UK-EU REGULATORY DIVERGENCE TRACKER

8th edition – July 2023

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Introduction

This is the eighth edition of the UK in a Changing Europe's regulatory divergence tracker, covering developments from April to July 2023. There are eleven cases of active divergence (where the UK, or some part of it, changes its rules); eight of passive divergence (where the EU changes its rules and the UK, or some part of it, does not follow); two of passive convergence (where the EU takes steps which align with UK rules); three of managed divergence (where the UK and EU make joint efforts to manage the implications of divergence); and one of internal divergence (changes in rules between different parts of the UK).

In May 2023, the UK government took a major decision to minimise upcoming divergence by removing the sunset clause from the Retained EU Law (REUL) Bill. This means that a body of almost 5,000 EU laws retained in UK law during the Brexit process will no longer expire by default at the end of 2023. Instead, the government has published a schedule of 587 pieces of REUL set to expire at the end of the year. This largely amounts to a tidying up exercise, as the vast majority no longer have any practical effect because they or the regimes they relate to have expired. Yet there are a couple of potentially consequential changes contained within the schedule, namely the removal of the **National Air Pollution Control Plan** and **Port Services Regulation.** The expiry of the former, in particular, has sparked concerns because it makes the government less accountable for its target to reduce emissions of five major pollutants by 2030.

Instead of the REUL Bill, more substantive reform of retained EU law is now taking place via separate reviews, with the Department of Business and Trade looking at **regulations on Working Time** and '**TUPE**'. The key proposals are to remove the obligation on companies to record how many hours their workers work, to allow holiday pay to be 'rolled up' into a worker's standard pay (meaning they are not paid when on holiday) and to remove certain requirements on employers to consult with employees, in cases where ownership of a company is transferred (if the transfer affects very few people). The UK government presents these as rationalisations saving billions in administrative costs, but these calculations are not clearly substantiated and there are concerns that – if replacement legislation is poorly designed – it could lead to a scaling back of worker protections, even if that is not the government's intention.

Beyond the matter of REUL, this tracker also highlights a growing divergence in regulatory principles between the EU and UK in developing sectors: respectively prioritising immediate and future risks. The updates to the draft **EU AI Act** highlight the potential challenges in the EU's 'horizontal' approach to regulation (which seeks to define and classify all risks relating to AI), as the legislation is struggling to keep pace with developments in the technology – in particular the growth of 'foundation models' of AI like ChatGPT. The UK's 'vertical' approach, by contrast, empowers individual regulators to adapt more quickly to technological changes, but there are big questions about whether they have sufficient guidance and funding. Similarly, the UK has taken a more future-focused (or 'crystal ball') approach to merger regulation, **blocking Microsoft's acquisition of Activision** on the grounds that it could stunt the rapidly-developing 'cloud gaming' industry, whereas the EU approved it on the grounds that the market is very limited today. The UK is seeking to reform **wine regulations** to allow the development of more innovative products, though there is a risk to consumer standards if poorly designed.

These cases also reflect a difference in regulatory methods, with the EU typically imposing defined, comprehensive regulations, whereas the UK puts more trust in the discretion of regulators to address developments. Both are seeking ways to increase supplies of novel medicines, and the **EU reforms to pharmaceutical licensing** set out clear incentives to try to secure greater supplies of novel and critical medicines, whereas the UK's approach to boosting supplies is predicated on trusting and replicating the regulatory approvals of other jurisdictions. Similarly, both want to clamp down on the '**greenwashing**' of consumer goods (through unsubstantiated claims about their environmental merits), ad the EU is seeking to prevent such claims *ex ante*, through a framework for verifying claims before a product reaches the market, whereas the UK is trusting the Competition and Markets Authority to spot and challenge dubious claims which appear on the market. The EU's approach is tougher, but the risk is that it takes longer – or indeed proves impossible – to implement effectively.

