

# **BRITISH AMERICAN FINANCE ALLIANCE:**

Scoping paper on formalizing UK-U.S. regulatory dialogue

## Executive Summary

The Financial and Regulatory Working Group (FRWG) presents a unique, unrealized opportunity to establish a new gold standard in cross-border regulatory coordination and supervisory cooperation between the United Kingdom (UK) and the United States (U.S.). In this paper, the British American Finance Alliance (BAFA) looks to help policymakers establish a new, robust mechanism through which coordination and cooperation can take place.

Our interest in regulatory cooperation is grounded in a desire to see improved and more consistent regulatory outcomes. More compatible regulatory outcomes, in turn, provide a strong basis for cross-border investment, growth and job creation across the entire economy – agriculture, manufacturing and services. We believe the model for regulatory cooperation set out in our paper will provide a robust foundation for stronger economic outcomes.

The COVID-19 crisis strengthens the case and opportunity for greater UK-U.S. regulatory cooperation. Minimizing market fragmentation as global economies re-open for business will be central. UK-U.S. regulatory dialogue will be an important element. COVID-19 has highlighted the importance of sound regulatory practices in key policy areas such as prudential standards. Greater systematic cooperation in these areas will ensure a more robust global recovery.

Most barriers preventing cross-border trade and investment in financial and professional services in the 21st century are regulatory in nature. For a rapidly evolving and heavily regulated industry such as financial services, regulation – and the mechanism through which the UK and U.S. discuss it - is therefore an essential component in the re-defining of the UK-U.S. relationship.

BAFA recognizes there has been a long-standing debate – in which most of our members have participated over many years – regarding what is the appropriate relationship between regulatory cooperation and trade agreements. BAFA believes that a ‘first best’ solution would be for a UK-U.S. trade agreement to include provisions establishing a framework for continuing the existing UK-U.S. financial regulatory working group. However, the organization and governance of the regulatory cooperation group – as well as its areas of substantive focus - should be established outside of the trade text, in a separate understanding, possibly building on how the FRWG already operates.

The FRWG can play a key role in promoting effective and pragmatic solutions to regulatory challenges on a number of priority topics. Some of these are ‘live’ issues that countries are wrestling with now. But a truly robust regulatory cooperation mechanism should be built to process future or fast evolving issues such as technology.

While there are positive features in existing cross-border regulatory mechanisms between the UK and U.S., more should be done to achieve a truly ‘gold standard’ arrangement. Presently, the existing FRWG mechanism tends to be fluid without a clear process. There are merits to having flexibility but there is a risk that processes lack predictability and transparency. In this paper, BAFA sets out several features that the FRWG should explicitly adopt:

- Successful regulatory cooperation requires robust stakeholder engagement including with industry groups. The FRWG should therefore promote open and direct engagement with industry to facilitate identifying and addressing cross-border issues early in the process. The formalization of procedures related to both the FRWG itself and its dialogue with BAFA will serve to enhance the efficiency of the process and signal an enduring commitment to regulatory cooperation and industry engagement.
- The regulatory cooperation process should be dynamic and underpinned by regular, formal meetings.
- The titles of core members involved in the dialogue and the departments and agencies they represent for their jurisdiction.
- The FRWG should commit to sharing more detailed meeting outcomes, helping establish a virtuous and more continuous process.

We believe the model for regulatory cooperation set out in our paper will provide a robust foundation towards stronger regulatory coherence and better economic outcomes. We hope policymakers on both sides of the Atlantic will engage with us to discuss translating this vision into a practicable reality.

## Introduction

In April 2018, HM Treasury (HMT) and the U.S. Department of the Treasury (UST) announced<sup>1</sup> the formation of a U.S.-UK Financial Regulatory Working Group (FRWG), to promote financial regulatory cooperation and increased compatibility between the countries' regulatory frameworks.

In September 2018, 17 UK and U.S. business representation organizations formed the UK-U.S. Financial and Related Professional Services Industry Coalition with the aim of actively contributing specific industry input into the FRWG as well as providing an industry perspective to the ongoing trade and investment discussions between the United Kingdom and the United States. In two years, the Coalition has extended its membership to over 20 associations and relaunched as the British American Finance Alliance (BAFA).

