



Global Counsel

Doing things differently

How the UK could use post-Brexit flexibility

January 2021

- **Regulatory divergence is an inevitable result of the EU and UK systems no longer being conjoined.** With the end of the transition period we will start to see the UK and the EU begin to diverge after 45 years of regulatory convergence, alignment and harmonisation. Pulse fishing is now banned, and the tampon tax has been scrapped. But these political optics will give way to a more complex dynamic.
- **Divergence is likely to be a side effect as much as a strategy.** In some cases it will be deliberate and strategic, in most it will probably just arise from different pressures, preferences and systemic protocols. In some cases it will be a question of clearly divergent regulatory pathways, in many it is likely to be a question of different ways of achieving the same broad regulatory or policy aims.
- **A number of areas are likely to be obvious places for divergence to appear.** Here we consider digital and data policy; industrial policy; the UK's approach to its food system; the UK's approach to its external tariff and customs system; the policy frameworks low carbon transition; the international status of London's financial markets. In each case the UK will have more scope to customise policy to its specific context - conditioned in some cases by weighing any costs of diverging from EU preferences.

Four key political contexts for divergence

- **Covid-19** - the covid-19 pandemic will add an element of urgency to regulatory change as a driver of economic recovery and has UK Ministers looking for ways to make new regulatory freedom a tool of economic recovery.
- **Equivalence and mutual recognition.** The EU has rebuffed UK requests for models of deference that would see the EU recognise UK standards, or UK conformity assessment bodies. In some cases this will reduce the incentive for the UK to pursue alignment for its contingent trade benefits, especially in financial services.
- **The Biden presidency.** Declining prospects of a quick UK-US trade deal removed some of the pressure for changes to UK food regulation, and new UK-US synergies are likely to emerge, particularly on sustainability and climate change policy.
- **Tensions in the British union.** The Internal Market Bill revealed a highly contested landscape for regulatory change in the UK, with the SNP administration in Scotland keen to emphasise its continued fealty to EU regulation.

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3 types of divergence

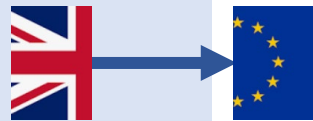
Status Quo



Examples from this overview

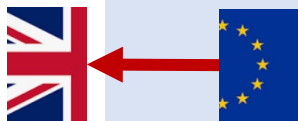
Model 1: The EU evolves a current regulatory approach where the UK does not

EU regulation of digital platforms, AI and fintech; EU social legislation



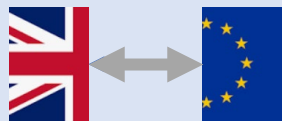
Model 2: The UK chooses a different regulatory pathway to the acquis

Possible UK approach to gene editing; IP protections; data liberalisation in life sciences; capital requirements in insurance; taxation of imports



Model 3: The UK adopts a new way of achieving the same basic regulatory approach

Possible UK changes to use of technology in customs protocols; UK balance in primary and secondary FS regulation; specific subsidy choices



- Divergence in regulatory approaches between the EU and UK will mean a range of different things. Three types of divergence are considered here. Each has different practical effects and different political ramifications.
- Some divergence will occur where the EU chooses to evolve its regulatory model in a way that the UK will no longer be bound to follow.
- Some will occur where the UK chooses to adopt an alternative regulatory pathway to that set out in the EU acquis.
- A third category will see the UK continue to maintain the same regulatory aims and outcomes, but use greater flexibility on how to achieve these.



Data liberalisation. The UK's health data could be packaged into a national strategic asset for use by researchers, and for the financial benefit of the NHS. The better application of data could also be the basis for streamlining regulatory approval processes, incentivising the use of AI, reducing the cost and time of clinical trials and could support recent scientific advances such as gene editing or AI diagnostics. This could accelerate investment in an industry that has traditionally had high barriers to entry and long product development life cycles.



New approaches to IP. Beyond the core frameworks of the European Patent Organisation, the TCA offers few restrictions on the UK's ability to vary IP protections, including in key areas such as medical products. Innovative intellectual property regimes and stronger protections for therapies that require greater R&D investment could be introduced, and rules in areas such as PTE export waivers could be revisited.