The UK's more light-touch approach may also be function of the more limited capacities of its regulatory state, as a couple of new cases show the UK moving in the same direction as the EU, but at much slower speed. The new **Digital Markets, Competition and Consumers Bill** largely replicates the EU's Digital Markets Act in empowering the state to clamp down on anti-competitive practices by the largest tech companies, but the UK regime is set to take effect – at the earliest – two years after the EU's. The UK has also been much slower than the EU in establishing its **green taxonomy** and **ratings for 'ESG' providers** – two crucial measures in making the UK an attractive market for

sustainable finance investment. Moreover, despite the common direction of travel in these areas, businesses are concerned that technical differences in regulation could make it harder to operate in both markets simultaneously.

Yet there also appears to be a growing recognition by the UK and EU that divergence is something they can manage for mutual benefit – rather than being a zero-sum game – with three new cases of 'managed divergence' picked up (following a first case in the previous tracker). Negotiations are set to commence on **cooperation and information exchange in competition matters**. This could allow the UK and EU to coordinate where they have common interests on competition regulation (such as their parallel **investigations into Google's dominance of digital advertising markets**). Similarly, an **MoU on financial services cooperation** could be used to minimise unwanted effects from divergence and find common solutions to regulatory issues, while a new **working arrangement on migration** aims to foster greater information and resource sharing.

Trade-related developments include the publication of the UK's new '**target border operating model**', which from October entails new administration for EU exporters to GB – and could curtail supplies of certain foods or increase their cost. The EU's new **economic security strategy** also seeks to build international coalitions to 'de-risk' trade in critical strategic areas by diverting it away from China. The UK, however, appears more minded to pursue such agreements on a bilateral basis with the US, via its new **Atlantic Partnership**, and others like Japan, as reflected in its new **Semiconductor Strategy**.

Finally, the EU has followed the UK in seeking to liberalise rules around **gene editing** (presented as an early Brexit win), though the UK might now point to a ban on new licenses for the **animal testing of cosmetic ingredients** as another benefit of Brexit. This could also lead to divergence with Northern Ireland, as could the UK **Product Security and Telecommunications Infrastructure Act;** while new EU rules on **e-commerce**, **greenwashing** and **pesticides** could create costs for Northern Irish businesses compared to counterparts in GB. Meanwhile, **Scotland's Deposit Return Scheme** has raised questions about the effectiveness of procedures for managing internal divergence.

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Joël Reland, 18 July 2023

Issue	Summary	Implications & impact	Timeline & region
1. Animal welfare / chemicals ACTIVE DIVERGENCE INTERNAL IMPACT *GB ban on new licenses for the animal testing of chemicals used exclusively in cosmetics.*	**Summary:** The UK government has reversed its decision to align with an EU ruling allowing the testing of certain cosmetic product ingredients on animals. The UK completely banned the testing of cosmetics or their ingredients on animals in 1998, and the EU did so too in 2009. However, a separate EU regulation on chemicals was introduced in 2007, requiring companies, for worker safety reasons, to identify and manage risks related to chemicals they manufacture and market in the EU. This runs into conflict with the ban on animal testing for cosmetics, because a company may deem it necessary to test a cosmetic ingredient on animals, if no alternative is available, in order to ensure staff safety during the manufacturing process (where chemicals are handled at much larger quantities than found in cosmetics, potentially posing different safety risks).	**Impact:** The UK's original decision to follow the ECHA ruling in favour of animal testing was covered, in a previous divergence tracker, as an example of the government choosing to follow EU regulation even where it did not have to after Brexit. This seemed especially notable as it would have been an opportunity for the government to show itself to be imposing higher animal welfare standards outside the EU; and also as at the forefront in using modern scientific alternatives to animal testing. Indeed, one possible reason why the government previously chose to comply with the ECHA rulings is that testing bodies lack familiarity with or access to 'New Approach Methodologies' (NAMs) which offer an alternative to animal testing. Therefore, the latest UK government decision to ban new licenses for the animal testing of cosmetic products could result in certain chemicals, which are subject to safety concerns but cannot be tested through NAMs, being unavailable for cosmetics manufacturers Great Britain. However, Dr Ernie Harpur, former President of the British	**Timeline/region:** The ban is effective immediately, with a legal framework to follow. It will not apply in Northern Ireland, which is subject to EU rules on chemicals under the Northern Ireland Protocol.

It transpires that, in light of this conflict, chemicals companies have often prioritised the worker safety regulation over the animal testing one.

