On the 29th of March; the Prime Minister confirmed that President of the European Council Donald Tusk had received the letter formally notifying him of the UK’s intention to leave the EU. Nine months after the initial referendum vote, it is this action that commenced the two year negotiation period.

As we are now four months into the exit period, agreeing transitional arrangements, as soon as possible; remains our number one priority. This is to ensure we have an orderly and well controlled exit from the EU and to give our FS companies as much certainty as possible before they have to deploy their contingency plans.

The Prime Minister also confirmed that the Government would publish a White Paper setting out plans for the ‘Great Repeal Bill’, which will transfer various EU laws on to the UK statute book.

Domesticating EU Law is widely recognised as the biggest legislative challenge that the UK has ever faced, both in its scale and complexity. Some 12,000 EU regulations require to be translated into UK Law and some 7,900 statutory instruments, plus primary legislation.

This challenge is compounded, by the very tight timescale in which to deliver it.

The ‘Repeal Bill’ needs to maintain the current position on the exit date, by preserving a robust regulatory regime and providing legal certainty. This is essential to maintain business confidence and stability for financial service companies and ensure the proper functioning of the state and society.

The UK remains the leading international centre for banking, financial and professional services. Scotland is the second largest FS centre in the UK next to London and has a highly diverse and sophisticated financial ecosystem.

Through many years, the Scottish FS sector in line with the rest of the UK has developed into a highly interdependent and interconnected ecosystem, comprising a large variety of firms, with many providing world class services, products and advice.

It is also important that for any new trade agreements established; they are as ‘friction free’ in their execution; as possible. This is in order to minimise any impacts on companies, their customers and clients. It is vital that we retain our reputation for being a country where it is easy and efficient to do business in. Any proliferation in complexity, creates a poor customer experience and can drive unwanted cost into business operating models.
Foreword

The UK’s exit from the EU and the new relationship with the EU are critical to the UK based financial services sector and to the wider economy that it serves.

As alluded to earlier, it is a highly interconnected ecosystem, developed over many years; and the impact of the UK’s exit from the EU could be could be more impactful than what is immediately obvious.

With Brexit negotiations now underway, it is important to prioritise the needs of the UK economy. The FS sector is and always has been, a hugely significant contributor to the UK economy and exports, contributing around £120BN GVA with around 1.1M people working in financial services up and down the country. The UK FS sector paid £71Bn in Tax which constitutes 11.5% of the UK total, higher than any other sector.

After three centuries of development and innovation; Scotland is no different in the concentration and diversity of its financial services industry and the significant number of people it employs directly and indirectly.

As the second largest FS centre in the UK; the numbers translate into £8.6BN of Scottish GVA, 4.4% of Scottish exports, 86,000 direct employees, with at least another 55,000 employees, providing value-added support services such as marketing, analytics, data science etc...

This scale means that all parties – the UK and the EU-27 – need to put business and the interests of customers and clients, at the heart of the negotiations.

We would suggest that the focus should remain on the following:

- Effective bridging and adaptation periods to enable a smooth and orderly Brexit
- Mutual market access based on mutual recognition and regulatory co-operation
- Mutual access to the best global talent

Early agreement of transitional arrangements

Temporary transitional arrangements are critical to ensure an orderly and non-disruptive exit from the EU. They will ensure continuity for businesses and customers at the point of exit, when existing rights and obligations may disappear overnight.

Arrangements need to cover the time between the date the UK exits the EU and the date the new partnership agreement is ratified and becomes unconditional i.e. a bridging period. A further phase, an adaptation period; starting on the date the bridging period ends or, if there is no bridging period, on the date of exit.

This will give companies, their customers and regulators; time to consider the implications of the new partnership and to adapt to the rules underpinning it.
The nature of this transition period and any phases within it, will depend on the new UK-EU trading relationship.

As mentioned earlier, transitional arrangements should be agreed as soon as possible, to help manage uncertainty for businesses and bolster confidence. Due to the wide variety of activities and business operating models, different companies will require certainty by different cut off points. Ideally there should be certainty on transitional arrangements by Q3/4 2017.

The bridging period should ideally include a temporary extension of passporting rights to help support efficiently functioning markets, investor protection and continuity of service provision to customers and clients.

Transitional arrangements need to cover new as well as existing business. Given the strong links between UK and EU markets, many existing contracts, distribution agreements and LTA’s will extend beyond the date of Brexit.

It is in the mutual interest of the UK and the EU-27 that early agreements are struck on the ability of these commercial contracts to be grandfathered, not least so, that firms can continue to service existing relationships with EU clients and customers following Brexit. This is particularly important in relation to long-dated contracts such as pensions.