This paper sets out BAFA's vision for UK-U.S. regulatory dialogue and advocates that mechanisms for coordination with the financial and professional services sector be built into the FRWG process. It also highlights potential opportunities and issues that should be featured on the FRWG agenda.

## The unique opportunity

The redefining of the UK-U.S. relationship presents a unique opportunity to establish a new gold standard in cross-border regulatory and supervisory cooperation. A UK-U.S. Free Trade Agreement (FTA) has the potential to align political support around a long-term vision for these efforts. Regardless of whether both sides achieve an FTA, there is an existing opportunity to repurpose the FRWG as the robust, long-term mechanism through which that coordination and cooperation takes place and unintended market access barriers can be avoided – to date, this group's work has focused largely on bilateral Brexit-related issues. This opening is unique for three inter-related reasons:

- The UK and U.S. are both market-oriented economies that are home to the world's two leading financial centres. They offer comparable regulatory approaches, use a common language and have a higher ratio of capital market finance compared with other jurisdictions. That context provides a solid foundation for future co-operation.
- Political goodwill and, arguably, uniquely strong levels of trust between financial regulatory and supervisory authorities provide a climate conducive to developing an ambitious future relationship.
- The importance of these two countries to international finance means that decisions they make together will have an impact well beyond their respective borders. Their markets' size and significance would mean that a high-quality regulatory direction from the UK and U.S. could 'spill over' to other markets benefiting both financial centres.

This opportunity will not be realized without a significant investment in advocacy by the industry. The public sector is focussed on the response and recovery from the COVID-19 pandemic and economic crisis. In the U.S., much of the focus is on the relationship with China, and the 2020 U.S. presidential and congressional elections. In the UK, efforts are focused on readying the country for the end of the transition period from the European Union (EU).

1. U.S. Department of the Treasury, 'U.S.-UK Financial Regulatory Working Group Joint Statement', (September 2018) available at: <https://home.treasury.gov/news/press-releases/sm485>

It is therefore important that the future UK-U.S. bilateral regulatory relationship be established as a high enough priority to transcend alternative outcomes in those national contexts and deliberations. Developing a long-term vision for this relationship will be central in achieving this ambition.

## Achieving gold standard regulatory cooperation

In today's economy, many barriers and frictions preventing cross-border trade and investment in financial and professional services are regulatory in nature rather than the consequence of 'classic' trade barriers. This is particularly true for services where tariffs and quotas typically do not apply.

For a rapidly evolving and heavily regulated industry such as financial services, regulation is therefore an essential component in the re-defining of the UK-U.S. relationship.

There are positive features in existing cross-border regulatory mechanisms between the UK and the U.S. The FRWG has been effective as a forum for addressing Brexit-related concerns. Looking ahead, more could be done to achieve a truly 'gold standard' forward-facing arrangement.

We believe that by establishing the right parameters and repurposing the FRWG behind a long-term vision, regulatory dialogue will reduce cross-border frictions between the UK and U.S., bolster cross-border investment, and support stronger economic growth and job creation for both parties.

In that spirit, what follows are several building blocks that could support this repurposing and help establish a vision for effective bilateral regulatory cooperation through the FRWG.<sup>2</sup>

## Regulatory cooperation in a trade agreement

As the UK and U.S. negotiate an FTA, which will include provisions on financial services, it is relevant to consider the relationship between the trade agreement and the financial regulatory working group and its impact in promoting cross-border regulatory cooperation.

The FRWG is an existing forum that involves dialogues most appropriately held between the key financial regulators, rather than trade experts. However, it is important to consider whether the UK-U.S. trade agreement can further the goals of the FRWG – and international regulatory cooperation more generally – through a formal framework, or reference, in the context of the trade agreement.

