursions into the prudential carve-out laid down elsewhere in CETA.[27]

(d) Some models focus on dispute resolution through consensus, but recognise that the ultimate solution for the parties may be for the FTA to come to an end. This is unlikely to be a desirable outcome for the bespoke arrangements between the UK and EU.

Otherwise, in a few FTAs that include investment protection provisions, and in virtually all bilateral investment treaties there is an alternative model in the form of the investor-state dispute settlement mechanism, under which investors from one participating state can bring proceedings against the national governments of other parties, usually through an arbitration procedure. This is not necessarily in itself a model that could be replicated to resolve disputes between states in relation to regulatory divergence, but some of the trends in relation to investor-state dispute resolution may nevertheless be of interest. For example, there have recently been moves away from the investor-state dispute settlement approach under the EU-Canada CETA, which establishes the Investment Court System ("**ICS**") – a tribunal relating specifically to that agreement,

27 Chapter 8 of the EU-Canada CETA provides for investment protection provisions, with a separate investor-state dispute resolution mechanism. This allows for private parties to bring disputes over investment, but is not directly relevant to dispute resolution between states.

which comprises members from both parties and from neutral countries. The decision of the ICS is binding.[28] The willingness of the EU to agree to be bound by a third party determination is potentially helpful when considering what arrangements could be made available for the bespoke arrangement.

7.4 Alternative models

As part of a bespoke arrangement, it would also be open to the UK and EU to develop an entirely new model for dispute resolution and not to follow any of the existing models. Such an arrangement might include:

(a) referring matters to the relevant global standard setters (e.g. FSB or IOSCO) to assist in the resolution of disputes or seeking to have representatives of the global standard setters involved in the dispute resolution model– if, of course, they are willing and able to perform such a role; or

(b) a new specific UK-EU panel with roster of experts, who would be selected according to the matter under dispute. Under such an arrangement, the majority of experts would come from outside the UK or EU.

In each case, the emphasis should be on a process which focusses on regulatory outcomes, but nevertheless is based on proper technical analysis against the criteria that have been chosen as part of the FTA.

The UK and EU may also wish to consider whether to submit to binding mediation. If there is no mechanism for the parties to be bound by a determination, the only recourse for a dissatisfied party is likely to be to withdraw the relevant access right – which itself would create the instability that a bespoke arrangement is intended to guard against.

28 The CETA arrangement itself may yet be superseded by a multilateral version of the same process – although since that has yet to undergo consultation, it is unlikely that a new arrangement will be put in place by the date of Brexit.

8 OTHER RELEVANT CONSIDERATIONS

8.1 Process and timing issues

As part of any bespoke arrangement, proper processes would need to be put in place. Both UK and EU firms would want certainty around the processes (for example, if applying for recognition or authorisation), so that they know that their applications will be processed before they lose their rights under the current arrangements. The nature and timing of any transitional Brexit arrangements will be important in this regard. In the Article 50 letter submitted on 29 March 2017, the UK indicated that it wishes to avoid any cliff-edge as the UK and EU move from their current relationship to its future partnership, and that both the UK and EU would benefit from implementation periods to adjust in a smooth and orderly way to the new arrangements. The UK is seeking to agree this principle early in the process.

8.2 Withdrawal of mutual access

The arrangements should also take into account the possibility of the withdrawal of mutual access only in respect of a particular activity that is affected by a change to the regulatory regime of one of the participants.

Any withdrawal should include an implementation period designed to allow financial sector firms to adapt, to minimise the economic impact on businesses and individuals and to preserve financial stability.

Market data may be required to assess the impact of any withdrawal (for example, based on an analysis of the relevant sector).

9 THE EXEMPTIVE REGIME

The main purpose of this Report is to consider what criteria could be used when building out a bespoke mutual access arrangement based on the comparability of regulatory and supervisory regimes.

However, it is apparent that there could also – in certain circumstances – be an additional route to market access that is not based on the comparability of regulatory regimes at all. This route would potentially allow the cross-border provision of services by UK firms to a limited range of clients in the EU (and vice versa) without becoming subject to a requirement to have a local presence or to licensing and other related requirements.