63 of 413 ingredients used exclusively in cosmetics have been tested on animals since the EU ban came into effect. In some cases, the tests follow explicit regulatory direction to do so. For example, in 2020, the European Chemicals Agency (ECHA) ruled that a German chemicals company had to carry out animal tests on two ingredients, for human safety reasons, despite the company itself wanting to use alternative methods.

During that case, it came to light that the UK government had, since 2019, been issuing licenses for animal testing on cosmetic chemicals in line with ECHA rulings, despite not being subject to its directives post-Brexit (though the regulations related to chemical safety, on which the ECHA bases its rulings, are still on the British statute book). This led the animal welfare group Cruelty Free International to challenge the Home Office (which oversees animal experimentation policy) in the High Court for breaching its legal obligations around preventing cosmetic testing on

Toxicology Society, argues that 'if there is uncertainty about worker (or user) safety of a novel chemical intended for exclusive use in a cosmetic product, then it should not be used until such times as an agreed non-animal alternative method has been developed. There is no commercial or social imperative that would justify the testing on animals in this context.'

The ban on new testing licenses could also lead to the UK pushing ahead of the EU in the use of more innovative testing technology. The Home Secretary told Parliament: 'modern alternatives mean there are opportunities to design non-animal testing strategies for these chemicals so that worker and environmental safety is unlikely to be compromised, and potentially enhanced. In this way, working with industry, the Government is seeking to improve safety by the application of new non-animal science and technology.'

It does not appear as if the ban extends to the sale of goods containing animal-tested ingredients (though the forthcoming legislative framework should offer more clarity). This means, for instance, that though it may not be

	animals. However, the Court ruled in May 2023 that no breaches occurred, as the rules around animal testing for human and environmental safety are 'more permissive' than the general ban on animal testing, and thus permissible as an act of 'last resort'. The judge said it was 'regrettable' that the UK policy decision 'was not fully documented or widely communicated at the time'. Yet, in another twist, days later the Home Secretary Suella Braverman made a statement to Parliament announcing a ban, with immediate effect, on the granting of new licenses for the animal testing of chemicals which are intended exclusively for use as cosmetic ingredients. She added that work is ongoing to ensure the 'effective administration' of the ban over the longer term, including a legal framework.	permissible to animal-test a cosmetic ingredient in GB, it would still be possible to buy cosmetics containing that ingredient on the GB market, if they were manufactured and subject to animal testing in the EU. The UK government ban will not apply in Northern Ireland, which is subject to EU rules on chemicals under the Northern Ireland Protocol. That means the animal testing of ingredients solely for cosmetic use could still take place in NI, and EU-made cosmetics containing ingredients tested on animals will still be available on the NI market. If such cosmetics are banned in GB – it's as yet unclear whether they would be – this would create a divergence between the two markets in terms of animal welfare standards and availability of cosmetic goods.	

2. CLIMATE & ENVIRONMENT ACTIVE DIVERGENCE *Revocation of UK National Air Pollution Control Plan.*	**Summary:** The UK government is set to revoke the National Air Pollution Control Plan (NAPCP) as part of its schedule of retained EU law which will expire on 31 December 2023. The NAPCP relates to the National Emissions Ceilings Regulations (NECR) 2018, which impose on the UK legally binding targets to reduce emissions of five pollutants by 2030: particulate matter (PM2.5), sulphur oxides (SOx), nitrogen oxides (NOx), ammonia (NH3) and non-methane volatile organic compounds (NMVOCs). The government is not proposing to abandon its emissions reductions targets under the NECR. Rather, the proposal is to remove the NAPCP, which imposes obligations on government to be accountable for those targets. Under the NAPCP, government must set out how it will meet its 2030 targets; publicly consult on the plans; and take action when forecasts show it is not on track to meet its targets. The UK government says the reporting requirements are 'long, complicated, resource intensive and duplicative', as a 'large majority of the information in the NAPCP is reflected in individual national strategies and more accessible	**Impact:** Katie Nield, a clean air lawyer for ClientEarth, told the Guardian that the government is 'proposing to snip out some quite critical elements that are there to make sure the targets are actually met… It raises major alarm bells. It is hard to see how this move could be anything other than a strategy to skirt accountability.' The UK government has previously had to update its reduction pathway because it exceeded its reduction target for fine particulate matter. Official projections show it is on track to miss four out of five pollutant reduction targets in 2030 without further action, triggering obligations under the NAPCP to review targets by August 2024. Yet these obligations would be removed if the NAPCP is abandoned at the end of this year. The government says the NAPCP legislation is being revoked because it has 'either been superseded by UK legislation or is a duplicate of existing domestic legislation and is no longer required', with Lord Callanan noting in a House of Lords debate how the national Environmental Improvement Plans contain 'a large majority of the same information'.	**Timeline/region:** The NAPCP regulations apply to the entire UK, and are set to expire on 31 December 2023, as part of the Retained EU Law Bill.

