

A Look At UK's Divergence Priorities After Brexit

By **Ian Hargreaves, Thomas Reilly and Alan Kenny** (July 26, 2021, 11:10 AM EDT)

The U.K.'s post-Brexit policy has been to focus divergence from the EU on those sectors where the U.K. has a competitive advantage. This is particularly so in the financial services sector, where the government, the Financial Conduct Authority and the Bank of England have focused on fostering technology and innovation.

The U.K. also has a competitive advantage in dispute resolution: England is a preferred jurisdiction, and English law a preferred governing law, for a range of commercial disputes, including those relating to financial services.

Here too, the U.K. courts and judiciary increasingly appreciate that to maintain this advantage they must embrace technology and increase innovation to keep pace with the people and industries they serve, and rival dispute resolution jurisdictions, and to ensure that they attract the financial services disputes of the future.

This article discusses a few of the many steps being taken in the U.K. by the government, regulators, judiciary and the courts to foster technology and innovation, and assesses how this may develop in the future.

Background

In the lead-up to and following the U.K.'s departure from the EU, London saw its share of several markets drop as business, assets and workforces migrated to EU competitor jurisdictions. This was predominately a result of the decision of the U.K. government not to include financial services as part of the negotiations which led to the EU-U.K. Trade and Cooperation Agreement.

From its side, the EU saw in Brexit the opportunity to onshore its financial services sector and to move more aggressively toward its long-held capital markets union plan.

Since then, the U.K. has granted an equivalence decision in most of the 40 possible areas. The EU has largely held its line and only granted a handful of equivalence decisions to the U.K., effectively denying U.K. firms access to EU markets.

The much-anticipated EU-U.K. memorandum of understanding on financial services, announced in March 2021, did little to improve the outlook. Although it created a joint Financial Regulatory Forum to



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discuss rulemaking for the sector, and may eventually open up some EU markets, it fell far short of the legally binding cooperation arrangements many in the U.K. had hoped for.

Policy of the U.K. Government, FCA and BoE

The view of the U.K. government and FCA is that eventual equivalence cannot be assumed, and even if it could, much of the damage already done to financial services may be irreversible, since the financial services companies which have already left the U.K. to establish branches or headquarters in the EU are unlikely to spend more money to relocate back to the U.K. Therefore, the focus has switched to developing competitive advantages.

Although the U.K. government does not view divergence or convergence in itself as a strategic objective, it recognizes that Brexit offers the U.K. the opportunity to play to its strengths. FCA policy is to avoid changes which would require companies to spend time and money complying with different regimes in the EU and U.K., wherever possible.

However, the FCA has already demonstrated a willingness to diverge where the cost/benefit analysis comes out in favor of doing so.

Some of the announcements from the government and the FCA in this regard have focused on:

- Making U.K. financial services more competitive by reducing tax and reducing regulatory complexity and duplication;
- Making U.K. markets more flexible and attractive to companies considering an initial public offering in the U.K., including via a special purpose acquisition company;
- Adding protections for — and increasing the information provided to — retail investors;
- Promoting the importance of environmental, social and governance, or ESG, issues; and
- Reforming the prudential regulation of the insurance sector.

However, the dominant focus is on embracing technology and innovation, particularly in two connected areas: (1) fintech and crypto-assets (and associated distributed ledger technology, and smart contracts), and (2) artificial intelligence.

Fintech and Crypto-Assets

Announcements and developments in this area include:

- The Kalifa Fintech Review, published in February 2021, which was commissioned by the U.K. government to identify priorities to focus on extending "the UK's competitive edge over other leading fintech hubs";
- New visa schemes allowing individuals with relevant technological expertise to qualify for easier/quicker access to the U.K.;

- The "Future Fund: Breakthrough," announced in March 2021, which is designed to steer £375 million of U.K. government investment into highly innovative businesses focusing on, among other things, quantum computing and "clean-tech";
- The Central Bank Digital Currency Taskforce, announced in April 2021, intended to explore the potential for a new digital currency issued by the Bank of England to "ensure the UK remains at the forefront of global innovation";
- An industry-led Centre for Finance, Innovation and Technology, announced in April 2021, designed to promote growth in the U.K.'s fintech sector, at the regional and national level.
- A so-called scale box from the FCA, announced in April 2021 — a package of measures to provide a one-stop regulatory shop for growth stage firms;
- A second phase of the FCA's digital sandbox, announced in April 2021, designed to help young finance companies test concepts to tackle sustainability and climate-change-related finance challenges;
- A new FCA sandbox delivered in collaboration with the Bank of England and HM Treasury, announced in April 2021, to assist companies exploring the use of technologies such as distributed ledger technology to improve market infrastructure; and
- A new omnibus account from the Bank of England, announced in April 2021, to allow access to innovative financial market infrastructure providers that can support the delivery of faster, cheaper, 24-hour wholesale payment and settlement using central bank money.

