The CityUnited Project recommendations to the Taskforce on Innovation, Growth and Regulatory Reform (TIGGR)

6th April 2021

1 – Background to The CityUnited Project

The CityUnited Project **("CUP")** is a non-partisan, senior practitioner led campaign whose vision and sole strategic objective is a world leading City and UK financial services industry, supported by a fair and competitive regulatory and taxation framework, attracting and drawing on the highest global skills and technology.

The CUP's approach is positive and forward looking, and its methodology is collaborative, working in complement with likeminded institutions where possible, filling a current need for a coordinated City and UK financial services industry voice, representative of all its diversity and immense and powerful attributes.

The CUP's concerns are specifically associated with initiatives and topics which appear not to be receiving the attention they deserve in the current period of change and redirection, rather than the more generally understood and well represented issues.

Further background and the principals involved can be found at www.cityunitedproject.com.

2 – Structure and executive summary

This report is written in support of TIGGR's stated objective to "consider all the options available to us to stimulate business dynamism and innovation, ensure that our markets are open and competitive and that businesses can scale up unencumbered by any unnecessary administrative burdens", in the context of the UK's largest industry, financial services, and with a very strong read across to a number of stated HMG policies.

Its recommendations are framed in the state of radical change within the global geopolitical structure and the impact of rapidly advancing digital technology on every aspect of life including specifically national and international financial service markets and their regulation. They also recognise how the UK's newly acquired independence from the EU provides an opportunity for radical reform of regulation, supervision and management of these markets and their participants and beneficiaries.

A principal recommendation **(Recommendation 1),** of huge importance to HMG's strategic geopolitical aims, builds on the opportunity provided by the development of a UK Central Bank Digital Currency (CBDC) in parallel with that already well advanced in China and calls for a small team drawn from all necessary sources to plan for and supervise such an initiative, based on current UK technology expertise. It recognises the geopolitical danger of the Chinese project whilst setting out the soft power and HMG management advantages together with specific workstreams associated with its application to financial services regulation and promotion.

It also underlines the importance of leveraging these developments to support the UK's continuing leadership within the international financial services community and a framework for future international regulatory partnerships, taking account of Real Time Regulation, competitive marketplaces, proportionality and cost, and the impact and supervision of parallel international financial markets, with associated specific recommendations. It makes proposals, in support of HMG's ongoing aims, for renewing a close working relationship with the EU, within that framework **(Recommendations 2 to 11).**

It makes recommendations to take advantage of further opportunities at a UK – as opposed to international – level, including, in support of HMG's headline policies, in respect of levelling up, regional development and Freeports thereby strengthening the Union and attracting ESG/Green investment, as well as setting digital standards, regulatory style and change implementation, reverse solicitation to take advantage of international parallel markets, improving derivative markets, assessing agency intermediaries, enhanced UK fund availability, the importance of ICO involvement and the support of University research and innovation **(Recommendations 12 to 24).**

It concludes with suggestions for further immediate collaborative actions by HMG, UK regulators, financial service representatives and other interested principals to provide the prioritised strategic framework implied by its recommendations and to work with speed towards their implementation.

The material and data backing the report and its recommendations has been supplied in its entirety by frontline financial service practitioners, with references in the text where appropriate.

3 – Recommendations

FinTech leading the development of a Central Bank Digital Currency (CBDC) in support of the UK's future global geopolitical strategy and UK financial services development:

- **Recommendation 1:** The creation of a small, prioritised, dedicated and tightly controlled team, principally from Government, intelligence community, FinTech, regulatory and financial services industry sources, to deliver a very early prototype and lever agile development processes to implement a digital pound sterling as a Central Bank Digital Currency (CBDC).

Exploiting and developing the regulatory opportunity:

- **Recommendation 2**: The identification of successful Real Time Regulation as compulsory aim of future UK financial service regulation.
- **Recommendation 3:** The UK taking a premier leadership role in the agreement and implementation of a globally recognised and respected framework for international financial service regulation, with a mandate similar to the US Administrations "Core Principles".
- **Recommendation 4:** The formal terms of reference of regulators to include a clear and where possible statutory requirement to maintain market attractiveness and openness, without prejudice to risk and safety.
- **Recommendation 5:** Any agreed international regulatory framework to be founded on an outcomes based approach to regulation, either through enhanced equivalence or mutual recognition of effective practice and outcomes.
- **Recommendation 6**: The level of prescription in future UK financial services regulation to take account of sectoral diversity in terms of risk, size and contribution of each participant, minimising cost burdens and avoiding "gold plating" and a "one size fits all" approach.
- **Recommendation 7**: The Office for Budget Responsibility to perform reviews of the regulatory costs of operating in the UK.
- **Recommendation 8**: All HMG departments to run, publish, and embrace, fresh and ranging red tape Audits, in conjunction with the CBDC technical developments recommended.
- **Recommendation 9:** The international regulatory community working within its agreed framework to support and develop parallel international financial markets and collaborate in their supervision.
- **Recommendation 10:** UK regulators to work together in close collaboration with the EU regulatory authorities to supervise and contain any systemic or market risk across Euro denominated parallel markets in the UK.

Leveraging the CBDC development opportunity to promote financial services

- **Recommendation 11:** HMG and other UK principals involved to leverage CBDC development opportunities in respect of lower transaction costs, the use of fractional spending technology, UK FinTech based partnerships with international strategic partners, and renminbi clearing.

Specific regulatory issues for attention within UK financial services

- **Recommendations 12:** The creation of a Wholesale Fund Hub using the Freeport template and involving financial centres throughout the UK.
- **Recommendation 13:** The reduction of Basel III capital requirements for regional banks and building societies.
- **Recommendation 14:** The agreement of common UK digital standards for regulation and markets.

- **Recommendation 15:** UK regulators to take account of the often widely differing interests of all participants, including specifically the smaller but more innovative and less well resourced players.
- **Recommendation 16:** HMG to look at ways of ensuring, without undue risk and with appropriate consultation, the quickest possible implementation of necessary regulatory change.
- **Recommendation 17:** UK regulators to provide a positive and helpful attitude to incoming investors in UK financial services alongside a robust requirement for regulatory protection of the attractiveness of markets.
- **Recommendation 18**: the opportunity for the use of legal "reverse solicitation" to attract EU participation in UK financial markets to be promoted at HMG, regulatory and industry trade body level.
- **Recommendation 19:** UK regulators to review specific opportunities to improve the quality of UK financial derivative markets.
- **Recommendation 20:** UK regulators to review the law of agency and its effectiveness to ensure that it identifies and minimises relevant risk.
- **Recommendation 21:** HMG to consider the need for new fund structures in order to provide a full UK range including a specifically Green/ESG fund, and to review double tax treaties to ensure UK fund competitiveness**.**
- **Recommendation 22:** HMG to revise MiFID II asset manager research spending rules.
- **Recommendation 23:** HMG to include the Information Commissioner's Office in regulatory discussions and have competitive and international outlook objectives included within the ICO's mandate.
- **Recommendation** 24: HMG to introduce Introducer Appointed Representative Agreements for alumnus asset managers to assist universities to fund research and innovation.

4 – Introduction

It is clear that the global geopolitical structure is in radical change, the central players being the US, China, Russia and the EU. The UK as a key independent but powerful nation, in partnership with other major economically significant countries, with financial services and technology as its main industrial assets and its regulatory soft power attributes.

In short, the way in which Britain builds on these assets and grasps its current opportunities and independence will set the framework for its future prosperity, positioning and leadership in a totally changed, digitally-shaped world. The purpose and objectives of the TIGGR initiative clearly recognise the fundamental importance of the UK's current crossroads.

The following CUP recommendations are aimed exclusively at UK financial services, prioritising long term strategic global geopolitical considerations as a framework for regulatory and structural reform, largely driven and/or assisted by technology, within which sectoral considerations can be addressed. Each of these layers overlap, but the CUP's overriding concern is that the UK has a unique and one off chance to establish building blocks which will provide strength, protection, wealth and quality of life for its citizens and for the global community it serves for generations to come.

5 – FinTech leading the development of a Central Bank Digital Currency (CBDC) in support of the UK's future global geopolitical strategy and UK financial services development

The UK has an established leadership position at the heart of world financial regulation and supervision through the high respect in which its regulatory management is held, its recognised expertise in corporate governance and stewardship and Socially Responsible Investment (SRI), and its membership of global institutions such as FSB (Financial Stability Board), the Basel Committee, IOSCO (International Organization of Securities Commissions) for markets, the IAIS (International Association of Insurance Supervisors)and the CPMI (Committee on Payments and Market Infrastructures) payments and settlements, chairing the latter two.