In this Report, we have referred to this route as the "exemptive regime", as it builds upon certain exemptions that already exist in some EU member states (as considered further below).

9.1 The nature of the exemptive regime

The exemptive regime would be appropriate when services are supplied across a border (i.e. without establishing a branch office) to a range of "qualified counterparties" – such as regulated financial institutions, large corporates, sovereign wealth funds and governmental or supranational entities – that could be considered sufficiently sophisticated that they do not need special regulatory protection.

The approach would remove the need for firms providing such services to be subject to licensing and regulatory requirements in the host state – such as requirements to obtain a licence, as well as capital and prudential regulation, reporting requirements, and rules related to internal organisation and operations. However, certain rules of the host state would still apply, such as local market integrity rules (e.g. restrictions on short selling, prevention of insider dealing, market manipulation and fraud, and reporting of long and short positions) and market structure rules providing pre- and post-trade transparency.

The exemptive relief approach route should be regarded as an addition to, but not a substitute for, the broader rights of mutual access based on the comparability of the regimes (as discussed elsewhere in this Report).

9.2 Examples of exemptive relief already in effect

There are already numerous examples of regulatory regimes containing provisions which allow access to foreign firms without the benefit of a licence.

Some EU countries already have rules which allow non-EU firms to conduct business with particular categories of clients or counterparties, e.g.:

- **Belgium**
  The Belgian rules allow non-EU investment firms to engage in cross-border securities and derivatives business with a broad category of authorised customers, which covers many financial institutions and some non-financial corporations, subject to notification of the local regulator.

- **France**
  The French regulator ACPR considers that foreign banks and investment firms that deal on the interbank market with French counterparties need not be authorised or passported in France. As confirmed again in 2015 by the ACPR, this exemption covers both banking business and investment services and activities.

- **Ireland**
  The Irish rules allow non-EU firms to engage in cross-border securities and derivatives business with persons other than individuals.

- **United Kingdom**
  The UK's overseas persons exclusion ("**OPE**") allows non-EU firms to engage in cross-border business with certain categories of customer or counterparty (particularly with investment professionals and companies with net assets of at least £5 million – although the exclusion can apply to other types of customer as well). The OPE is available for many types of regulated activity, but is used most commonly for securities and derivatives transactions.

Some countries, such as Germany, Luxembourg and The Netherlands, have arrangements under which a non-EU firm can apply to the local regulator to obtain a licence or exemption allowing it to conduct cross-border business with local clients and counterparties without setting up a local branch. In some cases, the licence or exemption may be limited to some categories of business or client or counterparty or subject to other conditions (such as a review of the adequacy of the relevant non-EU regulatory arrangements, which make them a less clear example in this regard). Germany achieves inter-professional business also through a widely interpreted non-solicitation exemption ("passive freedom to provide services").

There are also numerous examples outside the EU where professional counterparties are permitted to deal with each other with triggering licensing requirements:

- **United States**
  In the US, foreign broker-dealers are exempted from US registration requirements for certain securities business, including for soliciting and effecting transactions with registered US broker-dealers and with banks acting in a broker-dealer

capacity. There are further exemptions for foreign broker-dealers, for example with regard to unsolicited transactions, with regard to transactions with US institutional investors through a US "chaperoning broker-dealer" and (based on no-action relief) as regards certain transactions in non-US securities and certain communications outside US business hours. Cross-border derivatives business with US counterparties can be undertaken up to certain thresholds without the need to register with US regulators; for larger-volume business, an appropriate registration is available.

- **Australia**
  Australian securities laws allows foreign intermediaries to obtain an exemption from licensing requirements allowing them to conduct a class of securities business with wholesale clients in Australia where the Australian regulator recognises that the foreign regime provides sufficiently equivalent protections.

- **Canada**
  Canadian securities laws provide an exemption for 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.

There is also a potentially helpful precedent in an FTA to which the EU is a party – namely the CETA FTA between the EU and Canada.