The key objective within this is consistent regulatory coordination and cooperation between the UK and the U.S. – to the extent that can be achieved. Such cooperation will underpin the identification and reduction of unintended market access barriers to financial services providers, and underpin the existing mutual support of each other in international regulatory fora. Trade agreements are critical tools to promote cross-border commerce through robust market access and cross-border services commitments. Existing international agreements present a range of options based on differing ambitions for regulatory harmonization. The European Union's Single Rulebook, with the objective of creating a high-level of harmonization through a suite of prudential rules, is the most comprehensive example of achieving consistency across financial regulatory approaches. The EU-Japan Economic Partnership Agreement (EPA) takes a different approach through its regulatory cooperation Annex 8-A. This seeks to establish the principles for ongoing regulatory cooperation underpinned by international standards. Importantly, this latter approach does not limit the sovereignty of national regulators.

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2. BAFA also supports inclusion of measures to promote deference and substituted compliance alongside measures for UK-U.S. regulatory coordination and supervisory cooperation, but that is beyond the scope of this paper.

In the UK-U.S. case, securing commitments to regulatory and supervisory cooperation, and a firm willingness to work towards achieving coherence when it is productive and mutual recognition when coherence is not productive, should not impinge on national independent institutions' rights to regulate.

Enshrining in a trade agreement a framework for regulatory cooperation dialogues would provide greater regulatory and market certainty for ongoing regulatory cooperation and would clearly signal firm commitment to avoid unintended market access barriers that have arisen from regulatory measures. Furthermore, embedding the principles of this regulatory cooperation within an agreement, and grounding in law commitments to the use of deference, substituted compliance and similar methods, would be of value in defining both parties' collaborative spirit.

It is also crucial that the two sides have the flexibility to deliver regulatory cooperation in a fast- changing world, and that the relevant financial experts continue to address these challenges. Constraining that cooperation rigidly solely within a trade agreement would not guarantee that dialogues could keep up with changes in technology, international regulatory architectures and political and societal changes. It is also vital that this regulatory cooperation takes place in an expert forum and is undertaken by the regulatory agencies whose independence, autonomy and technical expertise are vital to financial stability. It is also crucial this process is not subject to trade arbitration and that it permits full participation by the affected industries.

**BAFA therefore recommends that a 'first best' solution would be for a trade agreement to include provisions establishing a framework to continue the existing UK-U.S. FRWG, or a similar UK-U.S. regulatory forum. A trade agreement would include the principles which this framework should seek to implement. In addition, this framework should include trade agreement provisions to foster opportunities for stakeholder engagement and transparency, while making clear that any decisions of this regulatory working group would not be subject to the dispute resolution or arbitration provisions of the trade agreement. The organization and governance of the regulatory cooperation group should be established outside of the trade text (based on the principles and issues discussed in this paper) in a separate understanding, possibly building on how the FRWG already operates. Finally, it should have a clear mandate to consider and resolve unintended market access barriers to the greatest extent possible while maintaining high prudential outcomes.**

### **Box 1: The Future of UK-U.S. Trade and Investment in Financial and Professional Services**

A new UK-U.S. financial and professional services relationship must be forged on the dual tracks of regulatory cooperation and trade and investment. Both present huge opportunities for these two economies to use their unique cross-border relationship to lay a foundation for greater prosperity. These two pillars can also be reinforcing and complementary.

UK-U.S. trade and investment in financial and professional services is already significant. For example, the U.S. exports around \$16bn worth of financial services to the UK per annum – 70% more than it exports to USMCA partners, Canada and Mexico, combined. The UK, in turn, exports over \$28bn worth of financial services to the U.S.<sup>3</sup>

As the UK-U.S. trade negotiations continue, BAFA will work collectively, and through our individual organizations, to ensure that the scope of a final agreement is as ambitious as possible for financial and related professional services. The agreement should, for example:

- **Ensure the free flow of data:** The financial services chapter of the United States, Mexico and Canada Agreement (USMCA) is a good example of a strong free flow of data provision that a UK-U.S. agreement can draw upon. It updates the approach from the 1997 GATS Understanding.

