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# Brexit & financial services

**Banking:** cross-border services and prudential regulation

## Introduction

The capital requirements regime aims to ensure that banks hold sufficient capital to withstand shocks and unexpected losses, whether arising from their own businesses or the economy more generally. Its goal is to ensure that banks, banking systems and the economy generally are resilient. In parallel, it also seeks to advance a banking union within the EU by harmonising rules and, critically, enabling banking licences granted in one member state to be recognised throughout the EU. This is referred to as passporting.

The UK's exit from the EU is unlikely to have an immediate impact upon the basic principles that underpin the capital requirements regime applying in the UK. But it will lead to an immediate and major impact upon the cross-border supply of banking services from the UK into the EU and vice versa through the removal of the passporting regime allowing the provision of banking services between the UK and EU.

The capital requirements regime is multi-layered and extremely complex. This note summarises the current EU regime at a high level, identifies where that regime is now set out in the UK and identifies the key changes and difficulties that will result from the UK's exit from the EU.

## The EU regime

The EU capital requirements regime has a multi-layered origin. The underlying core derives from the Basel III standards agreed by the Basel Committee on Banking Supervision ('BCBS'). These set out the broad parameters and terminology followed in many jurisdictions and promote a high degree of international standardisation in relation to capital requirements for banks to try to ensure stability across markets. This international body has 45 members, comprising central banks and banking supervisors from 28 different jurisdictions.

The Basel III standards have then been developed, modified and applied within the EU by:

- the Capital Requirements Regulation (Regulation (EU) No 575/2013 ('CRR');
- the Fourth Capital Requirements Directive (Directive No 2013/36/EU ('CRD IV');
- a large number of delegated regulations, technical standards and memoranda of understanding.

Insofar as necessary,<sup>1</sup> this regime has been implemented in the UK through a number of statutory instruments<sup>2</sup> and regulatory provisions of both the PRA and FCA.

The UK's departure from the EU coincides with substantial amendments to the EU capital requirements regime: the Second Capital Requirements Regulation (Regulation (EU) No 2019/876) ('CRR 2') and the Fifth Capital Requirements Directive (Directive 2019/878/EU) ('CRD V') were published in the Official Journal on 7 June 2019 and entered into force on 27 June 2019. The bulk of the provisions of CRR2 will apply from 28 June 2021, and the national transposition deadline for most of the provisions in CRD V is 28 December 2020.

CRD V makes a number of important changes, including as to supervisory requirements and guidance, remuneration policies, the establishment of Intermediate Parent Undertakings within the EU for non-EU groups with significant activities within the EU, and supervisory requirements in relation to interest rate risk.

### Capital Requirements Regulation

The CRR sets out a comprehensive regime of prescriptive provisions in relation to capital requirements in the EU, seeking to achieve maximum harmonisation across member states. It sets out a Single Rule Book applicable across the EU, predominantly focusing upon what is referred to as the Pillar 1 and Pillar 3 aspects of the capital requirements regime.<sup>3</sup> It does not focus upon what is referred to as Pillar 2 (risk management and supervision) where there is a greater degree of discretion afforded to member states.

A full explanation of the CRR is beyond the scope of this note, but, in summary, it sets out requirements as to:

- The quality and quantity of capital to be held by banks, in particular the central 'own funds requirement'. This is expressed as a percentage of risk-weighted assets: the riskier the assets, the more capital a bank must hold. That capital is itself graded according to quality and risk.
- Liquidity requirements: a bank must hold sufficient liquid assets to cover liquidity outflows under gravely stressed situations. This is principally provided for by the liquidity coverage ratio (the ratio of high-quality assets to net cash outflows in a stress period) and a net stable funding requirement.
- Leverage requirements, being the relationship between a bank's capital base and its total assets. The aim is to avoid excessive leverage.
- Certain large risk exposures, including the credit risk from certain counterparties to which banks are exposed.
- Disclosure to be given to supervisory authorities.

### Capital Requirements Directive

CRD IV contains those capital requirements provisions where there is scope for some national variation without that impacting upon the overall goals of the regime.

It includes one of the most important aspects of the regime that will be impacted by the UK's exit from the EU: the provisions for the exercise of freedom of establishment and the free movement of services for banks between member states: the so-called 'passporting' provisions. These provide that a bank properly authorised within one-member state is free to provide banking services or establish a branch within another member state without any need to obtain additional authorisations from that member state.