AI

The U.K. is recognized as one of the top jurisdictions for artificial intelligence in the world, ranked number three in the 2021 Global AI Rankings. This was a key consideration behind the Trade Agreement with Japan. Announcements in this area include:

- The AI sector deal launched in March 2018, containing varied proposals to promote AI-related partnerships between business, academia and government;
- Turing AI Fellowships, first announced in October 2018 and since extended: a government initiative to replace the EU's European Community Action Scheme for the Mobility of University Students Scheme and fund fellowships "aimed at retaining, attracting and developing [in the UK] the best and brightest AI international researchers";
- The Centre for Data Ethics and Innovation, announced in November 2018, intended to advise on the ethical use of data, including for AI;
- The U.K.'s Trade Agreement with Japan, agreed in January 2019 — important, among other things, for allowing the AI industry access to Japan's complimentary robotics industry;
- Publication of the "Ethics, Transparency and Accountability Framework for Automated Decision-Making" in May 2021: guidance "for public sector organizations on how to use automated or algorithmic decision-making systems in a safe, sustainable and ethical way";

- A new AI strategy, announced in March 2021, focused on growing the U.K. economy through widespread use of AI, but in a way that is ethical, responsible and resilient to change, emphasizing the importance of research and developing skills and talent; and
- The Alan Turing Institute report on "AI in FS," published in July 2021, commissioned by the FCA, which highlights the benefits but also the potential challenges and harms of pursuing innovation in the sector. This is likely to influence the FCA's perspective on the necessary AI regulatory framework — one allowing innovation to flourish, but in a manner that is transparent, responsible and socially beneficial.

Policy of the U.K. Courts/Judiciary

The focus of the U.K. courts and judiciary on the advantages offered by the use of technology is evident in three developments:

1. Greater use of electronic and online systems;
2. Recognition of crypto-assets and smart contracts under English law; and
3. The Digital Dispute Resolution Rules.

Electronic and Online Systems

In November 2018, the courts announced a reform program designed to modernize court systems, with a focus on increasing and speeding up access to justice for professional and public users.

This program has developed online services, remote hearing capability, and/or paperless systems for a variety of court proceedings, and there are plans to extend this to other areas, and for a wide-ranging rollout of new court IT systems and screens, and new scheduling and listing tools to improve efficiency.

In the business and property courts — those courts dealing with most high-value commercial disputes — while there has been electronic filing for professional court users in certain lists from as long ago as 2014, the use of remote hearings had, until recently, been minimal.

This changed markedly during the COVID-19 pandemic: The business and property courts switched to mostly online, or in rare cases hybrid, hearings. This switch has generally been well received by the business and legal community.

Indeed, while there is a recognition that further improvements are required, and it is not appropriate for all hearings to be conducted remotely, senior figures in the judiciary have advocated for widespread continued use of remote hearings post-pandemic, not least to boost the attractiveness of U.K. courts to international business users.

Further developments are in the pipeline: Sir Geoffrey Vos, Master of the Rolls and the head of civil justice in the court system of England and Wales, has announced an objective to introduce new portals for civil, family and tribunals disputes, managing these online end-to-end, with in-person hearings reserved for only a small minority of cases.

Further, he has suggested:

- Traditional written pleadings and statements of case may be jettisoned in favor of decision trees and mechanisms that may arrive more quickly at identifying the real issues;
- A greater focus on resolving issues as they are identified on an interim rolling basis, rather than at trial; and
- Incorporation of more alternative dispute resolution mechanisms in the litigation process, such as judges proposing outcomes in the form of early neutral dispute resolutions, and/or formal mediated interventions or on-screen algorithms suggesting solutions to points of dispute as and when they materialize, using AI and smart programming.

Crypto-Assets and Smart Contracts

In November 2019, the U.K. Jurisdiction Taskforce issued a legal statement expressing the view that crypto-assets were property and smart contracts were contracts under English law, in order to provide "much needed market confidence, legal certainty and predictability in areas that are of great importance to the technological and legal communities and to the global financial services industry."