- **The government has long taken a strong interest in driving life sciences and medicine innovation.** Life sciences is a highly regulated sector and within EU constraints, the UK government had sought a range of interventions, including funding for Genomics England to sequence the genetic code of 500K volunteers to better understand a range of diseases.
- **With Brexit, it can explore regulatory changes to increase innovation.** The pandemic has only increased the profile for this sector. Previous constraints of GDPR, state aid rules, and the drug approval regime no longer apply in the same way. Innovations from the pandemic in the NHS, such as new data dashboards and telemedicine, will likely also be consolidated in the longer term. The outcome of this might be a sector more readily able to embrace emerging health technologies.
- **This government is looking to refresh their industrial strategy.** This might include further proposals to monetise medical data, change the drugs and devices regulatory regime and reform intellectual property rules.
- **Challenges remain in a highly complex and regulated sector.** Divergence of EU data rules could risk UK adequacy status in the EU GDPR. The industry needs to be closely involved with reforms to ensure innovations go beyond the lab and into the market. Science by nature has risks, so UK governments may have to be patient when seeking quick Brexit wins.

- **The government views digital transformation as a key driver for UK growth.** Recent industrial strategy sector deals all have a heavy focus on technology, with a dedicated deal on AI. The Johnson Administration intends to double down on this theme as this strategy is relaunched later in 2021.
- **The UK is likely to review its data protection framework.** Outside of the EU, the UK will have the regulatory autonomy to review its data protection framework and potentially diverge from elements of the GDPR and the ePrivacy directive. This could mean lower compliance costs, though radical reform will be constrained by the EU data adequacy process.
- **The government is planning to relaunch a UK digital strategy, positioning tech at the heart of pandemic recovery.** It has ambitions for more interoperability, storage and application of data in public services, as well as plans for building an enterprise regime that generates more ‘unicorn’ startups.
- **However, divergence is likely to be constrained by domestic and external dynamics.** The digital sector is global by nature so divergence between the UK and EU may not be automatically welcomed by businesses. Most obviously, significant divergence from GDPR would come with the risk that the EU does not grant data adequacy to the UK. Broader tech liberalisation may also not be politically popular, given concerns around privacy rights and harmful content on social media platforms, an area where the UK is looking to legislate.



Divergence on data regulation. While there are strong incentives for the UK to remain close to the EU’s personal data protection framework to ensure adequacy under the EU GDPR, targeted reforms could reduce some obligations on businesses. There may also be a competitive advantage in not legislating in areas where the EU plans to do so. One example is artificial intelligence where the EU is planning to introduce a comprehensive legislative reform but the UK does not.



Greater state support for tech and digital infrastructure. Outside the EU’s state aid regime, the UK government could potentially provide greater financial support to the development of innovative technologies and the roll out of digital infrastructure. The agreement commits both parties to respecting general principles which nonetheless allow significant room for manoeuvre. One example could be funding schemes for 5G networks.





Regulation that encourages investment in long-term productive assets.

Inherited EU legislation like Solvency II discourages long-term investors from greater investments in assets like infrastructure or companies with long-term growth potential, and instead requires more investment in assets like government bonds. A review of Solvency II is already underway. A change to capital requirements for long-term assets would complement the government's levelling up agenda.



Greater freedom to forge relationships with financial centres beyond the EU.

Complete autonomy to decide the UK's financial services relationships with not only the US but the fastest growing markets in Asia could create new opportunities for growth. The UK is free to adopt a less defensive & politicised stance in financial services than the EU's. The UK's weight makes it an attractive partner for global norm-setting.



- **The UK government will want to actively support the UK and particularly London as a global financial centre.** Its historical legacy, time zone, global language, stable legal system, cluster of talent and expertise and competitive tax regime have all helped the UK to host a global financial services sector. Without the attraction of an easy location for cross-border service of the EU single market, the UK government will be looking for new incentives.
- **The government is already looking at how more bespoke regulation can support this aim.** This could involve better-targeted capital requirements for investments, reducing the threshold for initial public offerings and building new partnerships with other international finance centres around models such as deference. The Chancellor has already pledged to explore green finance proposals, digital currencies and review business listing requirements to boost attractiveness post Brexit for the financial services sector.
- **EU reluctance to base cross-border rights on equivalence may reduce UK appetite for alignment.** The EU has already made clear that onshoring financial services currently supplied from London is its priority meaning that equivalence regimes underpinning cross-border supply will not be activated, or their terms of alignment and the attached rights made strict enough to be unattractive to the UK. This may incentivise divergence if it comes with limited cost in cross-border trade with the EU.