Another important consequence of the regime is that the provisions do not permit discrimination between member states, thus, the risk weighting of assets is the same for all banks within the EU.

In addition, the directive addresses:

- Parameters for the prudential supervision of banks.
- Requirements as to capital buffers to ensure that banks have a sufficient capital base to allow them to withstand losses in a crisis. This includes specific provisions in relation to capital conservation, countercyclical buffers, and exposure to systemic risk. Global and other systemically important institutions are subject to additional buffer requirements because of the potential additional impact that would result from their failure.
- Restrictions upon the variable remuneration that can be paid by banks to their employees.
- Governance, diversity and transparency requirements.

Within the euro-zone there is additional harmonisation of the capital requirements rules applying to larger institutions. They are supervised directly by the European Central Bank under the Single Supervisory Mechanism. The national discretions under CRD IV do not therefore affect them.

<sup>1</sup> Save where discretions are afforded to Member States, CRR is directly applicable to firms.

<sup>2</sup> Including: Capital Requirements Regulations 2013 (SI 2013/3115), Financial Services and Markets Act 2000 (Qualifying EU Provisions) (No 2) Order 2013 (SI 2013/3116), Capital Requirements (Country-by-Country

Reporting) Regulations 2013 (SI 2013/3118), Capital Requirements (Capital Buffers and Macro-Prudential Measures) Regulations 2014 (SI 2014/894).

<sup>3</sup> These terms originate from the Basel regime and refer to minimum capital requirements (Pillar 1) and market discipline and disclosure (Pillar 3).

## Other European materials

A number of the provisions in the CRR and CRD IV have been developed and elaborated by a number of Commission Delegated Regulations, some of the most important include those addressing liquidity coverage ratios (EU) 2015/61 and leverage ratios (EU) 2015/62. In addition, there are a number of Regulatory Technical Standards, Implementing Technical Standards, and the European Banking Authority has produced guidelines. There are also a number of memoranda of understanding between supervisory authorities.

## UK implementation of CRD IV

The provisions of CRD IV have been implemented in a number of UK instruments. The principal secondary legislation includes:

- Capital Requirements Regulations 2013 (SI 2013/3115)
- Financial Services and Markets Act 2000 (Qualifying EU Provisions) (No 2) Order 2013 (SI 2013/3116)
- Capital Requirements (Country-by-Country Reporting) Regulations 2013 (SI 2013/3118)
- Capital Requirements (Capital Buffers and Macro-Prudential Measures) Regulations 2014 (SI 2014/894)

Much of the regime is also implemented through regulatory rules and guidance:

- In the PRA Rulebook, relevant provisions are contained in particular in the Benchmarking of Internal Approaches, Capital Buffers, Definition of Capital, Internal Capital Adequacy Assessment, Public Disclosure, Compliance and Internal Audit, Financial Conglomerates, Record Keeping, Remuneration, and Risk Control.
- In the FCA handbook, relevant provisions are contained in particular in provisions contained in: BIPRU, DEPP, FIT, GENPRU, IFPRU, IPRU(INV), SUP and SYSC.

## Changes to UK capital requirements regime after exit from the EU

The full range of EU capital requirement instruments continued to apply within the UK, as if it remained a member state, until the end of the implementation period on 31 December 2020. Thereafter, the limited scope of the agreement reached between the EU and the UK insofar as it relates to financial services means that there have been significant changes affecting firms operating cross-border business, either from the UK into the EU or vice versa.

For firms exclusively operating within the UK there should, however, be little change in at least the short term: a number of statutory instruments seek to transform the current EU capital requirements regime into domestic legislative provisions through a process of 'onshoring'. Over the longer term, however, it seems inevitable that differences in approach will emerge between the UK and the EU.

### The key UK onshoring instruments

#### Capital Requirements (Amendment) (EU Exit) Regulations 2018

This statutory instrument sets out the changes necessary to transform the CRR into a purely domestic piece of legislation. Key changes include:

- Specifying that the EU 27 are third countries. This impacts upon the passporting regime, as well as upon the risk weighting and eligibility of assets to mitigate risk
- The provisions of the CRR relating to consolidation are limited to banking groups within the EU.
- The PRA and FCA take the role of the European Supervisory Authorities in the making of technical standards and guidelines.<sup>4</sup>
- Obligations upon PRA and FCA to share information and co-operate with EU supervisors are removed.
- The Treasury is empowered to make equivalence determinations in place of the Commission, but previous EU equivalence decisions continue to apply.
- Broad powers are granted to the Treasury, PRA and FCA that could be used to implement policy changes in the future.