**Bespoke deal delivering mutual market access**

The UK should seek to agree a bespoke agreement with the EU-27 to allow for mutual market access. This should be based on mutual recognition and regulatory co-operation. It should deliver the same, or comparable, market access rights to those currently available. UK-based businesses want to continue to provide and have access to the widest possible range of financial and related professional services and products without the need to establish a commercial presence in each market.

**Mutual recognition**

Mutual recognition is a long-standing international principle based on the understanding that two regimes have similar regulatory objectives and that the outcomes they deliver are broadly comparable. The notion of mutual recognition implies that a good/service entering one market from another market should be allowed unhindered access even if the relevant domestic regulation somewhat differs from those in the country of origin, as long as the outcomes and regulatory objectives are similar. It is the end-result not the means to deliver it that is the focus.

**Regulatory co-operation**

In order to preserve global markets and maintain the flow of financial services, it is in the interests of both the UK and the EU to ensure continued deep and ongoing regulatory and supervisory co-operation between authorities across the globe. The FCA and PRA have excellent relations with the ESAs and Member States’ competent authorities. There are also good links between the ECB and the wider work of the Bank of England. These should be maintained post-Brexit so that
regulatory needs are appropriately satisfied and current market structures that customers rely on are not disrupted. Regulatory coherence could take the form of, for example, equivalence, mutual recognition, exemptive relief or substituted compliance.

**Mutual access to talent**

There is an unequalled pool of global talent and expertise assembled in the UK. This is a major competitive advantage across the UK-based financial and related professional services industry and many others. To retain its status as the leading global financial centre, the UK and Scotland within it, needs continued access to the best talent: home-grown, from across the EU and from the rest of the world.

**Executive Summary:**

As an overall objective, UK FS industry is seeking access to the Single Market comparable to the levels of access we currently have.

FS companies want to keep as much of their activities in the UK as possible which needs to be done within the confines of regulatory and operational considerations. Companies also want to continue to service their existing EU customers and clients following Brexit, with as little disruption as possible.

It is a regulatory requirement for FS companies to manage risk and have plans in place to mitigate against these. Sam Woods, Deputy Governor at the Prudential Regulation Authority (PRA), wrote a letter to all firms regulated by the PRA on 7 April 2017, requesting details on firms’ full contingency plans, covering a ‘range of potential scenarios, including the most adverse potential outcomes’ by 14 July. Accordingly FS companies are putting in place contingency plans and structuring solutions on the assumption that various scenarios could apply. For these different scenarios, the extent of any disruption will depend on the way that individual businesses require to re-structure their current operating models.

Clearly, there is uncertainty around equivalence at this stage. Firms would prefer arrangements to be negotiated that enable EU and UK firms to access each other’s markets on the basis that their respective regimes are broadly consistent. Current TCR’s do not provide a long term, sustainable solution for the entirety of the FS ecosystem.

Government and FS need to work much more closely together to understand in more detail, what needs to be negotiated and put in place, to secure an orderly Brexit and an effective transition to a new UK-EU relationship both for FS companies and their customers and clients. This means a greater frequency of meetings and consultations to exchange ideas, formulate joint strategies and share networks of contacts in the EU.

Brexit may provide an opportunity for the UK to reconsider its regulatory approach so that the framework is more tailored to the specifics of the UK market.

Whilst the financial services sector is not seeking a “bonfire of regulation”, some companies feel that this re-framing should be considered in parallel with the exit
agreement negotiations. Equally, the financial services sector recognises the value of having a regulator that is recognised globally for its high standards and leadership.

The general view across the financial services sector is that the two-year negotiation period is unlikely to provide sufficient time to negotiate the UK’s exit arrangement, for the

UK Government to redefine its ongoing relationship with the EU, or provide the lead time needed for firms to effect any required reorganisation or restructuring.

There are a number of areas where securing “grandfathering” rights is important for firms, not least so that firms can continue to service existing relationships with EU clients and their customers following Brexit.

Ensuring continuity of existing contractual arrangements is important across the financial services sector.

Continued access to talent after Brexit is also essential to the ongoing success of the UK-based financial services sector and a solution needs to be found to ensure such access can continue in the future.

Finally, financial service companies of all types and scale, rely on the ability to transfer and use personal data freely to run their internal operations and also to provide new and ongoing services to existing customers. Ensuring that they can receive and transfer personal data is a key priority that should be kept front of mind.

I do hope this paper is a helpful summary of the challenges facing the UK Financial Services sector and Scotland. The scale, diversity and sophistication of Scotland’s FS ecosystem, is of national importance both in terms of its contribution to the economy and employment.

We need to ensure we work together to get the best possible deal going forward, which will require close working between the FS sector and government.

SFE will continue to work actively, with both governments and their agencies; with energy and commitment, to represent the needs and concerns of its members, their customers and clients throughout the process.