	documents, including the Environmental Improvement Plan for England.'	The Environmental Improvement Plan (EIP), published in 2023, sets out actions to – amongst other things – reduce air pollution. However, the EIP's legislative content is vague and does not apply to the majority of pollutants covered by the NAPCP. Nor does the EIP contain the same transparency and accountability requirements as the NAPCP, and thus has much weaker provisions for ensuring the UK remains on track to meet its targets (though in theory the new Office for Environmental Protection could intervene). There are reduced requirements for public consultation on plans to meet the 2030 emissions reductions targets; there is no obligation on government to set out the specific policies it is implementing to achieve targets, the expected emissions reductions from them, or their timeframe for implementation; and there is no requirement for plans to be reviewed where emissions exceed or are predicted to exceed targets.	

3. COMPETITION / DIGITAL & DATA ACTIVE DIVERGENCE *UK Digital Markets, Competition and Consumers Bill - Part 1 (Digital Markets).*	**Summary:** The UK Department for Business and Trade has introduced its Digital Markets, Competition and Consumers Bill (DMCCB). Part 1 of the Bill grants new powers to the Digital Markets Unit (DMU) – a new unit within the Competition and Markets Authority (CMA) – to tackle the market dominance of the largest tech companies. Certain firms will be designated as having 'strategic market status' (SMS), if the DMU considers that is has 'substantial and entrenched market power and holds a position of strategic significance in respect of one or more digital activities'. This will be based on a 'forward-looking assessment of a period of at least 5 years', and the company must meet one or more of the following criteria: • having achieved a position of significant size or scale in respect of a digital activity; • a significant number of other companies use that digital activity for their business; • its position over that digital activity would allow it to extend its market power to a range of other activities;	**Impact:** The central aim of this part of the DMCCB is to boost competition within digital markets by reducing the dominance of the largest tech companies, who leverage their predominant position to further entrench market control. This should give smaller third-party providers more opportunity to compete for the provision of products and services, and a UK government impact assessment states that, while there will be a direct cost to business of £184m in compliance and familiarisation, it could save the public £10bn in a decade due to greater competition within digital markets. The proposals are strikingly similar in shape to the EU's Digital Markets Act, which became applicable in May 2023, and the tech industry group Tech UK has welcomed the Bill for 'ensuring UK law can keep pace with other similar initiatives such as the EU's', though the UK legislation is not expected to come into force before 2025 – two years after the EU's. Under the DMA, the EU will, by September, identify 'gatekeeper' platforms which have an entrenched position of dominance within an aspect of digital markets – similar to the DMCCB's proposal to identify 'strategic market status' (though the EU turnover threshold is slightly lower	**Timeline/region:** The UK Digital Markets, Competition and Consumers Bill is currently being scrutinised by Parliament and thus subject to amendment. It is expected to take effect in 2025. The EU Digital Markets Act became applicable in May 2023 and 'gatekeeper' companies will be announced in September.

- its position over that digital activity allows it to determine or substantially influence the ways in which other companies conduct themselves.

These criteria are relatively ambiguous, relying to a large extent on perceptions of 'significant' influence, and SMS can only be designated to firms with a global turnover above £25bn, or a UK turnover above £1bn. In all likelihood, this will only apply to the very biggest tech companies like Meta, Twitter, and Amazon. Once designated, SMS lasts for five years.