Although the overall goal is simply to make the minimum necessary changes such that the CRR is intelligible in a solely UK domestic context, it is not wholly straightforward. Some provisions seem likely to give rise to complications in future. For example, certain of the provisions depend upon the ability later to identify the regulatory rulebooks 'in effect on exit day' and what amounts to 'Directive 2013/36/EU UK Law', which broadly refers to the UK law relied upon to implement CRD IV in effect on exit day, but which is defined in two subtly different ways for different provisions.

<sup>4</sup> See also Financial Regulators' Powers (Technical Standards) (Amendment etc) (EU Exit) Regulations 2018

The EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018

This instrument provides for a temporary permissions regime to enable EU firms to continue to provide services into the UK as if under EU passporting regimes while they obtain authorisation within the UK. Firms intending to do so must notify the PRA.

The Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019

This instrument provides transitional relief for a limited period of 15 months from the UK's exit:

- For that period, firms can continue to treat EU exposures and assets preferentially, under the applicable capital frameworks, and under the CRR liquidity and large exposure regimes. For example, with regards to liquidity requirements, firms may continue to recognise claims on EU sovereigns as level 1 (i.e. very high quality) assets.
- UK groups that are part of EU headquartered banking groups will not need to comply with consolidated liquidity requirements at the UK level for this time.
- Reporting and disclosure requirements will also continue as before.

Public Record, Disclosure of Information and Co-Operation (Financial Services) (Amendment) Regulations 2019

These regulations amend the Financial Services and Markets Act 2000 to enable the disclosure of confidential information to EU supervisors, and the FCA has entered into memoranda of understanding with ESMA and EU MS supervisors to allow cooperation to continue.

**Implementation of CRR 2 and CRD V**

In addition to existing measures, it is also necessary for adjustments to be made to reflect the changes resulting from CRR 2 and CRD V. These will soon apply within the EU, but will not automatically apply in the UK. Firms are expected to comply with CRD V from 29 December 2020 and, by the terms of the withdrawal agreement, the UK is also required to implement CRD V.

The required adjustments were originally to be implemented through the Financial Services (Implementation of Legislation) Bill. This would have empowered the Treasury to create UK statutory instruments that corresponded or were similar to<sup>5</sup> European instruments that were 'in flight' at the date of the UK's departure, for up to 2 years after exit day. The Bill, however, failed to complete its passage through Parliament before the end of the last session and will therefore make no further progress.

The Treasury and the Bank of England are therefore currently engaged in consultations as to how to implement CRD V. The intention appears to be to complete implementation by means of secondary legislation (using its s.2(2) ECA powers as retained under the European Union (Withdrawal Agreement) Act 2020), as well as amendments to the PRA's regulatory rules, supervisory statements and statements of policy,<sup>6</sup> as well as various aspects of the FCA's regulatory handbook.

**Impact of the UK's exit from the EU**

Since the end of the transition period the UK is now a third country under the capital requirements regime from the perspective of EU institutions. EU member states will be third countries from the UK perspective. This leads to a number of important changes.

**Passporting**

Under CRD IV firms that are authorised in any EU or EEA state can exercise passporting rights in order to trade freely throughout the EU with minimal additional requirements for authorisation in other member states.

As a third country, banks authorised within the UK are no longer able to exercise this freedom. In order to open branches or to do any banking business within an EU member state they will need to analyse the position and the nature of the business that will be carried out. Where that business is comparatively limited, a bank could investigate the specific rules applying in the states in which it will operate and either obtain licences for specific aspects of its business in each individual member state, obtain authorisation for a branch in a particular state (which can only operate in that state), or otherwise provide limited services complying with the specific rules of each such member state. The need to consider the domestic rules of individual member states when seeking to open a branch is expressly stated in the Agreement between the EU and UK at Annex SERVIN-1 Article 14.

The only way in which a UK bank is now able to effectively retain the ability to benefit from the CRD IV passporting regime (and to provide services throughout the EU without obtaining a licence in each member state) would be to incorporate within an EU member state and obtain authorisation under CRD IV. The steps required are expensive, complex and cumbersome.