Article 13.7.6 of CETA appears to allow the parties to access each other's markets either through the provision of cross-border services or by permitting the sale of products for visitors from the other territory – in both cases without the need for local authorisation, as long as the firm from the other territory does not establish a physical presence (e.g. a branch office). The article provides that each party shall permit a person located in its territory (and a national, wherever they are located) to purchase a financial service from a cross-border financial service supplier of the other party located in the territory of the other party.

At first sight, this has similarities to the exemptions that exist in various EU member states for access via reverse solicitation, and to the UK's OPE (see above). The provision could be read so that it would allow an EU person to purchase a product from a Canadian financial institution without the Canadian financial institution needing a licence in the EU member state in which the customer is based. As CETA was only entered into as recently as October 2016 and is not yet in force, it may be some time until the meaning of the provision is properly tested.

Even if the wider reading of the article 13.7.6 is accepted, there are other provisions of CETA that could prevent it being used as the basis for a right of access for financial services firms. In particular, article 13.7.6 states that it does not require a party to permit suppliers from the other territory to do business or solicit in its territory – and it allows each party to define what it means to "do business" or "solicit" in this context. A party to the FTA could negate the wide interpretation of article 13.7.6 by defining such terms in such a way as to prevent its citizens from purchasing financial services from a supplier in the other territory. A party to the FTA could also rely on the prudential carve-out in CETA (see section 9.3 below).

Notwithstanding these limitations on the utility of article 13.7.6, the provision is significant because it shows that the EU has already agreed in an FTA to a concept like the exemptive regime. Although that agreement is subject to major restrictions in the case of the relationship with Canada, the fact that the UK already has a very degree of regulatory alignment with the UK should place it in a better position to agree a less restricted arrangement as part of the UK/EU FTA.

9.3 Enacting an exemptive regime

In order to give the future trading relationship in financial services between the UK and the EU a stable basis, any exemptive regime should be enshrined through the FTA. This should mean that the approach will take effect across the whole of the EU without individual member states seeking to take a different approach in relation to their own territory.

The challenge with having an EU-wide exemptive regime is that, as the examples above show, exemptions from local authorisation requirements are typically treated as being strictly within the purview of national discretion and are not generally agreed on a multi-country (e.g. EU-wide) basis. Not all EU-27 Member States currently allow for such exemptions and in some cases the domestic regulator has specifically stated that the exemptions will not apply to certain sensitive activities. For the EU to be able to agree to an EU-wide arrangement could meet with some political resistance from member states, and it may be necessary to persuade those member states of the merits of the approach. It is, however, also possible that the terms of the FTA could provide for different treatment for individual member states; existing FTAs (such as CETA) contain separate commitments for different member states.[29]

Like other FTAs in this area (including GATS), the commitments under the UK/EU FTA could be made subject to a prudential carve-out – i.e. a provision that allows a party to take measures that might otherwise contravene the terms of the FTA in order to protect (i) investors, (ii) the safety and soundness of financial institutions, and (iii) the integrity

29 In relation to such arrangements, the FTA could take one of two approaches: a "positive list", under which individual member states make specific commitments on cross-border supply (as in CETA) or a "negative list", under which the FTA contains a general commitment on cross-border supply and individual member states make exceptions for non-conforming measures in their territories. Either approach can be used to reach the same objective.

and stability of the financial system. This exception could, for example be based on the draft EU-Singapore FTA, and require that such measures be reasonable, not be more burdensome than necessary to achieve their objective, and not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on trade.

9.4 Disputes

The analysis in section 7 regarding dispute resolution mechanisms focusses on the situation where criteria for access have been specified in the FTA and an assessment needs to be made about whether those criteria have been satisfied.

If the FTA includes an arrangement under which no comparability of the regimes is required (such as the exemptive regime), there should be less need for a dispute resolution mechanism in relation to that aspect of the regime. Nevertheless, insofar as there are disputes in relation to the exemptive regime (for example, about whether a particular firm amounts to a "qualified counterparty", as discussed above) the dispute resolution mechanisms established for the FTA would seem to be the appropriate forum for resolution of such disputes as well.