The CMA has the power to investigate SMS companies' activities and impose conduct requirements upon them. Investigative powers include being able to demand relevant information from the company or connected persons; imposing a requirement for a company to obtain, generate, collect or retain certain information; summoning an individual to interview; and having access to a business premises without a warrant. It will become a criminal offence to give false or misleading information the CMA; destroy or falsify information it requests; or obstruct a CMA officer from exercising their powers.

than the UK's). The DMCCB's proposed obligations for these companies are also similar to the DMA's: for example allowing interoperability with third party services in certain situations; opening up data on business behaviour; and preventing the platforms from promoting its own products/services ahead of others'.

A key difference, however, is that under the EU regime companies will be presumed to be gatekeepers once they meet certain criteria (with only narrow grounds for firms to contest this), whereas the under the UK regime the DMU has greater discretion to decide, based on less clearly defined factors such as 'substantiated and entrenched' market power and 'strategic significance'. Moreover, the DMU will create bespoke codes of conduct for each firm it designates with SMS, with greater scope for exemptions, whereas the EU has established universal obligations for gatekeepers. The law firm Sidley Austin notes that the UK appears to be seeking a more 'participatory and collaborative' approach – perhaps to make it a more appealing environment for tech firms, and allowing for more bespoke 'strategic market interventions' than under the EU regime – yet the differences in approach 'risk creating a complex web of

	The conduct requirements aim to prevent some of the root causes of market dominance. For example, they can prevent a company from: applying discriminatory terms, conditions or policies to certain users; giving favourable treatment to its own products; requiring or incentivising users to use other products alongside the main product/service it is offering; restricting interoperability between its service or content and that offered by competitors; using data unfairly; or restricting how users can use the service/product, or those of other companies. This could, for example: oblige Apple or Android to allow rival app stores to be installed on their phones (rather than users only being able to use the pre-installed Apple/Google one); prevent them from artificially promoting their own apps within the stores; grant users more choice over which messenger or search engine apps they use; or allow users of different messenger apps to communicate with one another. The CMA also has powers to investigate suspected breaches of conduct requirements, which can lead to penalties (of up to 10% of global turnover for the company) or enforcement orders. A 'final offer mechanism' enables the CMA to enforce unfulfilled conduct requirements in cases where a	parallel and overlapping obligations and may lead to conflicting outcomes. In turn, this could result in a highly disruptive environment for both industry players and consumers'. Another element of divergence could be around oversight and enforcement. Although the financial penalties for non-compliance are similar under the two regimes, the EU regime will be enforced by the European Commission, whereas in the UK it will fall to the CMA's new Digital Markets Unit – which is being given statutory powers for the first time and may, like other UK regulators taking on new responsibilities, take some time to get going. Indeed, the National Audit Office highlights that the CMA has experienced skills shortages in relation to post-Brexit responsibilities, and the 'increased scale and complexity of [its] merger and competition work may… limit what enforcement action it can take in other areas'. However, it also notes that the CMA 'has been broadly successful in securing the resources it asked for up to 2024-25', and the CMA has taken a tougher stance on merger regulation than	

	company has failed to provide 'fair and reasonable' terms of payment for the provision/acquisition of goods/services to/from a third party. In such cases the CMA invites both sides to suggest what constitutes fair payment, and then rules which sum should be respected. The CMA will also have powers to make 'pro-competition interventions' where it deems an SMS company's activity to be having an adverse effect on competition. It can then impose an order on how the company must act in relation to that activity (this could be a behavioural prohibition or obligation; or divestment order) or recommend that a public body with more expertise take action. SMS companies will also be obliged to report proposed mergers to the CMA, if it relates to a British company with a value of £25m of more and the SMS company will gain a significant increase in voting rights on the board, or if certain types of 'joint venture' are formed.	the EU since Brexit (see entry #4), suggesting it may well seek to be a similarly active regulator on digital markets.	