- **Food policy is becoming more political as the government considers what its approach to the food system should be.** Underlying issues around affordability and inequality are driving the UK's first ever national food strategy, setting out its approach to the whole food system.
- **Post-Brexit, there are more tools for the government to use to meet its goals for the food system.** Subsidies are set to be reformed, with the EU's CAP policy replaced with subsidies focussed on land management and environmental and public goods rather than acreage. Control of border tariffs also means more direct control over the cost of imported food, which a high EU tariff wall to protect domestic farming heavily distorts.
- **The regulation of food safety is an area where the UK has appetite for change.** The UK was a critic inside the EU of some of its precautionary approaches to novel foods and food-related technologies, including genetic modification and gene editing. With gene editing, the UK is clearly tempted to revise its approach outside the EU. The UK government is also considering a more liberal approach to alternative proteins and plant-based meat substitutes.
- **Reforms in this area will be politically sensitive.** Government arguments for more innovation in the food system inevitably confront accusations of weakening safety standards. The Scottish administration will also make a political point of rejecting any divergence from EU practice.



The UK's proposed Environmental Land Management scheme (ELMs) will mark a **significant shift from the previous EU system**. ELMs will replace the CAP subsidy system with a tiered approach to rewarding sustainable land management. This means farmers will no longer be paid on the basis of acreage, but instead by the contribution to public goods. The precise framework for how payments will operate is yet to be determined with a series of tests and trials running through to full roll-out in 2024.



Reform of GMO regulations to allow gene-editing. Gene-editing accelerates the process of selective breeding that has long been used in agriculture to improve crop yields. Banned across the EU in 2018, the government is now looking to amend the GMO regulations to allow its use in England. This, alongside a potentially more liberal approach to novel foods such as alternative proteins, points to how the government believes regulation can be better designed for innovation in agriculture.





An accelerated regulatory framework. The government has a number of forthcoming strategies on specific technologies. It can be expected to use these strategies to clarify the funding that will be provided for green initiatives, and set out a legislative timetable for regulatory changes. While the EU already has a timeline for some of these changes, complex EU internal politics mean the UK is likely to move faster and this may act as an incentive to invest in UK projects.



New incentives to build-up the UK's EV battery capabilities. The TCA phases in tough restrictions on exporting EVs to the EU with non-UK batteries. This means the UK will need a battery plan for 2026. The UK's own car manufacturers need to be convinced that they will be supported in onshoring their manufacturing and that this can be delivered at the same quality and cost as is currently the case with Japanese imports. Nissan will be an important test case.



- **The government wants to demonstrate its role as a low emissions leader ahead of COP26.** The UK was one of the first European countries to enshrine in legislation a carbon emissions target and has committed to ban internal combustion engines by 2030. The hosting role provides an opportunity for the UK to showcase itself as a world-leader in green energy, at least matching the scale of ambition of both the EU and the US.
- **Brexit is an opportunity to accelerate funding, R&D and regulation for green technologies.** The UK has set out its plan for a new green industrial revolution focused on green and blue hydrogen, CCUS and EVs. If these are the areas that they want to attract investors to and direct consumption to the UK, Britain can now demonstrate a clear regulatory pathway, independent of the EU, and deliberately favouring UK energy priorities.
- **But there is an acknowledged role for convergence as well as divergence.** Given the end goal of reducing net emissions is broadly the same, the UK and EU are clear there will be instances of collaboration on energy. For example, the UK remains open to linking its ETS to the EU's given that a robust cross-carbon price will make renewables more competitive.
- **The scale of financial commitment shown by HMG will be key.** The EU has already demonstrated a willingness to commit large sums to facilitate an increasing role for renewables; the UK will be tempted to do the same.