When it is necessary to establish an entity within the EU, that entity will be required to fully comply with the capital requirements regime applicable within the EU, with its regulatory capital controlled and overseen within the EU. Banks cannot, for example, seek to operate through empty shells or solely rely upon back-to-back or remote booking<sup>7</sup> in order to try to use assets held and managed outside the EU to satisfy capital requirements.

Where a banking group's EU operations are larger in scale, with two or more EU credit-institutions or investment firms in the group and over EUR 40 billion in assets within the EU (including branch assets), it will also need to comply with the obligation to establish intermediate EU parent undertaking – i.e. it will have to set up a specific holding company within the EU.<sup>8</sup>

The position is equivalent for banks based within the EU seeking to provide services into the UK, but (so long as the requisite notifications have been given) from the end of the temporary permissions regime rather than on 1 January 2021. They now need to obtain authorisation to operate in the UK. This may be through a subsidiary or branch. Whether the latter route is available is a question of the nature and scale of the intended operation, as well as the manner in which its business is conducted. Where a firm intends to carry out retail deposit taking above certain thresholds, it must operate as a subsidiary and not just a branch. Again, the process of obtaining authorisation is expensive, complex and cumbersome. It is also possible that the UK will introduce a regime of similar effect to the CRD V intermediate parent undertakings, further complicating operations for large global banking groups.

5 Subject to any adjustments appropriate to the UK's new position outside the EU  
 6 See PRA consultation paper [www.bankofengland.co.uk/-/media/boef/files/prudential-regulation/consultation-paper/2020/cp1220](http://www.bankofengland.co.uk/-/media/boef/files/prudential-regulation/consultation-paper/2020/cp1220)  
 7 See [www.bankingsupervision.europa.eu/press/publications/newsletter/2018/html/ssm.nl180214.en.html](http://www.bankingsupervision.europa.eu/press/publications/newsletter/2018/html/ssm.nl180214.en.html) and [www.eba.europa.eu/sites/default/documents/files/documents/10180/2137845/2dc0224a-c5e2-4c6e-bea9-35c678cd7b47/EBA%20Opinion%20on%20Brexit%20preparations%20%28EBA-Op-2018-05%29.pdf](http://www.eba.europa.eu/sites/default/documents/files/documents/10180/2137845/2dc0224a-c5e2-4c6e-bea9-35c678cd7b47/EBA%20Opinion%20on%20Brexit%20preparations%20%28EBA-Op-2018-05%29.pdf)  
 8 CRD V Art 1(9), adding Art 21b to CRD IV

There is little prospect in the short to medium term of arrangements approximating to the effect of the CRD IV passport. Although Article 47(3) of CRD IV permits the EU to conclude agreements with third countries to apply provisions according to branches of a third country credit institution identical treatment throughout the territory of the Union, there is little prospect of such an agreement in the short term

The free trade agreement is almost silent as to the treatment of banks. The most that was offered in this field during negotiations was a reference in the original EU negotiating position permitting the UK and member states to require firms to obtain authorisation before providing financial services within the EU, and specifying that this may only be refused for prudential reasons. This is the approach that has now been adopted in the agreement (Article SERVIN.5.39 and 5.42.2).

But in the banking context this is critical. It meant that there is no creation of a broader equivalence (or even passporting) regime for banks. The agreement provides little benefit for the cross-border supply of core banking services beyond the position that would have applied from 31 December 2020, under what is usually referred to as World Trade Organisation rules, or, more particularly, the protections arising under the General Agreement on Trade in Services (GATS) (which is summarised below).

The only other relevant aspect of the negotiations reflected in the agreement also originates from the EU's negotiating draft agreement. Article SERVIN.5.41 requires the parties to 'make their best endeavours to ensure that internationally agreed standards in the financial services sector for regulation and supervision ... are implemented and applied in their territory'. These are specified as including the standards adopted by the Basel Committee on Banking Supervision. In theory, this should lead to a continuing substantial degree of alignment between the EU and UK capital requirements regimes.