Furthermore international financial centres for the most part base their legal framework on the English system of Common Law which provides both flexibility and predictable enforcement, with its combination of statute law and judicial precedent providing financial service participants with clarity and certainty in their decision making.

Whilst these give the UK essential assets to continue its dominant position, inexorable digital development continues to be the biggest challenge the global regulatory, central banking and intelligence community faces. The ability, ever more cheaply, smoothly and quickly to pay, settle, record and analyse financial transactions through technology, whilst respecting privacy and security, will provide both opportunity and danger, in terms of global geopolitical positioning and systemic and market risk.

Global players are looking to take advantage of this opportunity. In particular China expects to complete its plans to convert the renminbi to a Central Bank Digital Currency **(CBDC)** to launch the Beijing Winter Olympics in 2022, in effect providing a direct pipeline for payment and settlement to every nation, institution, company and individual in the globe with a renminbi account, based round its Central Bank and without any interference or check from outside China. This will give China first-mover advantage, something it could leverage to challenge the incumbency of the Western system and gain global dominance.

This development will provide massive opportunity, not only for renminbi based financial service markets and regulation but also for international security and intelligence and, for instance, for the thwarting of sanctions against nations perceived as miscreant by the international community and leveraging government and other debt repayment in China's interest. It also explicitly targets and potentially undermines the current SWIFT (Society for Worldwide Interbank Financial Telecommunication) system for international transactions and its related software.

A Central Bank Digital Currency (CBDC) is a cryptographically secure digital currency issued by central banks. It represents the next generation of payment technology, and the UK has unique world-leading expertise in this sector. Due to their cryptographic and technological properties, CBDCs allow fractions of currency to be spent (fractional spending) without the costly overheads associated with current payment rails, and, more importantly, every fraction of the currency can be forensically traced and tracked through the lifetime of the digital currency giving the central bank full visibility and allowing it additional policy flexibility. Crucially, because a CBDC uses 21st Century technology it is faster and less expensive than current payment systems.

With a multi-stakeholder model (industry, HMG/ regulators), using the UK's collective intelligence, we can deliver our own CBDC, faster, cheaper and smarter than other nations and establish a strategic advantage that will last for many decades. The technology, the people, with the leading global knowhow are all resident within the square mile of the City of London.

It is therefore quite feasible for the UK to implement a CBDC alongside China and gain a multi-decade advantage that would transfer soft-power to the UK and confer similar strategic advantage in both its regulatory and financial market development, as well as:

- Assisting HMRC by raising more revenue for the UK treasury at much lower collection costs and enable new sources of revenue such as replacing Fuel Duty with a per pay mile charge to enable HMG's carbon neutral initiatives and allow HMRC to collect and distribute taxation in real time
- Safeguarding, supporting and expanding the capabilities of the UK intelligence agencies, national crime agency and UK police
- Allowing HMG to slash red tape via centralising components of identity for business and individuals
- Using increased identity verification to combat hostile threat-actors wishing to undermine democracy, and offer this as a model for other democratic countries

What is required to deliver it at speed and scale is a small, prioritised, dedicated and tightly controlled team, principally from Government, intelligence community, FinTech, regulatory and financial services industry sources, to deliver a very early prototype and lever agile development processes to implement a digital pound sterling, with four immediate workstreams:

- Technology: leveraging the UK's collective intelligence in ledger design and application, in effect finessing and replacing processes previously involved in payment infrastructure
- Legal: ensuring that existing rules and regulations are adapted to support the digital pound.

- Engagement or community: focused on building the adoption and use of the digital pound, including a socialisation and hearts and minds initiative
- Integration within HMRC

<u>Recommendation 1</u>: The creation of a small, prioritised, dedicated and tightly controlled team, principally from Government, intelligence community, FinTech, regulatory and financial services industry sources, to deliver a very early prototype and lever agile development processes to implement a digital pound sterling as a Central Bank Digital Currency (CBDC).

