Checklist and other risks of disruption to the provision of financial services at the end of the transition period

Table 1 Checklist of actions to avoid disruption to end-users of financial services at the end of the transition period

This checklist reflects the risk of disruption to end-users including households and companies if no further arrangements are put in place for cross-border trade in financial services for the end of the transition period on 31 December 2020. The risk assessment takes account of progress made in mitigating any risks. It assesses risks of disruption to end-users of financial services in the UK and, because the impact could spill back, also to end-users in the EU.[(a)]

Risks of disruption are categorised as low, medium or **high**. Arrows reflect developments since the FPC's previously published checklist in the August 2020 *Financial Stability Report*. Blue text is news since then.

The checklist is not a comprehensive assessment of risks to economic activity arising from the end of the transition period. It covers only the risks to activity that could stem from disruption to provision of cross-border financial services.

	Risk to UK	Risk to EU	
Ensure a UK legal and regulatory framework is in place			The passage of the EU (Withdrawal) Act 2018 and secondary legislation has ensured that an effective framework for the regulation of financial services will be in place, and that EU financial services companies can continue to serve UK customers. Some secondary legislation is still required to ensure new EU legislation and provisions coming into force in 2020 can operate effectively in the UK following the end of the transition period. The State Aid (Revocations and Amendments) statutory instrument has been laid. If passed, this would ensure the Bank of England can continue to provide certain types of emergency lending, should it be needed in future.
Insurance contracts			The UK Government has legislated to ensure that the 16 million insurance policies that UK households and businesses have with EU insurance companies can continue to be serviced after the end of the transition period. UK insurance companies have restructured their business in order to service the vast majority of their £60 billion of EU liabilities. They plan to continue to progress restructuring most of the remaining liabilities through the end of 2020. The European Insurance and Occupational Pensions Authority (EIOPA) has published recommendations to national authorities supporting recognition or facilitation of UK insurance companies' continued servicing of EU contracts at the end of the transition period.
Asset management			Co-operation agreements between the Financial Conduct Authority (FCA), the European Securities and Markets Authority (ESMA) and EU National Competent Authorities have been agreed, and will apply from the end of the transition period. This enables EU asset managers to delegate the management of their assets to the UK. The UK Government has legislated for EU asset management firms to continue operating and marketing in the UK. And to operate in the EU, the largest UK asset managers have completed their establishment of EU authorised management companies.
Banking services			The UK Government has legislated to ensure that UK households and businesses can continue to be served by EU-based banks after the end of the transition period. EU authorities have not taken similar action. As a result, major UK-based banks are transferring their EU clients to subsidiaries in the EU so that they can continue providing services to them. All material subsidiaries are now authorised, fully operational and trading. Firms continue to build the capacity of their EU entities. On average, over two thirds of clients — including larger clients which represent a greater share of activity — of major UK-based banks have now completed the necessary documentation to enter into derivative trades with the EU entities. The number of clients actively trading in the new entities is materially lower. Some operational risks therefore remain, including if many clients seek to migrate to the EU entities in a short period of time. These could amplify market volatility. The EU has stated that in the short to medium term it will not assess the equivalence of the UK's regulatory and supervisory regime to its own for the purposes of MiFIR[(b)] Article 47, which covers investment services. This would have allowed for material cross-border access for investment services, further reducing the residual risk of disruption.

(a) In most cases, the impact on EU end-users will apply to the wider European Economic Area (EEA).
(b) Markets in Financial Instruments Regulation.

	Risk to UK	Risk to EU	
Over-the-counter (OTC) derivative contracts (uncleared)			Certain 'lifecycle'[(c)] events may not be able to be performed on UK/EEA uncleared derivative contracts after the end of the transition period. In the absence of mitigating actions, this could compromise the ability of derivatives users to manage risks. There are £17 trillion of uncleared derivative contracts between the EU and UK, of which £13 trillion is currently due to mature after 31 December 2020. Some uncleared derivative transactions will no longer be exempt from certain EU requirements, including the clearing obligation. The UK Government has legislated to ensure that EU banks can continue to perform lifecycle events on contracts they have with UK businesses. The European Commission has not reciprocated for UK-based banks' contracts with EU businesses. Some EU member states have permanent or temporary national regimes which could enable lifecycle events on certain contracts to be performed. UK firms are prioritising the novation of at-risk contracts, but progress will be dependent upon client engagement. The EU has stated that in the short to medium term it will not assess the equivalence of the UK's regulatory and supervisory regime to its own for the purposes of MiFIR Article 47, which covers investment services. This would have mitigated risks of disruption to lifecycle events on the majority of contracts.
OTC derivative contracts (cleared)		⇩	The UK Government has legislated to ensure that UK businesses can continue to use clearing services provided by EU-based clearing houses after the end of the transition period. The EU has adopted a decision to provide equivalence to the future UK legal and supervisory framework for central counterparties (CCPs) until end-June 2022, and UK CCPs have been recognised by ESMA. This will allow UK CCPs to continue servicing EU clearing members after the end of the transition period. The Bank and ESMA have put in place a new co-operation agreement to support this activity. There are currently £59 trillion of derivative contracts between UK CCPs and EU clearing members, £48 trillion of which is due to expire after December.
Personal data			The UK Government has legislated to allow the free flow of personal data from the UK to the EU after the transition period. The European Commission is undertaking an assessment of the adequacy of the UK's data protection standards. If the EU does not deem the UK's data regime adequate, both UK and EU households and businesses may be affected due to the two-way data transfers required to access certain financial services. Companies can add standard contractual clauses (SCCs) into contracts in order to comply with the EU's cross-border personal data transfer rules in the absence of adequacy. UK firms are generally well advanced in implementing these clauses.