- **The government wants to use its new autonomy on trade to help deliver UK industrial strategy goals.** For the first time in over 40 years, the UK government will be able to engage in trade negotiations solely on the basis of advancing specific UK industry interests - improving market access and the conditions of operations for British firms abroad and reducing tariff costs - and potentially other frictional costs - for critical inputs.
- **New free trade agreements (FTAs) form an important part of the UK's approach, but the policy will ultimately look beyond FTAs.** The primary targets are the US, Australia, New Zealand, and Japan, with a view to opening the door to CPTPP accession. Modernising existing deals is also important with a focus on Canada in particular. Expect a focus on 'regulatory diplomacy' and participation in issue-specific agreements, such as the Digital Economy Partnership Agreements led by Singapore and the proposed Global Financial Partnership with Switzerland.
- **The UK's control on two key import levers will be important.** The UK has already conducted one revision of its external tariff to customise it to UK preferences and reduce input costs where its industrial base does not demand the same protection provided by the EU - further reviews will follow. Out of necessity the UK is also likely to consider new ways of using technology to transform its customs system now that it is no longer bound by the specific approach of the EU Union Customs Code.



The focus will shift from rollover deals to new bespoke agreements. With the transition period over, the UK is now more able to negotiate deals with third countries without time pressure hanging over the talks. This allows for more thorough analysis of the UK's defensive and offensive interests, and provides more time to win the support of domestic political interests for both negotiating mandates and final deals. Ensuring there are clear lines of communication between industry and government will be central to success here.



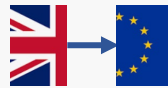
Greater freedom to define customs protocols could see a new role for technology. The UK is likely to consider ways to sustain its current level of border integrity but use new technological tools to improve trade facilitation and manage flows at its bottleneck ports in the South East of England and on the UK-Ireland RO-RO routes.



EU divergence



EU Directives requiring transposition into member state law by 2022 will increase workers' rights. These include limitations on employers' ability to prevent them from taking other work, and give them greater ability to take leave for parental and caring duties. In a number of these areas, this brings EU law up to the UK's standards. In others it creates rights that outstrip UK requirements - such as for five days of carers' leave per year or non-transferable parental leave.



The pandemic has spurred a measure of greater EU integration. The crisis has driven a new approach to collective financing of resources and will see the EU bid for a bigger role in health policy coordination. Both these agendas would have been impeded had the UK been a member of the bloc in 2020. This will certainly not be the last time that the UK's absence from the EU has itself been a factor in what the EU aims to achieve in key areas such as integration of policy areas where the UK's liberal preferences were a check on alternative approaches.



- **Divergence is a two-way street.** While there has been a heavy focus on how the UK is going to diverge from EU standards, this often overlooks where and how the EU may evolve its own policies away from the current *acquis*.
- **Without the UK as a block, there is the prospect of a deeper and closer social union.** Already we have seen unprecedented financial burden sharing as part of the covid-19 response, and it is likely moves will progress in the coming years to deepen the union in areas such as health policy in response to the pandemic. The evolution of a concept such as 'strategic autonomy' would almost certainly have progressed differently with the UK inside the bloc, and the UK may find itself dealing with some of the consequences in defensiveness on industry policy and an increasing focus on a level playing field in trade. The "rebalancing measures" in the TCA (see below) may become relevant here.
- **Two social and employment rights directives are being transposed by member states now which the UK does not have to follow.** The work-life balance directive and the transparent and predictable working conditions directive increase EU-wide rights for workers, in some areas beyond what the UK already does. Other such directives will follow across the suite of areas the EU regulates, and moves such as these are likely to be a prime driver of divergence between the EU and the UK.

Penalising divergence?

The TCA level playing field commitments (P2-H1-TXI)

- The TCA provisions related to conditions of production (labour, environmental standards, state aid, competition policy) are rooted either in international agreements, or in joint standards codified in the text which draw on existing WTO provisions or past EU FTAs. EU law is not the benchmark in any case, although the standards captured by it may be.
- In principle, either side can resort to retaliatory measures in the event on a substantiated and unaddressed claim that the other side is failing to uphold agreed standards in a way that affects trade.

The TCA rebalancing mechanism (P2-H1-TXI)

- A more sweeping mechanism allows in principle both parties to argue that a divergence in practice for any reason (including the choice of the party claiming a material shift in the terms of competition) may constitute a basis for the reimposition of trade barriers to level the playing field. These claims can be subject to dispute resolution.