10 NEXT STEPS

Once it has determined its preferred approach, the UK should develop a more granular set of proposals, with specific proposals regarding the criteria for access, the mechanisms for assessing and maintaining regulatory alignment (where necessary) and the way in which disputes should be resolved.

APPENDIX

Models for dispute resolution

This Appendix contains details of various models for dispute resolution in the context of FTAs and access rights.

1. CJEU

The CJEU is the forum for resolving disputes relating to EU law. It is also the forum that would consider disputes relating to the TCRs (which themselves are part of EU law).

Under Article 263 of the TFEU, the CJEU has jurisdiction to review the legality of acts of the Commission and other bodies, offices or agencies of the EU (such as ESMA) and, if appropriate, declare them void. A claim can be brought on the grounds of lack of competence, infringement of an essential procedural requirement, infringement of the Treaties, or misuse of powers. Claims under Article 263 can only be brought, however, by EU member states, certain EU institutions or "any natural or legal person" to whom the act of the Commission under challenge is "expressly addressed" or of "direct and individual concern". This means that third countries do not have standing to bring actions to the CJEU. Third country firms may have sufficient standing if the decision is of "direct and individual concern" – and the CJEU has tended to define this narrowly.

2. EFTA Court

The EFTA Court has jurisdiction with regard to EFTA States which are parties to the EEA (at present Iceland, Liechtenstein and Norway) and EFTA (those three plus Switzerland) agreements.

The Court is mainly competent to deal with infringement actions brought by the EFTA Surveillance Authority against an EFTA State with regard to the implementation, application or interpretation of EEA law rules, for giving advisory opinions to courts in EFTA States on the interpretation of EEA rules and for appeals concerning decisions taken by the EFTA Surveillance Authority. Thus, the jurisdiction of the EFTA Court largely corresponds to the jurisdiction of the CJEU over EU States, whose case law it is obliged to follow (and vice-versa).

The EFTA Court consists of four Judges, one nominated by each of the EFTA States. The Judges are appointed by common accord of the Governments for a period of six years.

3 WTO settlement dispute system

Disputes in the WTO are essentially about breaches of obligations under the WTO agreements (wide ranging and broadly formulated rules concerning international trade in goods, trade in services and trade-related aspects of intellectual property rights). If a WTO member believes that one or more fellow-members are violating trade rules, the WTO member will use the multilateral system of settling disputes instead of taking action unilaterally.

The jurisdiction of the WTO dispute settlement system is both compulsory and exclusive. It is a government-to-government system that is only accessible to members of the WTO.

The WTO Dispute Settlement Understanding provides for the procedures and the timetable to be followed in resolving disputes. It includes the setting up of a Dispute Settlement Body ("**DSB**").

The preferred solution is for the members concerned to discuss their problems and settle the dispute by themselves. The first stage is therefore consultations between the governments concerned, and even when the case has progressed to other stages, consultation and mediation are still always possible.

If consultations cannot resolve the dispute, the DSB has authority to establish a panel to consider the merits of the particular dispute. While the role of the panel is advisory, in practice its conclusions are rarely overturned. If the panel decides that the disputed trade measure does break a WTO agreement, it will recommend that the measure be brought into conformity with WTO rules, and its report becomes the ruling of the DSB unless it is rejected by a majority of WTO members.

The Panel's ruling can then be appealed to the Appellate body, whose decision is final.

If a case runs its full course to a first ruling, it should not normally take more than about one year — or 15 months if the case is appealed. The agreed time limits are flexible, and if the case is considered urgent (e.g. if perishable goods are involved), it is accelerated as far as possible. Conversely, complex cases can take much longer. Panel and Appellate Body rulings are automatically adopted unless there is a consensus to reject a ruling — any country wanting to block a ruling must persuade all other WTO members (including its adversary in the case) to share its view.