These provisions of the agreement are extremely limited in their scope. The provision of banking services across the UK/EU border will therefore be subject to the individual laws and regulations of individual member states, subject only to Articles SERVIN.5.41 and 5.42, as well as the broader provisions of the agreement in relation to services and investment which effectively reflect the limited protections provided by GATS with the annex on financial services (i.e. national treatment and market access). Although the agreement also includes a most favoured nation treatment obligation for services, this does not assist with the provision of banking services, since it does not apply to authorisation and licensing requirements or to the recognition of prudential measures (Article SERVIN.2.4(3)(b) and 3.5(2)(b)).

This significant change began to have a significant impact upon cross-border banking business before the end of the transition period. There were multiple relocations and transfers of business from the UK into the EU (for example, in *Re Barclays Bank Plc* [2019] EWHC 129 (Ch), the court approved a transfer of 5,000 clients and €190 billion assets out of a UK entity to an Irish entity)<sup>9</sup>. Several UK based banks notified their customers residing in the EU that they can no longer hold bank accounts within the UK.

## Other changes

In addition to the loss of the ability to passport, there will also be changes to the risk weighting of assets,<sup>10</sup> particularly the risk weighting that EU banks apply to UK exposures, and the weighting that UK banks apply to their EU exposures. For example, under the CRD IV regime EU sovereign debt in the currency of the sovereign is subject to a 0% risk weight, but this will cease to apply to UK debt at the end of the transition period (and vice versa for EU sovereign debt in the UK). There is therefore the risk that assets that immediately become third country assets<sup>11</sup> will be dumped and switched in order to maintain ratios.

There will also be a significant reduction in the co-operation and interaction between the PRA and FCA and EU and member states supervisors. CRD IV Art 116(1), however, permits third country supervisors to participate in supervisory colleges, subject to confidentiality restrictions. This provides a process whereby the PRA and the FCA may be permitted to participate, but would require a high degree of co-operation. Although falling short of this, the UK and EU are engaged in efforts to agree memoranda of understanding to enable some cross-border supervisory co-operation.

## Equivalence

The EU regimes applying to other financial services sectors incorporate the possibility of decisions being made as to equivalence (i.e. that the regime in a third country is materially the same as that in the EU). A determination of equivalence then opens up the ability to provide services into the EU in a comparatively straightforward manner.

But there is no parallel general equivalence mechanism under the capital requirements regime. Procedures only exist in relation to the equivalence of certain risk exposures and their preferential treatment.

Even decisions in relation to these risk exposures will require an analysis of the approach of a third country's regulatory and supervisory system to a wide and detailed range of matters. The EU's technical assessment of the UK's regime for these purposes would be undertaken by the European Banking Authority with the final decision taken by the Commission, while the equivalent technical process from the UK side will be undertaken by the PRA, but with all the EU's pre-existing equivalence determinations rolled over into UK law. No decision has yet been taken by the EU as to equivalence in this field. It seems likely, however, that there will be some divergence by the UK (for example in relation to the rules on variable remuneration), which would provide a basis for a determination that the UK regime is not equivalent.<sup>12</sup>

By contrast, by the Capital Requirements Regulation Equivalence Directions 2020, the UK has determined that the prudential supervisory and regulatory requirements applied in EEA states are equivalent to those applied in the UK for the purposes of the CRR (as it has been onshored). This has the effect of maintaining the risk weighting of certain EEA state assets for UK firms such that those firms are not subject to increased capital requirements in relation to EEA state exposures.

9 See also *Re UBS Ltd* [2019] EWHC (Ch) 261, transferring contracts from the UK to Germany, and *Re Triodos Bank NV* [2019] EWHC 647 (Ch) in which UK assets of a Dutch bank were transferred to a UK subsidiary.

10 Under the capital requirements regime banks must calculate the risk that they are exposed to in order to determine that they have sufficient capital to withstand shocks. Each asset must be subject to a risk assessment, with different classes of asset having different risk weights attached to them.

11 i.e. UK assets by EU entities, and EU assets by UK entities

12 The EBA has previously indicated that it did not consider the variable remuneration regime to be critical when judging a system to be equivalent and future EU legislation may move away from the approach.

## Protections under GATS?

Given the limited scope of the trade agreement's application to the cross-border provision of banking services it is worth considering the position that would have applied if there had been no agreement. Under this scenario, the only protections for UK banks seeking to provide services into the EU would have arisen under the WTO General Agreement on Trade in Services. But these protections are exceptionally limited in scope.