6 – Exploiting and developing the regulatory opportunity

A vital collateral regulatory opportunity from these developments is the challenge and opportunity of Real Time Regulation, a central feature of RegTech (enabling compliance processes to be better) and SupTech (the use of innovative supervisory technology by financial authorities to support their work, typically encompassing big data architecture supporting advanced analytic applications) as opposed to FinTech (the application of digital and technical enabled business model innovations in financial services). Regulators will be able increasingly to work with and where appropriate act upon instantaneous information relevant to regulatory management. In exactly the same way that internal auditors should be involved from initiation in corporate management systems, so regulators should be involved in, indeed encouraging, the framing of these systems to suit their regulatory needs. Ledger intelligence, drawing on transactional and other financial data, will provide ever-increasing opportunities for optimising analysis and decision making.

Successful Real Time Regulation, measured in terms of appropriate containment of systemic and market risk, must be a compulsory aim of future UK financial service regulation working wherever possible in step with international partners but without losing the opportunity from the UK's digital technology expertise and innovation, and requiring common Digital Standards.

<u>Recommendation 2</u>: the identification of successful Real Time Regulation as compulsory aim of future UK financial service regulation.

Indeed immediately behind the priority assigned to CBDC and contingent developments is the need for a globally recognised and respected framework for international financial service regulation, in which the UK can and should take a premier leadership role in agreement and implementation giving its regulators a clear mandate internationally. They should have an explicit mission (and reorient resources) to engage deeply in international forums and to advance the UK's national interests. This mandate could be similar to the 'Core Principles' set out by the US Administration by Executive Order and implemented by the Departments and regulators. Certainly the UK authorities should work closely with their US counterparts, not least in reconstructing a balanced and appropriate relationship with their EU equivalents.

[Reference: https://committees.parliament.uk/writtenevidence/23401/pdf]

<u>Recommendation 3</u>: The UK taking a premier leadership role in the agreement and implementation of a globally recognised and respected framework for international financial service regulation, with a mandate similar to the US Administrations "Core Principles".

Building on that essential requirement and the UK's implied responsibility for the supervision of financial systemic risk, such a framework, working in the context of Real Time Regulation and Digital Standards, should also take account of the following:

- **The requirement for competitive markets:** the formal terms of reference of regulators should include a clear and where possible statutory requirement to maintain market attractiveness and openness, without prejudice to risk and safety. Successful regulation will therefore require practical knowledge and up to date/immediate awareness of market developments and the needs of all market participants (not just the most dominant and vocal) as well as regulatory skill, the latter clearly diminishing recently in the context of ever more prescriptive regulation and the demise of Self Regulating Organisations (SROs).

  <u>Recommendation 4:</u> the formal terms of reference of regulators to include a clear and where possible statutory requirement to maintain market attractiveness and openness, without prejudice to risk and safety.

- **The need for cross border access to financial markets:** founded on an outcomes (as opposed to methodology) based approach to regulation, either through enhanced equivalence, a broader and more binding version of the EU's current sectoral approach, or mutual recognition of effective practice and outcomes. The realities of international financial markets require such clearly and formally defined access, allowing for differences in national regulatory practices, but always within agreeable risk parameters, and they must lie at the heart of open market participation.

  <u>Recommendation 5:</u> Any agreed international regulatory framework to be founded on an outcomes based approach to regulation, either through enhanced equivalence or mutual recognition of effective practice and outcomes.

- **Proportionality and cost:** effective regulation requires a balance between cost and risk. Whilst within the EU, the UK was constantly in danger of implementing over-prescriptive regulation for several reasons: the natural prescriptive bias of the Continental Civil (as opposed to Common) Law and its "one size fits all" approach, the tendency of British implementation of EU Directives to "gold plate", and the increasing distance between and lack of awareness of UK regulators of the markets they were regulating. An acceptable degree of risk and outcomes-related approach to regulation allows for considerable flexibility in levels of prescription.

This one size fits all tendency can also lead to oversimplification with added administrative burden and promotional limitations, as exemplified by the Key Information Document (KID) required by the EU Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation. The resultant difficulties and costs experienced have been well set out by the Association of Investment Companies (AIC), particularly as they affect investment trusts and other vehicles for less liquid investments, such as private equity holdings *[Reference AIC]*

Over-prescriptive regulation can lead to unacceptable cost burdens, despite their diminution with digital enhancement, often resulting in otherwise successful innovative smaller participants being driven out or not even entering markets, clearly an undesirable result. Equally SMEs, given their intrinsic size, are less likely to create major risk issues. It is therefore essential that the level of prescription recognises the diversity in terms of risk, size and contribution of each participant. Such a 'two speed' regulatory system is the best way to encourage new market entrants.