- **The EU-UK TCA contains a range of provisions designed to disincentivise some forms of divergence.** At EU insistence, both sides are bound to maintain a defined level of labour protection, environmental protection and subsidy control. Substantive standards are either set out in the agreement or defined by reference to international agreements to which the EU and the UK are both party. There is also a general rebalancing mechanism that allows either side to argue that divergence in practice justifies rebalancing trade protection.
- **These provisions chiefly address conditions of production not product or service regulation.** The latter is dealt with through the requirement to comply with EU law in placing goods on the EU market (and vice versa). So changes in UK product standards or sectoral regulation are likely to remain outside their scope where the EU can impose its preferences through domestic market regulation. They may however be relevant in areas such as data adequacy or financial services equivalence determinations
- **In other areas there is considerable uncertainty about how the provisions might work.** The state aid provisions reflect the EU's own desire for flexibility in their broadness. In many areas of environmental regulation the UK is likely to be ahead of the EU. While the EU might be expected to codify some workplaces rights the UK has not, it is not clear how easy it would be to evidence this as a factor in trade. These are questions that will only be answered with time.

Developments to watch

Description	Timing
Solvency II. This regime governs the prudential regulation of insurance firms in the UK with a consultation to reform the sector to boost competitiveness and innovation the sector.	Consultation by 19 February 2021
Gene editing reform. The government is seeking to decouple gene editing and the more controversial genetic modification regulation to boost UK food competitiveness.	Consultation by 17 March 2021
Financial equivalence decisions. A protocol to the TCA provides a timeline to reach a memorandum of understanding between the UK and EU on the framework of regulatory co-operation on financial services, a key step on whether the EU will grant financial equivalence to the UK.	MoU by 31 March 2021
Reviewing listings and international overseas regime. The treasury has announced a taskforce is reviewing the listings regime to boost the number of new companies that want to list in the UK and an overseas regime to ensure that overseas firms can access the UK's markets in a way that is predictable, safe and transparent.	Expected Q1 2021
Cryptocurrency and stablecoins regulation. The government is consulting regulation on cryptocurrency, including actively researching central bank digital currency as an alternative to cash.	Consultation by Q1 2021
Internationally recognised standards for AI. The UK is looking to coordinate with G7 partners to explore coordinated regulation on AI, with the UK set to host the G7 summit in June 2021.	June 2021
EU data adequacy decision. The TCA provided up to a six month bridging mechanism for free flow of data between EU/EEA and UK till a adequacy decision is reached. The UK government plans to introduce legislation via the online harms bill which points to some EU divergence that may complicate this process	Latest June 2021

Developments to watch

Description	Timing
<p>National food strategy. The government will respond to the expected publication of the independent Henry Dimbleby review part two in spring 2021 on improving the entire UK food system.</p>	<p>Expected Q3 2021</p>
<p>Green financing. Treasury has outlined ambitions on green financing, including delivering green bonds 2021, alongside a green finance taxonomy regime which is under consultation with a new UK green technical advisory group.</p>	<p>Expected in 2021</p>
<p>Subsidy control regime. As part of TCA, the UK committed to introducing its own domestic subsidy control regime. The UK has indicated they will undergo a public consultation in 2021 to design a new regime.</p>	<p>Consultation expected in 2021</p>
<p>Revamped industrial strategy. The government is revamping the industrial strategy with a particular focus on innovation.</p>	<p>Expected in 2021</p>
<p>Revamped digital strategy. The government is planning to relaunch a UK digital strategy in 2021, with ambitions of more interoperability, storage and application of data in public services, as well as building an enterprise regime that generates more fast growing scale ups' startups.</p>	<p>Expected in 2021</p>
<p>Review energy infrastructure framework. The government has pledged to review the energy national policy statements by the end of 2021 to ensure it focuses investments that progress transition to net zero.</p>	<p>End of 2021</p>
<p>Key trade deals. The government has committed to having 80% of UK trade covered with a FTA, including with the US, Australia and New Zealand.</p>	<p>End of 2022</p>
<p>Biomass energy review. The government is reviewing the amount of sustainable biomass available to the UK, and how it could utilised as part of the UK's commitment to net zero by 2050</p>	<p>Committed for 2022</p>
<p>Environmental Land Management. This is a post EU Common Agricultural Policy scheme that will reform land subsidies.</p>	<p>Full launch in 2024</p>

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