4. COMPETITION / DIGITAL & DATA ACTIVE DIVERGENCE *UK Digital Markets, Competition and Consumers Bill - Part 2 (Competition).*	**Summary:** Part 2 of the Digital Markets, Competition and Consumers Bill (DMCCB), published by the UK government in May 2023, proposes reforms to the UK's competition regime, specifically in relation to merger control, market inquiries and cartel offences. On mergers, the bill amends the two tests through which a merger can qualify for potential investigation by the Competition and Markets Authority (CMA). The 'turnover test' sets the minimum UK turnover which the target company must meet. This will increase from £70m to £100m. The 'share of supply test' sets the minimum share of supply of a certain good or service which the merging parties must account for within the UK (or a substantial part of it). This will increase from 25% to 33%. A 'safe harbour' will also be introduced for mergers involving companies with UK turnover of under £10m, reducing their regulatory obligations. Further amendments would give the CMA statutory powers to move to a fast-track merger investigation where the parties request it; allow it to extend investigations in certain circumstances; and simplify the process for publishing merger notices. Antitrust regulations – prohibiting agreements which prevent, restrict or distort competition	**Impact:** The changes to the CMA's statutory powers are, according to the UK government, intended to allow it to conduct faster and more flexible competition investigations, and take stronger enforcement action against anti-competitive practices. However, they can also be read, at least in part, as necessitated by the greater regulatory responsibilities which the CMA has had to take on since Brexit. It now has responsibility for all mergers affecting the UK (whereas the EU previously took responsibility for those with EU-wide or multi-member state impacts), and the CMA itself estimates that the number of mergers it will have to investigate will increase by 50-90%. This workload could increase even further given the number of mergers and acquisitions in the UK increased by 140% from 2016 to 2022. Added to this, the CMA is struggling to recruit certain specialised staff for competition and mergers work in particular and the CMA has limited discretion over the volume of mergers work it carries out – compared to other areas like consumer protection and competition – due to statutory deadlines it must meet around decisions and investigations; often exacerbated by appeals processes.	**Timeline/region:** The UK Digital Markets, Competition and Consumers Bill is currently being scrutinised by Parliament and thus subject to amendment. The CMA decision to block the Microsoft-Activision merger is set to be challenged by the two companies.

	within the UK – will be extended to cover agreements made outside the UK. Market inquiries relate to the CMA's abilities to investigate and improve competition within certain markets. The bill would remove time limits on the beginning of consultations; allow greater specificity in the features being investigated; allow the trialling of remedies before implementing them formally; impose a duty on the CMA to monitor the effectiveness of orders it lays down; and grant it powers to adjust remedies found to be ineffective. The bill would also enhance the CMA's powers to request information during investigations into suspected cartel activity.	Thus, the reforms to the merger regime can be seen as an effort, where possible, to reduce the capacity pressures generated by post-Brexit responsibilities. The increased turnover and supply thresholds for opening investigations, coupled with the safe harbour measures for the smallest mergers, likely reduces the number of investigations the CMA will carry out; while the relaxation of processes for fast-tracking or extending mergers should make it easier to relieve situations putting significant pressure on its regulatory capacity. This does not, however, necessarily mean that the UK will become a much more lenient regulator of mergers and acquisitions in future. For instance, the European Commission in May 2023 cleared the £55bn acquisition of the video game company Activision by Microsoft, shortly after the CMA had blocked it on the grounds that it would reinforce Microsoft's already significant advantage (60-70% market share) in global cloud gaming services. The CMA deemed the merger would likely stifle innovation in the relatively new market of cloud gaming, just as it begins to grow rapidly.	

		The European Commission acknowledges that the merger 'would harm competition' in cloud gaming but argues that the market 'is very limited today' (around 1% of the global gaming market). Instead, its rationale for approving the deal is that it does not harm competition in the much larger consoles market, and a proposed remedy from Microsoft - allowing free licenses to stream Activision games on other cloud services for a period of ten years – 'fully address[es] the competition concerns identified'. Nonetheless, the merger cannot be completed without CMA approval. This divergence in approach has led Zach Meyers of the Centre for European Reform to comment that 'the UK is getting way ahead of the European Commission on mergers'. He notes that UK decision-making on mergers is more focused on potential future trends (hence the greater concern with the impact on the development of the cloud gaming market), which also led it to order Facebook's parent company, Meta, to sell the online image platform Giphy on the grounds it could in future become a competitor with Facebook for advertising revenue. There is an open debate about whether the CMA's approach is good or bad for competition and innovation. It could	

		prompt an exodus of bigger firms from the UK, with Activision stating that the decision showed the UK was ‘closed for business’. Perhaps a bigger risk, according to Zach Meyers, is that, if the EU is seen as more permissive of mergers, small companies may prefer to focus on the EU market in order to ‘cash out’ their company via a marquee merger in the future. However, he notes that the flipside of this is that the EU ecosystem encourages small firms to innovate in ways that make them attractive to acquisitions by bigger companies (for example developing services which interact with those of the major players) whereas the UK model could encourage more genuine competition and innovation for services.	