<u>Recommendation 6:</u> the level of prescription in future UK financial services regulation to take account of sectoral diversity in terms of risk, size and contribution of each participant, minimising cost burdens and avoiding "gold plating" and a "one size fits all" approach.

The Office for Budget Responsibility should perform reviews of the regulatory costs of operating in the UK. These should consider all regulatory costs, including the Financial Services Compensation Scheme levy, which now costs the investment management industry more than the FCA (£200m). The idea of "polluter pays" has a role here: the investment management industry, a largely wholesale sector, has not increased its risk profile over time but is now funding the bill for the poor behaviours of other sectors, fully one-fifth of the levy. Ultimately, a high-cost regulatory regime acts as a powerful disincentive for firms to establish themselves or stay in the UK. *[Reference: https://committees.parliament.uk/writtenevidence/23401/pdf]*

<u>Recommendation 7:</u> The Office for Budget Responsibility to perform reviews of the regulatory costs of operating in the UK.

In parallel, and following up robust Regulatory Impact Assessment on all regulatory measures under consideration, all HMG departments should run, publish, and embrace, fresh and ranging red tape Audits, in conjunction with the CBDC technical developments set out in 5 above. The reviews should be ambitious, and identify management and control failures in previous anti-red tape policy. *[Reference:*

http://www.theredcell.co.uk/uploads/9/6/4/0/96409902/brexits_red_tape_challenge.pdf]

***Recommendation 8**: All HMG departments to run, publish, and embrace, fresh and ranging red tape Audits, in conjunction with the CBDC technical developments recommended.*

- **The development and regulation of parallel markets:** international financial markets thrive on the opportunity to trade in similar products but in different places at different times. Sometimes restrictions in one location can lead to greater volume in another. The development of the Eurodollar market for wholesale US dollar deposits, principally in the City of London, as a result of a costly Federal Reserve imposition, Regulation Q, in the US, is a classic example.

  Whilst on the one hand the cross regulation of such parallel markets demands international collaboration between the respective regulators concerned, the support and development of these markets is an important feature of the liquidity and attractiveness of key international products, particularly when systemic risk is present and there is a need for market reassessment of specific products.

  ***Recommendation 9:** The international regulatory community working within its agreed framework to support and develop parallel international financial markets and collaborate in their supervision.*

  A particular case in point are the parallel markets currently springing up as the EU builds a protectionist wall round its financial centres for Euro denominated financial markets. The ecology of the related cash security and derivative transactions is such that, whilst the basic transaction may take place within the EU, the value added for the continuing majority is created by decision makers and sales traders outside the EU, most of which are located in the City of London or other UK financial centres. *[Reference: https://www.cityunitedproject.com/1/a-foundation-for-future-prosperity/]*

  A priority for the development of a global financial service regulatory framework will therefore for the international financial regulation community, and specifically the. UK regulators as those most directly affected, to work together in close collaboration with the EU regulatory authorities to supervise and contain any resultant systemic or market risk across the parallel markets involved.

  ***Recommendation 10:** UK regulators to work together in close collaboration with the EU regulatory authorities to supervise and contain any systemic or market risk across Euro denominated parallel markets in the UK*

7 – Leveraging the CBDC development opportunity to promote financial services

In addition to its geopolitical and regulatory advantages and complementing a more competitive market sensitive approach, the proposed UK CBDC could promote UK financial services by:

- Offering substantially lower transaction costs which would have the effect of rebalancing service income from the EU, as well as making the UK even more competitive than, for instance, Shanghai or New York
- Allowing the UK service industry to generate revenue using fractional spending which is currently impossible with current payment systems and payment rails and supporting the expansion of the UK service industry overseas
- Promoting UK FinTech in its provision of solutions for our strategic partners
- Safeguarding and continuing to be a clearing route of choice for renminbi (via increased compatibility)

***Recommendation 11*: HMG and other UK principals involved to leverage CBDC development opportunities in respect of lower transaction costs, the use of fractional spending technology, UK FinTech based partnerships with international strategic partners, and renminbi clearing**

8 – Specific regulatory issues for attention within UK financial services

Whilst the proposed global financial service regulation framework provides the foundations and the main pillars in support of future reform of financial services there are a number of generic – ie pan financial service industry – issues which need immediate attention by HMG and regulators.