The legal statement has since been adopted by the English High Court.

The broader aim is to demonstrate that English law and the jurisdiction of England and Wales together provide a state-of-the-art foundation for the development of distributed ledger technologies, smart contracts and associated technologies.

The Digital Dispute Resolution Rules

On April 22, 2021, the UKJT published the Digital Dispute Resolution Rules. This is a new procedural framework designed to facilitate — by arbitration or expert determination — the rapid resolution of disputes relating to novel digital technologies such as crypto-assets/cryptocurrency, smart contracts, DLT/blockchain, and fintech applications.

The rules are innovative and/or tailored to digital disputes in five key areas.

1. They envisage a very quick process. For arbitration, the commencement and appointment process is streamlined, the tribunal is required to use its best endeavors to determine a dispute within 30 days of appointment, there is no automatic provision for an oral hearing, and there is no right of appeal on a point of law.
2. They are designed to be compatible with new technologies and processes, including "automatic dispute resolution: — meaning a process associated with a digital asset that is intended to resolve a dispute by the automatic selection of a person or panel or AI agent whose vote or decision is implemented directly within the digital asset system (including by operating, modifying, cancelling, creating or transferring digital assets). Further, the rules provide for incorporation into "digital assets or digital asset systems," including by adding incorporation language in "electronic or encoded form."
3. Parties may express their preferences as to the necessary technical expertise of arbitrators and/or experts appointed, and it is anticipated that over time the Society for Computers and Law, the default appointment body, will develop a panel of experts with proven expertise in relevant technologies, assisting in the efficient resolution of disputes.

4. Parties may agree that there is to be anonymous dispute resolution, meaning parties must only identify themselves to the tribunal and not each other. Identities may then only be disclosed in limited prescribed circumstances (e.g., if required for enforcement).

5. Tribunals have enhanced default powers and enforcement mechanisms. They may at any time operate, modify, sign or cancel any digital asset relevant to the dispute using any digital signature, cryptographic key, password or other digital access or control mechanism available to them, and direct any interested party to do the same, and may implement decisions directly "on-chain" using a private key.

The Future

The U.K. government has made its intentions clear, most recently in the Chancellor's Mansion House Speech on July 1: There will be a concerted effort to modernize the financial services sector in ways designed to attract more business.

While the chancellor was eager to emphasize that the regulatory regime will remain robust and as such there should be no reason for the EU to continue to deny the U.K. equivalence, his speech also recognizes the reality that as the U.K. modernizes it will necessarily diverge, making equivalence less likely.

Indeed, the ability to diverge in areas of relative competitive strength is a core tenet of the rationale for Brexit. This intent underpins the chancellor's specific references to developing greater financial services-related ties and regulatory cooperation with the U.S., China, Singapore and Switzerland, as well as the need for the U.K. to take more of a leading role in setting the regulatory agenda for financial services — its most global industry.

Further, to enhance its leading role in this sector, it is increasingly clear that the U.K. will prioritize technology and innovation and associated green and sustainable financing trends, in order to leverage a first-mover advantage. Moreover, it seems more likely that the U.K. will push for more and higher regulatory standards as a differentiator, rather than lead a race to the bottom.

The chancellor's speech indicates that these objectives will be partnered with a commitment to promoting social benefits from financial services for citizens and communities globally. This is consistent, for example, with the rationale underpinning the FCA's commissioning of the Alan Turing Institute report on "AI in FS," discussed above, which looked in detail at the ethical and other challenges that the growth of AI will inevitably present.

This suggests that the U.K. will not prioritize economic benefits above all else — something reflected not only in the focus on the "leveling-up" agenda, but also in the chancellor's comment that developing the U.K.'s economic relationship with China must be pursued "in a safe, mutually beneficial way without compromising [the UK's] values or security."

These are lofty objectives. Whether or not the U.K. can meet them and maintain competitive advantages in the financial services and dispute resolution sectors in the medium-to-long term, remains to be seen.

To a certain extent, this depends on the competition with the EU: how successful the EU continues to be

in poaching companies and expertise from the U.K., versus how dynamic, creative and flexible the U.K. can be, and therefore how attractive it is to new business from outside the EU.

The U.K. competitive edge is assisted by the fact that its financial regulators, courts and judiciary are already well joined-up in prioritizing the use of technology and innovation.

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