GATS seeks to liberalise the global trade in services between members of the WTO. The central obligation is that each WTO member must accord all other members 'treatment no less favourable than that it accords to like services and service suppliers of any other country'. Importantly, however, regional trade agreements are a recognised exception to this Most Favoured Nation obligation. EU member states are therefore able to provide more favourable treatment to suppliers from other member states.

GATS also enable states to opt in to additional obligations, including a National Treatment Obligation (preventing discrimination between domestic and overseas suppliers) and a Market Access Obligation (preventing certain restrictions upon market access).

The provision of services under GATS is divided into four modes, with countries able to opt in to the two obligations above for particular services and particular modes by setting this out in a Schedule of Specific Commitments.<sup>13</sup> The four modes are:

- Mode 1: the provision of services from the territory of one WTO Member into the territory of another WTO Member – i.e. the provider and consumer are in different states.
- Mode 2: Provision within the territory of one WTO Member to the service consumer of any other WTO Member – i.e. the consumer travels to the provider's state and receives the service there.
- Mode 3: Provision by a supplier from one WTO Member, through their commercial presence in the territory of any other WTO Member – i.e. a provider from one state establishes a legal entity such as a branch in another state.
- Mode 4: Provision by a supplier from one WTO Member, through the presence of natural persons in the territory of any other WTO Member – i.e. an individual employee of the supplier travels to another state to provide the services.

The general provisions of GATS are then supplemented in an Annex on Financial Services. But this is of limited relevance to issues arising from capital requirement rules for banks since it includes a carve out for prudential measures, providing that states are not 'prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system'. Thus, EU member states may be able to rely upon the EU capital requirements regime to justify measures otherwise inconsistent with their obligations under GATS.

Some relevant protections are provided by the Understanding on Commitments in Financial Services, which again operates on an opt-in basis.

This broadly:<sup>14</sup> (1) provides for a non-discrimination national treatment obligation for banking and other financial services supplied through a commercial presence (i.e. mode 3); (2) provides some mode 2 commitments for banking services; but (3) excludes all commitments in relation to mode 1 provision of banking services – i.e. cross-border supply. A bright line distinction between mode 1 and 2 provision can, however, be difficult to apply in practice in relation to financial services, where the online presence of a consumer could sometimes be equated to consumption abroad.<sup>15</sup>

As a result, the specific WTO commitments of each EU member states in relation to the provision of banking services are complex to determine and require the review of the consolidated EU Schedule to GATS covering both EU and member state level commitments across all services (not just financial services). Typically, in line with the Understanding, mode 1 provision of banking services (cross-border trade) is generally excluded while modes 2 (consumption from abroad) and 3 (commercial presence) are accepted.

There are, however, some significant differences in approach between the various member states. Portugal and Austria for example, reserve the right to restrict the mode 3 provision of banking services by subjecting the establishment of a bank with those states to an economic needs test. Hungary makes no mode 2 banking commitments, and other member states impose significant restrictions upon mode 2.

Generally, however, member states undertake to 'make their best endeavours to consider within 12 months complete applications for licenses to conduct banking activities, through the establishment in a Member State of a subsidiary in accordance with the legislation of that Member State, by an undertaking governed by the laws of a third country'.

Thus, the default provisions under the GATS protections are exceptionally limited in comparison to the regime under CRR and CRDIV. They do not provide anything approaching a parallel to the passporting regime. Instead, GATS essentially provides only a baseline protection that EU member states cannot discriminate against UK banks when compared with those from other WTO members. In this respect therefore, although also very limited in scope and closely resembling the GATS regime, the agreement in fact entered into between the UK and the EU does improve upon the default GATS provision: the position is as if the key GATS opt-in obligations had been adopted by all member states. UK banks are protected (to a limited degree) against discrimination when compared with those from EU member states under the National Treatment obligation under Article SERVIN.2.3 and 3.3, and benefit from the Market Access obligations of Article SERVIN.2.2 and 3.2. Article SERVIN.5.42 on new financial services also goes beyond the provisions of GATS. It will still be necessary, however, for banks to consider the individual requirements of each member state in which they wish to do business – a far cry from the passporting regime.

In addition to providing limited protections, the GATS provisions covering financial services have been subject to little testing in practice, and the state level WTO disputes settlement process provides a far from ideal forum for the resolution of issues that may arise and impact upon banks. The dispute resolution procedures under the agreement can therefore be regarded as an improvement upon this default position.