3. BEA, 'International Transactions, International Services, and International Investment Position Tables', (September 2020), available at: <https://apps.bea.gov/iTable/iTable.cfm?reqid=62&step=9&isuri=1&6210=4>

- **Prohibit data localization measures:** The UK and U.S. should prohibit data localization as long as financial institutions provide the access to data to regulators for their regulatory and supervisory purposes. This is especially important in light of the recent European Court of Justice decision in the Schrems II case that invalidated the U.S.-EU Privacy Shield data transfer regime, and the ensuing push from certain privacy regulators across Europe to promote localization.
- **Explore deeper regulatory cooperation in FinTech:** The UK and U.S. should seek to complement multilateral and other bilateral efforts aimed at promoting cross-border financial technology development and growth, through the Financial Innovation Partnership or other means.
- **Deference/substituted compliance:** The UK and U.S. should commit to comity in financial services through use of mutual recognition, deference, substituted compliance and similar methods.
- **Investment:** The agreement should include transparent, stable and predictable rules which guarantee that both parties treat foreign investors fairly. Investors should be allowed to transfer their capital in the U.S. back to the UK and vice versa. Any remaining barriers to foreign investment should be identified and addressed.
- **Secure investor protections:** Financial institutions must invest abroad to serve customers and clients and, in doing so, make significant investments under the prudential regime of the trading partner. These investments should be protected in a UK-U.S. agreement.
- **Provide for effective dispute resolution system:** A UK-U.S. agreement should include robust investor protection measures that extend to financial services. Given the complexities of specific sectors of the FRPS industry, the body tasked with adjudicating any dispute should include an individual who is an expert in the field.
- **Include an ambitious chapter on digital trade:** This should include, for example, prohibitions against customs duties, fees, and other charges in connection with the import or export of digital products transmitted electronically. It should also prohibit application of discriminatory measures to digital products distributed electronically.
- **Modernize market access commitments:** The negotiators should revisit the standard financial services trade and investment commitments across all modes of services trade, most of which were developed in the early 1990s, and modernize them to maximize the facilitation of financial services trade and investment between our markets.

This list is not exhaustive but provides a flavor of what matters most to BAFA members in driving growth and employment.

It has long been recognized that regulatory inconsistencies, in addition to conventional market access barriers, can inhibit cross-border trade and investment in financial and related professional services. That is why it is important that the trade and regulatory tracks are complementary and inform one another as relations evolve and deepen.

**As set out elsewhere in this paper, BAFA believes the trade agreement should include reference to the establishment of a UK-U.S. financial regulatory cooperation group with the organization and governance established and maintained separately.**

## Potential priority areas for the future agenda of the FRWG

In its current guise, the FRWG plays a key role in promoting effective and pragmatic solutions to regulatory challenges. To date, most of these have been 'live' issues created by Brexit. For the FRWG to become a robust regulatory cooperation mechanism necessary for delivering a forward-looking vision for the bilateral relationship, it should consider future or fast evolving issues.

Existing issues include:

- **Market integrity:** UK and U.S. regulators both prioritize enforcement against the abuse of inside information, but the legal basis and scope of the offences of insider dealing differ significantly between the UK and the U.S. The divergence has significant implications for funds: both the EU and the U.S. regimes have potential extra-territorial impact, and fund compliance policies often need to take both regimes into account. Outside the EU, the UK could adopt its own approach to insider dealing. The FRWG could explore whether the UK and U.S. would be willing to work together on this area.
- **Data transfer:** Restrictions on cross-border data-flows threaten the ability of firms in the UK and the U.S. to harness the full potential of transatlantic trade. Both countries share numerous objectives and similarly high ambition in data policy. The FRWG should provide a forum through which a mechanism could be established to permit a financial or professional services firm that is regulated in either jurisdiction to transfer information that is relevant to their licenced activities into and out of that jurisdiction.
- **FinTech:** The traditional prudential model of regulation based on capitalization and liquidity may not be suitable for start-up companies or for other smaller technology companies that facilitate transactions without holding money reserves or providing capital themselves. The UK and U.S. are leaders in FinTech and regulatory fora have a role in taking forward cooperation and innovative solutions in this area. The establishment of the U.S.-UK Financial Innovation Partnership (FIP) in 2019 is a ready-made platform to build on and deepen bilateral engagement on emerging trends in financial services innovation. We support the stated aims of the FIP, including boosting collaboration with the private sector, sharing information and expertise about regulatory practices and promoting growth and innovation.
- **Cyber security and operational resilience:** As the pace of technology innovation and adoption increases, cyber-attacks are becoming more sophisticated and targeted. For many firms, technology risks and vulnerabilities are heightened through increased use of mobile, social, cloud, and web technologies. Regulators and industry could share insights and learning around protecting the financial and related professional services industry from cyber risks. Industry and regulators could also share insights on their approaches to operational disruptions which have the potential to harm consumers and market participants, threaten firm viability, and cause instability in the financial system. This issue also has potential relevance to the FIP agenda.
- **Prudential measures:** There are several areas of prudential regulation where the two jurisdictions could explore ways to make standards more compatible so as to remove unnecessary inefficiencies between the two regulatory frameworks. There is notably scope to improve the coherence of stress testing frameworks and internal TLAC levels as well as strengthen cooperation in relation to resolution of cross-border groups. There could also be closer collaboration between the UK and the U.S. on the implementation of the remaining Basel III standards in terms of their calibration and timing. Regulators could also explore options for facilitating cross-border supervisory cooperation.
- **Unintended market access barriers:** As a highly regulated sector, financial services firms often find that regulatory divergences, or regulations that are not proportionate to the scale of overseas operations can unintentionally bar them competitively operating in a foreign market. Greater regulatory cooperation with an explicit mandate to address regulatory market access barriers and appropriate industry participation could create a best-in-class system for encouraging trade and investment while maintaining high prudential outcomes.

FRWG discussions should also consider issues of international scale. These include:

- **Global financial stability:** Effective cooperation between regulators in different jurisdictions is vital in both delivering financial stability and ensuring that the global financial system can make its full contribution to economic growth through robust flows of cross-border capital formation.
- **Market fragmentation:** There are several substantial differences between the regulatory frameworks in the UK and the U.S., and regulatory fragmentation between the two leading financial centres inevitably contributes to fragmenting the global financial system as a whole. Conversely, if the two countries work together to develop common standards, global fragmentation would be significantly reversed.
- **Establishing a level playing field:** G20 Leaders in 2009 resolved to ‘... take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage’. However, global approaches continue to be undermined by the unilateral and uncoordinated implementation (and extraterritorial application) of rules by individual jurisdictions.
- **The work and progress of the international standard-setting bodies:** The UK and U.S. should acknowledge the many areas on which they are aligned and, where possible and mutually desirable, present a united front in global standard-setting bodies. Further, at an appropriate time, the development of some form of UK-U.S.-EU trilateral regulatory and supervisory dialogue should be considered.

Other areas that are important for the industry that should be addressed but are not directly under the FRWG purview include:

- **Audit and accounting:** The UK framework is currently undergoing a series of reforms which will affect not only audit firms but also other players in the corporate and financial reporting ecosystem. These reforms emanate from three reviews: the structure of the audit market (by the Competition and Markets Authority); the regulation of the audit market (led by Lord Kingman); the quality and effectiveness of audit (led by Sir Donald Brydon). Taken together, they have the opportunity to increase choice in the listed audit market, incentivise high quality audits (including through the creation of a strong, independent and forward-looking regulator), improve market resilience and strengthen the wider corporate governance framework (including the introduction of a UK equivalent of Sarbanes-Oxley). The UK audit and accounting sector is strongly committed to international standards, both because of the public and market confidence which compliance with them generates and their role in increasing foreign direct investment and promoting cross-border capital market activity. The FRWG provides an opportunity for greater cooperation between the UK and U.S. on accounting and audit matters to promote convergence of standards which will in turn reduce both risk and associated compliance costs for companies subject to both UK and U.S. audit requirements.

There should also be efforts to be creative in including sub-federal issues in bilateral discussions, as well as the inclusion of sub-federal financial regulators where regulation is undertaken at the state level. On certain areas, this will be critical to the success of talks. For example, each U.S. state has its own procurement access conditions and, across FRPS, state-level regulation applies in varying degrees to the insurance, legal and financial services sectors. Addressing regulatory issues between the UK and U.S. will often require action to be taken at both state and federal level.