The WTO dispute settlement system has been widely used (there have been some 500 cases since the establishment of the WTO in 1995). But it is not ideally suited to disputes over regulation, for two key reasons:

(a) The system essentially concerns disputes over "nullification or impairment" of rights (usually rights of market access or rights to national treatment) enjoyed under the WTO agreements: the outcome may be compensation rather than a restoration of rights.

(b) The system has seen few disputes over highly regulated services, as the system is not well suited to adjudicating on regulatory questions.

4. College of supervisors

For systemically important banks and investment firms, supervision and oversight could be undertaken by an international college of supervisors. See section 6 above.

5. ISDS

Investor-state dispute settlement ("**ISDS**") is the traditional model for investor-state dispute settlement in free trade agreements (see NAFTA section below). It allows investors to settle disputes with the national governments of the parties to the agreement before a private arbitration tribunal.

ISDS gives foreign investors alleging a breach of the investment provisions of a bilateral or multilateral agreement (e.g. NAFTA or Mercosur) recourse to international arbitration under rules such as the ICSID (World Bank) or UNCITRAL (UN) arbitration rules. The disputes are normally adjudicated by ad-hoc tribunals appointed by the parties to the dispute and ISDS provides for the possibility of compensation for the investor, which is normally directly enforceable by the investor against the foreign state without the need to involve the investor's home government. It also allows potential investors to take advantage of investment treaties by structuring their investments so that they can be assured that they will benefit from the protections offered by those treaties.

ISDS has been controversial and has been criticised as a method lacking transparency and used by investors to evade public justice in domestic courts. However, proponents argue that it promotes investment by creating a neutral forum for the resolution of investor-state disputes.

6. CETA

The EU-Canada Comprehensive Economic and Trade Agreement ("**CETA**") is a free trade agreement entered into between the EU and Canada in 2016.

Chapter 29 of CETA provides for dispute settlement between the parties to the agreement. In the first instance, the parties should aim to resolve disputes through consultation and voluntary mediation. If this fails, CETA allows for parties to use either the bespoke dispute settlement procedure provided for under CETA, or the WTO dispute settlement procedures, but only one or the other. (Some Chapters of CETA are also carved out of the dispute resolution mechanism.)

Either party may refer the dispute to an arbitration panel composed of three arbitrators and the parties can choose the composition of the panel. Where the parties are unable to agree, the composition of the panel is chosen from a pre-agreed list of at least fifteen arbitrators (five of whom are Canadian nationals, five from the EU and five from third countries). The panel is made up of one EU national, one Canadian national and one national of a third country (who acts as chair of the panel).

The panel publishes its determinations in an interim report and subsequently a final report. The latter is binding on the parties and if the losing party fails to comply with the panel's judgment, the winning party may receive compensation or suspend some of its obligations under the Agreement up to the extent of the losing party's breach. The remedies are temporary and can be lifted once the party in breach has complied with the determinations in the final report.

Chapter 8 of CETA also contains separate provisions for the settlement of investment disputes. It confers a number of protections including compensation for losses, expropriation of property and national (i.e. non-discriminatory) treatment. The arbitration arrangement for investor-state dispute resolution under CETA is known as the Investment Court System ("**ICS**") and was introduced to replace the more traditional Investor-State Dispute Settlement method (see below under "NAFTA"). Unlike ISDS, ICS is an institutionalised investment dispute resolution system with a Tribunal of First Instance and an Appeal Tribunal, both comprising permanent judges. ICS was developed as a response to the criticism of the neutrality and transparency of ISDS.

ICS provides for an arbitral tribunal comprised of three arbitrators, one of which is appointed by the investor, another by the defending government, and the third by agreement of the two disputing parties, or by agreement of the two appointed arbitrators, or by an appointing authority. The arbitrators are chosen from a roster of fifteen people that is created by Canada and the EU and comprises five Canadians, five EU nationals, and five members from non-party third countries.

7. Multilateral investment court

The Commission and the Canadian Government are working together to establish a "multilateral investment court". The idea is to establish a permanent body to decide investment disputes, moving away from the ad-hoc ISDS system – see paragraph 5 above.