In addressing these issues CUP does not intend to raise topics which are strongly and widely supported, such as the abolition of bonus caps, the need for attractive corporate tax rates to draw in overseas investment, the resetting of Solvency II requirements for insurance companies capitalisation and revised listing proposals as set out in the recent Hill Review, with its emphasis on attracting a broader, growth oriented range of companies with a UK quote.

- **Regional focus and the Freeport opportunity for a Wholesale Fund Hub (WFH) in support of the Union:** whilst there is tendency for attention to focus on the needs and concerns of the City of London there are a number of established and thriving financial centres located across the UK, notably in Belfast, Liverpool, Edinburgh, Glasgow, Bristol and Leeds which could be bound together, using the recently announced Freeport template, into a Wholesale Fund Hub (WFH), nurturing jobs in custody, administration and all areas of wholesale financial services, akin to those in Singapore, Cayman, the Republic of Ireland, Luxembourg and even Malta, and drawing back resource and employment from these existing centres for wholesale markets. In additional support Basel III capital requirements for non internationally active UK banks and building societies should be reduced, thereby increasing lending available to regional UK businesses.

Such initiatives would not only endorse the Government's regional strategy but would also support the Union, binding national centres together.

<u>Recommendations 12</u>: The creation of a Wholesale Fund Hub using the Freeport template and involving financial centres throughout the UK.

<u>Recommendation 13</u>: The reduction of Basel III capital requirements for regional banks and building societies.

- **Digital standards:** global financial services require common digital standards and the UK RegTech/SupTech programme has had an excellent start and first mover advantage should be maintained. These standards define market practice and need to involve multiple trade associations (e.g., ISDA, ISLA, ICMA, AFME, UK Finance, ACI etc.). In particular a new cross regulatory body (BoE, PRA, FCA, ICO) is required to convene a cross sectoral group to break down barriers to digital collaboration, agree plans and fast-track UK digital maturity
[Reference: https://www.fujitsu.com/uk/imagesgig5/6887-RegTech-White-Paper-SCREEN-v1.2.pdf]
<u>Recommendation 14:</u> The agreement of common UK digital standards for regulation and markets

- **Attention to sectoral structure:** each sector of UK financial services has a heterogeneous structure, generally ranging from massive, mainly overseas owned, well resourced and capitalised multinational institutions, through more medium sized participants and SMEs, down to individual traders and advisors. Whilst there is are generally well organised and managed trade bodies associated with each sector, their representations can often be dominated by the best resourced members. It is important for regulators to take account of the often widely differing interests of all participants, including specifically the smaller but more innovative and less well resourced players, particularly in respect of proportionality and the avoidance of unnecessary and restrictive over-prescription and gold plating, with related cost implications.

  <u>Recommendation 15:</u> UK regulators to take account of the often widely differing interests of all participants, including specifically the smaller but more innovative and less well resourced players.

- **Regulatory style and implementation of change:** noting both the immense speed of change and innovation in financial markets and the need, for competitive reasons, to seize the immediate UK market opportunities provided by regulatory reform, HMG needs to look at ways of ensuring, without undue risk and with appropriate consultation, the quickest possible implementation of necessary change.

<u>Recommendation 16:</u> HMG to look at ways of ensuring, without undue risk and with appropriate consultation, the quickest possible implementation of necessary regulatory change.

UK firms setting up in EU financial centres have noted the welcoming and user friendly approach of local regulators to their start up activities, in contrast to the formal and sometimes bureaucratic approach of British regulators. A positive and helpful attitude to incoming investors in UK financial services should be an important collateral attribute to a robust requirement for regulatory protection of the attractiveness of markets.

<u>Recommendation 17</u>: UK regulators to provide a positive and helpful attitude to incoming investors in UK financial services alongside a robust requirement for regulatory protection of the attractiveness of markets.