## Architecture for dialogue between officials

The FRWG process should be dynamic, working incrementally towards greater integration. This should be underpinned by formal meetings that take place at regular intervals.

BAFA members would welcome the publication of meeting dates well in advance which are shared with key stakeholders. Announcement of the forthcoming year's meetings in December would facilitate longer-term thinking and planning for both officials and private sector representatives, and express a commitment to robust, forward-looking dialogue.<sup>4</sup>

The FRWG joint statement commits the group to "be used as a platform for furthering financial regulatory cooperation, with the general operational objective to improve transparency, reduce uncertainty, identify potential cross-border implementation issues, work towards avoiding regulatory arbitrage and towards compatibility, as appropriate, of each other's national laws and regulations."

BAFA recognises these as useful general objectives and suggests that setting out explicit goals in specific regulatory areas would help increase the sense of accountability and ensure that issues are followed up and commitments are met. Making public the titles of core members involved in the dialogue, and the departments and agencies they represent for their jurisdiction, would give further structure to the regulatory cooperation process and create a sense of ownership for the FRWG.

Policy and regulatory discussions tend to take place behind closed doors and the contents of these dialogues are only minimally released into the public domain, in some cases several weeks after the meetings. It is understandable that certain issues are sensitive and need to be discussed in private. However, this should not mean that only general level information is made public, as it inhibits effective private sector engagement. BAFA would welcome the sharing more detailed meeting outcomes with the private sector within one week of any formal meeting. A dedicated webpage on both of the treasuries' websites could be a useful way of sharing information.

Open and direct engagement with industry would facilitate identification of cross-border issues in a timely fashion. Although regulatory cooperation has helped to address a number of critical concerns for the industry, these issues often are addressed very late in the decision-making process. Involving industry at an early stage will help regulators to assess any effects of various proposals on market stability and institutions operating in both jurisdictions, and can facilitate development of effective solutions.

## Architecture for dialogue between officials and BAFA

The formalization of procedures related to both the FRWG itself and its dialogue with BAFA will serve to enhance the efficiency of the process and signal an enduring commitment to regulatory cooperation and industry engagement.