The multilateral investment court would adjudicate disputes under future and existing investment treaties. For the EU, it would replace the bilateral Investment Court Systems included in the recent EU level trade and investment agreements.

By way of background, the Commission is pursuing the objective of developing a fully-fledged, permanent multilateral investment court in order to develop a coherent, unified and effective policy on investment dispute resolution.[30] The Commission intends to engage in consultation on this shortly.

CETA and the EU-Vietnam trade agreement both contain a reference to the establishment of a permanent multilateral investment court. The EU includes similar references in all of its ongoing negotiations involving investment.

8. EU-Switzerland bilateral arrangements

A large number of bilateral agreements govern the EU-Switzerland economic and trade relationship.

Each agreement applies different elements of EU law to Switzerland. Some, like the agreement on the free movement of persons, apply substantive sections of EU law. Others, for example the free trade agreement, do not.

Each of the principal agreements establishes its own 'joint committee'. As with CETA, these joint committees are made up of representatives of the EU and Switzerland. In each instance, they have responsibility for managing the agreement, ensuring its proper application, and taking any steps required to implement the adjustments or revisions provided for in the agreement itself.

All of the bilateral agreements are treaties, and hence give rise to binding commitments in international law. Should disputes under the principal agreements not be resolved by the relevant joint committee, the ultimate remedy would ordinarily be termination, and some of the agreements are linked, such that if one is terminated, so are others. With a few exceptions, there is usually no recourse to a court or tribunal.

30 See the Concept Paper of 5 May 2015 on "Investment in TTIP- the path beyond" and the Commission's Trade for all communication of 2015.

9. NAFTA

North American Free Trade Agreement ("**NAFTA**") has clear rules on dispute settlement, including in relation to investment disputes, financial sector disputes and a main dispute settlement procedure.

Chapter 11 of NAFTA provides for the ISDS dispute resolution system that was initially included in CETA and later replaced by ICS. An investor claiming that a host government has breached its investment obligations may have recourse to one of the following arbitral mechanisms:

(a) the World Bank's International Centre for the Settlement of Investment Disputes (ICSID);

(b) ICSID's Additional Facility Rules; and

(c) the rules of the United Nations Commission for International Trade Law (UNCITRAL Rules).

Each Party is required to provide for enforcement of the arbitral award made by the tribunal in its domestic courts.

Chapter 20 of NAFTA sets out a general dispute resolution mechanism for disputes relating to the interpretation of NAFTA. In the first instance, the relevant governments aim to resolve any potential disputes amicably through NAFTA's Committees and Working Groups or other consultations. If it is not possible to reach a mutually acceptable solution, NAFTA provides for the referral of disputes to ad-hoc arbitration, involving a five-member arbitral tribunal. Each party is able to select two members of the tribunal and the fifth, the Chairman, must be agreed by the Parties. The decision of the tribunal is binding.

The resolution of disputes in the financial sector follows the same procedure as the Chapter 20 process, and in addition provides for arbitrators to be chosen from a list of financial services experts.

10. Mercosur

Mercosur (or Southern Common Market) is a regional trading bloc and customs union encompassing Argentina, Brazil, Paraguay, Uruguay and Venezuela (with other South American countries as associate members).

Under the treaties establishing Mercosur, in the first instance, disputes are resolved by direct negotiations. If agreement is not reached, or is only agreed in part, the parties can agree to submit the dispute to:

(a) the Common Market Group (made up of representatives of the Mercosur member states) to issue a recommendation; or

(b) an ad hoc arbitration tribunal.

Decisions of the ad hoc tribunal can appeal on a point of law to a Permanent Review Tribunal which can issue a decision by majority agreement. Decisions of the Permanent Review Tribunal are final and are binding on the parties.

11. New Zealand-Korea Free Trade Agreement

The New Zealand-Korea FTA includes a mechanism for the resolution of disputes, in the form of an arbitration panel. The parties must comply with the findings and rulings of the panel.

The parties may also agree alternative forms of dispute resolution, including through conciliation or mediation.

The focus is on co-operation and consultation to reach a mutually satisfactory outcome.

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