- **Supporting parallel markets in EU products and reverse solicitation:** it is clear that EU award of equivalence for designated financial service sectors is currently politically motivated rather than based on objective assessment and in any event can be withdrawn at very short notice. At the same time the forthcoming MoU on financial services whilst setting a forum for discussion and collaboration has no binding characteristics. Given these uncertainties, City firms affected have efficiently used the post referendum years to ensure that their business remained as little harmed as possible by establishing trading platforms on the Continent and setting up appropriately regulated subsidiaries. Yet the transactional core has stayed, on the whole, in the City and the UK financial services industry, since institutional share trading is conducted through an eco system that spans UK decision makers, ie fund managers and sales traders, together with the more technical value added aspects of transaction processing, such as so-called algorithms and smart order routers. So too have the associated volumes of derivatives (transactions for future settlement) which are a multiple of their underlying cash basis and represent highly complex systems.
  [Reference: https://www.cityunitedproject.com/1/a-foundation-for-future-prosperity/]

  This burgeoning and liquid parallel market in Euro denominated products in the UK, as described in section 7 above, is therefore a significant and attractive part of the UK's international financial offering. It is important therefore formally to recognise and promote the legally available opportunity under MiFID II and AIFMD for EU regulated market participants to access these UK financial markets by virtue of the "reverse solicitation" exclusion, in effect providing many types of service to customers in the relevant EU Member States solely under UK regulation and supervision. Use of this reverse solicitation exclusion requires the provision of the service by the UK

firm to be at the client's exclusive initiative. It is possible to construct business on this basis, so long as the first move in the relationship is made by the EU customer(s), and this opportunity needs to be promoted at HMG, regulatory and industry trade body level.
[Reference: The Art of the No Deal: https://www.politeia.co.uk/wp-content/Politeia%20Documents/2017/The%20Art%20of%20the%20No%20Deal/Reynolds,%20Barnabas%20'The%20Art%20of%20the%20No%20Deal%20-%20How%20Best%20to%20Navigate%20Brexit%20for%20Financial%20Services'.pdf]

***Recommendation 18*: The opportunity for the use of legal "reverse solicitation" to attract EU participation in UK financial markets to be promoted at HMG, regulatory and industry trade body level.**

- **Improving the quality of UK derivative markets:** MIFiD II has imposed a number of burdensome and unnecessary requirements on derivative markets which should be swiftly removed or revised:
    - Regulatory reporting obligations for exchange traded derivatives, which are already available through exchange requirements
    - The emissions trading regime, which creates a distorted market and encourages speculation
    - The proposed Open Access provisions for UK CCPs, which are unnecessary and anticompetitive
    - Appropriate risk adjusted "haircuts" for Eurozone debt for capital and collateral purposes

***Recommendation 19:* UK regulators to review specific opportunities to improve the quality of UK financial derivative markets.**

- **Understanding the importance of agency intermediaries:** financial markets are riddled with intermediaries, and arguably the cause of many of the problems in financial services arises when the client/customer is unclear who the intermediary is acting for. As an example, the FCA currently issues one set of rules for all "insurance intermediaries" regardless of whether they are agents of the insurers or agents of the policyholder. The law of agency should be central to the regulation of financial intermediaries and should be clear about the respective responsibilities of each party, buyer, seller and intermediate agent.

***Recommendation 20*: UK regulators to review the law of agency and its effectiveness to ensure that it identifies and minimises relevant risk.**

- **A full shopfront of UK funds to meet the wide range of needs of British and international investors:** Some of the issues that impede the UK's competitiveness as a fund domicile of choice can only be addressed through new fund structures, such as the Long-Term Assets Fund (LTAF) and Onshore Professional Fund (OPF). A further useful workstream is the need to

review and prioritise the UK's network of double taxation treaties (for instance with the US, Canada, and India, where the current UK tax treaty requirements could make it difficult for an exempt fund to use the treaty's provisions.
[Reference: https://committees.parliament.uk/writtenevidence/23401/pdf/]

Recommendation 21: ***HMG to consider the need for new fund structures in order to provide a full UK range including a specifically Green/ESG fund, and to review double tax treaties to ensure UK fund competitiveness.***

Looking to the longer term, however, fund promotion is only one part of sectoral requirements, unlike in Luxembourg or Ireland. The priority is to promote the industry's excellence and expertise in discretionary portfolio management services. This is the most highly prized link in the investment value chain, linking in as it does to parallel market development set out above, and previously stated comments on leadership within FinTech, Socially Responsible Investment and corporate governance and stewardship, all of which are topics of enormous interest to an international marketplace
[Reference: https://committees.parliament.uk/writtenevidence/23401/pdf]

- **Assisting long term HMG objectives in ESG/Green investment:**
  An opportunity clearly exists for developing the City and the national financial services industry into an international hub for all aspects of developing ESG/Green initiatives and businesses. In line with this and in addition to the fund range that fits with the government's G7 and COP26 (the United Nations Climate Change Conference) leadership in 2021 would be the creation of a specifically Green or ESG Fund (see Recommendation 21). This requires regulatory approval and also the willingness of HMG to create a new class of fund that can compete in tax terms with Luxembourg and Ireland. The tax gains to the UK would come from the employment in back-office functions that would be placed outside London and the south-east, working towards the regional and levelling up agenda identified above.