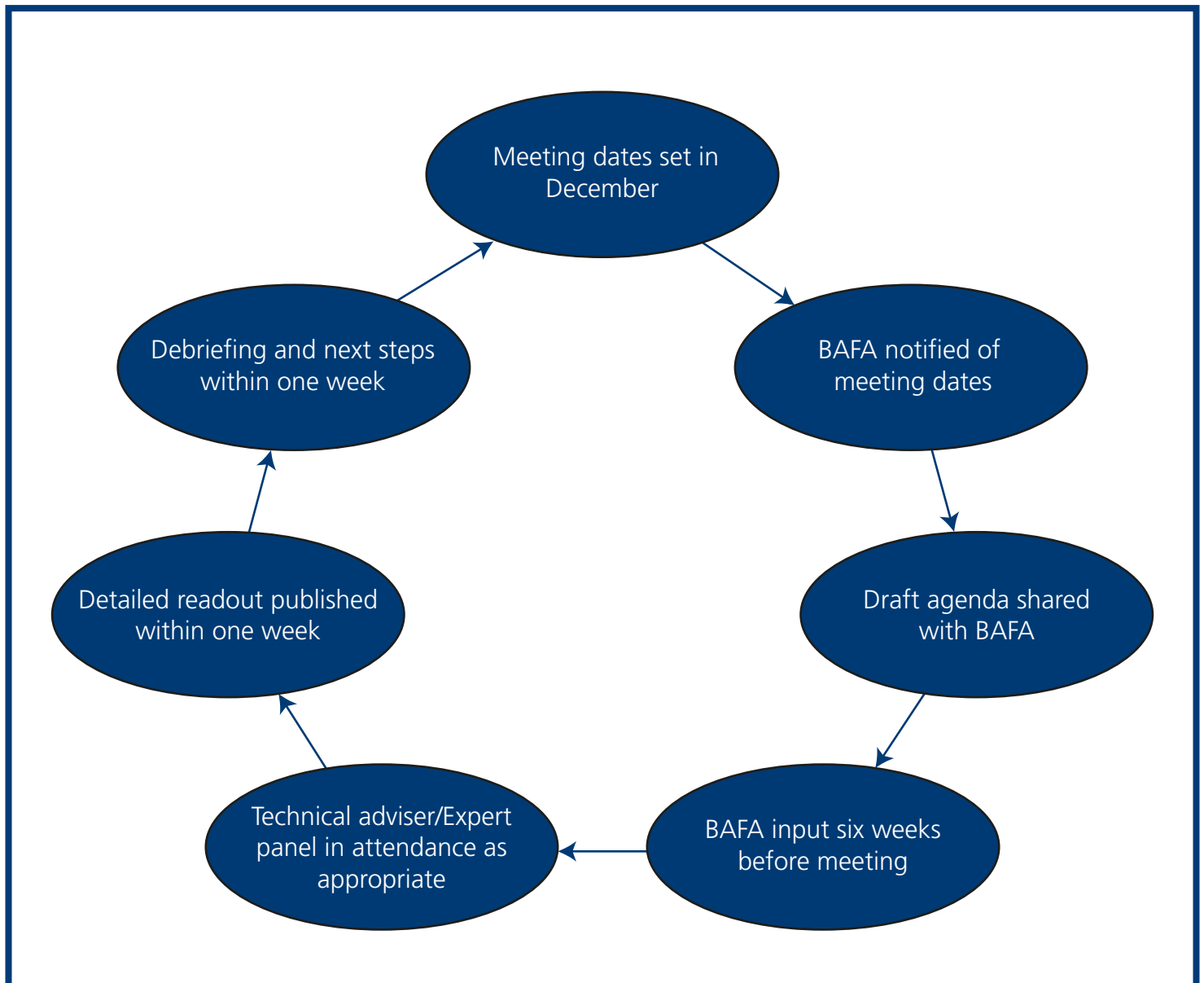
We request that BAFA be notified of the next meeting date as soon as it is confirmed and be invited to comment on a draft agenda. This would give BAFA time to consider input as well as propose additional areas of potential focus for the meeting. BAFA could submit its proposals to the FRWG six weeks in advance to give the FRWG time to reflect on the input. A robust mechanism through which BAFA can contribute to UK-U.S. policy and regulatory dialogue will be of mutual benefit to industry and government in both countries. BAFA will provide a unique transatlantic industry perspective and is well-suited to assess whether changes to approach or regulation could have unintended consequences for the functioning of markets or operability of firms.

In those instances where a specific technical topic is to be discussed, it would be beneficial to have a nominated industry representative participate in the meeting. Any industry representative would be subject to appropriate non-disclosure agreements to safeguard the sensitive nature of discussions. An alternative would

be to establish a private sector expert committee that could be consulted on technical issues.

We request that a debriefing for BAFA take place within a week of the FRWG meeting to discuss outcomes in more detail and share thoughts on subsequent steps. Any proposed changes to rules or regulations should be discussed with the financial and related professional services industry and a minimum of 10 weeks given for the industry to consider and respond to any proposed changes.

**Box 2: Regulatory cooperation architecture: the virtuous circle**



## Membership of the British American Finance Alliance

- Alternative Investment Management Association (AIMA)
- American Council of Life Insurers (ACLI)
- American Property and Casualty Insurance Association (APCIA)
- Association of British Insurers (ABI)
- Association of Chartered Certified Accountants (ACCA)
- Association for Financial Markets in Europe (AFME)
- BAFT (Bankers Association for Finance and Trade)
- Bank Policy Institute (BPI)
- BritishAmerican Business (BAB)
- City of London Corporation
- Coalition of Services Industries (CSI)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Investment Association (IA)
- Investment Company Institute (ICI)
- London Market Group (LMG)
- Re-Insurance Association of America (RAA)
- Securities Industry & Financial Markets Association (SIFMA)
- TheCityUK (TCUK)
- The Law Society of England and Wales
- US Chamber of Commerce (USCC)
- UK Finance