<sup>13</sup> The position of EU member states is set out in a consolidated EU Schedule, defining commitments both at an union and individual member state level.

<sup>14</sup> There is no single uniform EU approach. Although the position of all EU member states is set out in a single schedule, the position of each member state varies

as to whether it has opted in to certain obligations with or without additional exceptions.

<sup>15</sup> See WTO document (S/C/W/304) [www.docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_S009-DP.px?language=E&CatalogueIdList=73970&CurrentCatalogueIdIndex=0&FullTextHash](http://www.docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.px?language=E&CatalogueIdList=73970&CurrentCatalogueIdIndex=0&FullTextHash)

=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True

## Future course of UK capital requirements regime

The BCBS has amended Basel III (these amendments are typically referred to as Basel 3.1 or Basel 4), which amendments are not included in CRR II or CRD V. The UK Government has stated its intention to implement Basel 3.1, in order to 'maintain a global outlook on regulatory best practices, regardless of where those practices come from' and to '[maintain] high standards'.<sup>16</sup> At the same time, however, it has also expressly identified 'the impact of regulatory requirements on UK competitiveness' as a factor to be taken into account in future prudential regulation alongside 'international developments in prudential regulation', 'our relationships with other jurisdictions, such as financial services equivalence', and 'the impact on sustainable lending to the UK economy'.<sup>17</sup> The UK government has also referred to the EU's approach to capital requirements being 'designed as a compromise for 28 countries'. This gives rise to the real prospect of the UK seeking to depart from the approach adopted by the EU, insofar as it can do so within the parameters of its obligation under Article SERVIN.5.41 to use best endeavours to implement the Basel standards.

In addition to these governmental statements, the PRA has expressed a commitment to robust prudential standards, over and above international baseline standards. What constitutes those standards, however, is plainly a matter of interpretation, but the reference is most likely to the Basel standards rather than the EU regime: the Bank of England has specifically identified certain limited areas where the UK could seek to roll back some specific provisions of the EU capital requirements regime, particularly the cap on variable remuneration (i.e. bonuses)<sup>18</sup> and the immediate application of the full force of the regime to start up banks and building societies.

These appear to have led the EU to become concerned during negotiations about the risk of UK divergence from its capital requirements framework. Even potentially small variations could have a significant impact upon the future relationship between the UK and the EU. The EU may, for example, choose to require precise and full compliance with the relevant parts of the CRR II and CRD V regime in order to make a determination that the UK was equivalent for those purposes, or when considering its preparedness to enter into broader agreements. It could also have an impact upon the willingness of the EU to enter into agreements for services strictly falling outside, but connected to the capital requirements regime, such as commercial lending.

The non-binding Joint Declaration on Financial Services Regulatory Cooperation does not shed much light on the future potential for these limited but important divergences. It does, however, maintain the possibility of future close alignment and co-operation between the UK and the EU, and even positive equivalence decisions (insofar as relevant in the capital requirements field) by the EU at some stage.

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<sup>16</sup> [www.assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/901075/CRDV\\_consultation\\_document\\_to\\_publish\\_.pdf](http://www.assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901075/CRDV_consultation_document_to_publish_.pdf)

<sup>17</sup> [www.assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/893792/Prudential\\_policy\\_draft\\_policy\\_statement\\_V4.pdf](http://www.assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/893792/Prudential_policy_draft_policy_statement_V4.pdf)

<sup>18</sup> Under CRD IV Art.94(1)(g) member states are required to ensure that financial institutions set appropriate ratios between fixed remuneration and variable remuneration (i.e. bonuses), but the variable component cannot exceed 100% of the fixed component unless shareholders agree an increase

(subject to a cap of 200%). This was the subject of a legal challenge by the UK (Case C-507/13), which, following an opinion from Advocate-General Jääskinen that the challenge should be rejected, was not ultimately pursued.



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**Richard Hanke**

Author

[rhanke@3vb.com](mailto:rhanke@3vb.com)



**David Simpson**

Series Editor

[dsimpson@3vb.com](mailto:dsimpson@3vb.com)



3 Verulam Buildings  
Gray's Inn, London WC1R 5NT  
T +44(0)20 7831 8441  
E [chambers@3vb.com](mailto:chambers@3vb.com)

[www.3vb.com](http://www.3vb.com)