  Furthermore, the MiFID II asset manager research spending rules pose an existential threat to the UK's long-term ESG ambitions and indeed to its fund management sector as a whole. It imposes a burden which does not exist for its competitors in the US and other international centres. In contrast MiFID II has resulted in most UK managers funding critical external research (including ESG) from their own P&L account. This spending is therefore contingent on the manager's profitability, driven primarily by total assets under management which are heavily influenced by the level of financial markets. Most managers have cut research spending by ~70% since before MiFID II, harming both returns and the competitive position of UK managers globally.

  Recommendation 22: ***HMG to revise MiFID II asset manager research spending rules***

UK asset managers play a critical role in achieving the UK's ESG objectives by "engaging" with the companies they invest in to encourage them to meet specific targets related to achieving the UK's Carbon Zero objective by 2050. These initiatives are tremendously expensive for asset managers and will take decades to play out. Yet asset manager ESG spending is growing rapidly and was completely unanticipated when MiFID II was conceived.

There are two key risks. The first is an immense funding duration mismatch between long-term ESG targets (UK Carbon neutrality in 2050) and the current ESG funding regime – (research budgets set annually based on manager revenue determined quarterly – 30 years in advance of the ESG target). The second is the market sensitivity of manager profitability that funds ESG engagement and particularly the impact of a sustained bear market. However UK pension funds, whose liability profiles mirror long-term ESG timeframes, could be incentivized to use their long duration and low research costs to underwrite long-term ESG objectives by funding asset manager ESG budgets

In short, failure to address ESG funding issues could jeopardize the government's long-term Green objectives by compromising investor confidence in the entire ESG process. *[Reference: https://bit.ly/3smiE7r]*

- **ICO sensitivity:** HMG should include the Information Commissioner's Office in regulatory discussions and have competitive and international outlook objectives included within the ICO's mandate. As a vivid example, the U.S. SEC's interpretation of GDPR led recently to the near suspension of the registration of UK investment advisors. *[Reference: https://committees.parliament.uk/writtenevidence/23401/pdf]*

  ***Recommendation 23:* HMG to include the Information Commissioner's Office in regulatory discussions and have competitive and international outlook objectives included within the ICO's mandate.**

- **Supporting University research and innovation:** reflecting how US universities such as Harvard and Yale are able obtain alumni investment in their capital as well as recognising the world renowned research capability of British universities, an initiative to set up Introducer Appointed Representative Agreements with alumnus fund managers to make UK the centre of excellence again for such investments.

  ***Recommendation 24:* HMG to introduce Introducer Appointed Representative Agreements for alumnus fund managers to assist universities to fund research and innovation**

9 – Conclusion

This report sets out a considerable suite of recommendations, structured around global change and everchanging market demands, and in the context of the unrelenting development of digital technology, with an UK CBDC as a fundamental foundation. There are underlying themes associated with building on and exploiting world leading UK resources in technology, financial regulation and supervision, and attractive global financial service markets.

Whilst manifestly in support of many HMG policies, they also call for HMG and UK financial industry understanding and acceptance of their rationale, coupled with the vision to use them to set a prioritised set of strategic objectives, and recognising the need for collaboration, leadership and speed of decision making and implementation.

It is certain that the opportunity is both massive and achievable, provided the UK's considerable and diverse assets are applied within a such a clear and fully supported strategic framework, as outlined by these recommendations.

However CUP each recommendation will require further detailed appraisal, including identification of, and working in collaboration with, the principals involved in each case, the resources needed, delivery timetables and a SWOT (Strength, Weakness, Opportunity and Threat) type analysis. The CUP with its front line practitioner base and approach would be glad to interact with this process in any appropriate and useful way.

Main contacts: Professor Daniel Hodson, Chairman, The CityUnited Project: d.h.hodson@btinternet.com 07801 233094

Leigh Evans, Vice Chairman, The CityUnited Project: opco@cityunitedproject.com