(c) These lifecycle events include amendments, compressions, rolling of contracts or exercise of some options.

Table 2 Other risks of disruption to financial services

These risks could cause disruption to economic activity if they are not mitigated and there are no further financial services arrangements in place at the end of the transition period. The FPC judges their disruptive effect to be somewhat less than that of those issues in its checklist.

Access to euro payment systems	The Single Euro Payments Area (SEPA) schemes are currently used by UK payment service providers (PSPs, including banks) to make lower-value euro payments such as bank transfers between businesses, mortgage and salary payments on behalf of their customers. The European Payments Council has confirmed that the UK will retain SEPA access after the end of the transition period subject to its continued compliance with the established participation criteria. Once the UK becomes a third country, processing some payments — notably direct debits — will require additional information to be included for the payment instructions to meet regulatory requirements. Firms continue to put the necessary information in place where possible, but may not resolve all information gaps in time. This could result in disruption to both EEA and UK customers and businesses seeking to make and receive payments. UK firms will also need to maintain access to TARGET2 to use it to make high-value euro payments. UK banks intend to access TARGET2 through their EU branches or subsidiaries or correspondent relationships with other banks.
Ability of EEA firms to trade on UK trading venues	EU-listed or traded securities are traded heavily at UK venues which offer deep liquidity pools for a range of securities traded by UK and EU firms. The EU's Trading Obligations require EU investment firms to trade EU-listed or traded shares and some classes of OTC derivatives on EU trading venues or venues in jurisdictions deemed equivalent by the EU. The UK will also have analogous trading obligations when the transition period ends. Firms and venues are taking action to ensure they can trade securities and affected derivatives in both the EU and UK and other equivalent jurisdictions after the end of the transition period. However, the process of adjustment might pose operational risks. And it would fragment liquidity across jurisdictions and venues. The EU and UK could deem each other's regulatory frameworks as equivalent for the purposes of relevant regulations, thereby comprehensively mitigating risks of disruption. ESMA has proposed excluding from the EU Trading Obligation EU shares which are traded on third-country venues in the local currency of the third country. Absent a finding of equivalence, this would provide a partial mitigant to risks of disruption. It is unclear whether the proposal will be adopted as action is required on the part of the European Commission and co-legislators to effect the proposal before the end of the transition period.
Servicing banking and insurance customers	Major UK banks' and insurers' continued actions to prepare their EU subsidiaries will enable their provision of new services to many EU customers after the end of the transition period. The ability of UK banks and insurers to continue providing some services to customers — particularly retail customers — resident in the EU will be determined by national regimes. The scope and availability of national regimes is decided by individual EU member states. Depending on the national regime in place, the ability of UK banks and insurers to provide certain services to EU-based customers may be impaired. Some UK banks have begun notifying EU-based customers that they will not continue to provide certain retail banking services in some jurisdictions. As referred to above, EIOPA has published recommendations to national authorities supporting recognition or facilitation of UK insurance companies' continued servicing of EU contracts at the end of the transition period.
Financial market infrastructure	After the end of the transition period, UK financial market infrastructures (FMIs) will no longer be protected under EU law against payments or transfers being revoked, or collateral being clawed back, in the event that an EEA member enters insolvency. EEA countries accounting for most of the EEA members of UK FMIs have implemented national legislation intended to provide settlement finality protection in the event of insolvency of local firms using financial market infrastructure in non-EU countries. However, some member states will need to take additional steps to maintain settlement finality protection, and in some member states, UK FMIs need to apply for protections under national regimes. The UK Government has legislated transitional provisions to allow central securities depositories (CSDs) established outside the UK to continue to provide CSD services in the UK after the transition period. However, for UK CSDs to continue to provide CSD services to issuers in respect of securities issued under EU law after the end of the transition period, the UK and UK CSDs will respectively require either permanent or temporary equivalence and recognition from EU authorities.

Prudential requirements	The UK Government has legislated to allow regulators to delay the impact on UK-based firms of prudential requirements on EU exposures that would apply after the transition period. UK regulators intend to delay the application of some requirements for 15 months, to end-March 2022. EU regulations will subject EU banks' and insurance companies' UK exposures to stricter capital and liquidity requirements. Some restrictions might also be imposed for EU Money Market Funds and institutional investors on holdings of UK-managed or located exposures. If the EU and UK were to deem each other's regulatory and supervisory regimes as equivalent, this would avoid the application of some of these requirements.
Credit rating agencies (CRAs)	EU rules will prevent some banks and insurance companies in the EU from calculating prudential requirements using ratings issued by UK CRAs unless the ratings are endorsed by an EU CRA after the end of the transition period. In advance of the UK's withdrawal from the EU, the FCA and ESMA reached a co-operation agreement and undertook assessments to facilitate endorsements. The FCA and ESMA have confirmed that their co-operation agreement will apply from the end of the transition period and are engaged to ensure the assessments also continue to apply. The largest UK CRAs have EU entities. The decision to endorse ratings ultimately lies with the CRA.