5. DIGITAL & DATA ACTIVE DIVERGENCE INTERNAL IMPACT *UK Product Security and Telecommunications Infrastructure Act.*	**Summary:** The UK government has outlined plans for the implementation of the Product Security and Telecommunications Infrastructure (PSTI) Act, which establishes, for the first time, cybersecurity protections in relation to 'connectable' products (like smart phones, TVs, baby monitors, connected speakers and fitness trackers) which connect to the internet when in function. The Act empowers ministers to: specify and amend minimum security requirements in relation to these products; place duties on manufacturers, importers and distributors to uphold these; and provide enforcement powers against breaches. The recent announcement now details the specific regulations which will take effect from 29 April 2024. The new rules will ban the use of universal or easily guessable passwords from connectable consumer goods, making it harder for them to be hacked. Manufacturers of devices will have to provide contact information so that vulnerabilities can be reported to them, and must transparently outline how long their products will continue to receive security updates for (while ensuring that	**Impact:** The UK Act bears significant resemblance to the EU's own proposed Cyber Resilience Act, covered in a previous divergence tracker. Both the UK and EU acts set out minimum security criteria, including requirements to provide contact information for the reporting of security issues, and transparency around the impact of software updates. In both jurisdictions, there are likely to be adaptation costs, as affected companies learn to comply with the new regulatory requirements (hence the year's notice period before the UK regulation takes effect). Despite the significant overlap, however, the existence of separate UK and EU regulations is likely to create new administrative challenges for British exporters of relevant goods to the EU. The House of Commons European Scrutiny Committee notes that, even if UK and EU requirements are substantively the same, the EU 'has not indicated it intends to recognise an assessment of the cyber-security performance of a particular product carried out in the UK as valid for assessing compliance with the obligations under the Cyber Resilience Act'. That means goods which are certified as cyber-safe in the UK will have to be re-certified by an EU-recognised authority, for export to the EU. The UK	**Timeline/region:** The UK regulations take effect from 29 April 2024. The EU regulation takes effect two years after it has been finally agreed upon by the institutions.

	customers are made aware of this before completing an online purchase). The draft statutory instrument states that some products in Northern Ireland will be exempt from the new regulation, if they are subject to restrictions on movement under the Windsor Framework. This likely refers to any goods which fall within the scope of the PSTI Act but are subject to other EU regulations under the terms of the NI Protocol. It remains unclear which goods these might be.	government has said, however, that it anticipates discussions with the EU on potential mutual recognition of assessments - which would offset this issue. There are separate implications for Northern Ireland. As the EU legislation is new, it does not automatically apply under the terms of the NI Protocol. The EU could seek the UK's consent in applying it in NI, if it thinks it necessary for the operation of the Protocol, but so far it has not done so. The European Scrutiny Committee considers this to imply strongly that it will not seek to do so. This would mean that NI will be subject to UK rather than EU regulation on cyber security. Yet, as noted in the previous column, the statutory instrument brought forward by the UK government states that certain products will be exempted from the regulation in NI. Although we do not yet know exactly which products this might be, it does imply that certain goods on the NI market could end up in a cyber-regulatory black hole, subject to neither UK or EU cybersecurity regulations, making those goods a heightened security risk.	

6. LABOUR RIGHTS ACTIVE DIVERGENCE *UK reforms of Working Time and 'TUPE' Regulations.*	**Summary:** As part of a new policy paper entitled 'Smarter regulation to grow the economy', the Department for Business and Trade has outlined plans to amend elements of the Working Time and 'TUPE' (Transfer of Undertakings) Regulations which the UK adopted as an EU member state and continue to apply as retained EU law. There are three distinct proposals, which will be consulted on. EU case law on recording working hours The first proposal is to remove retained EU case law requiring businesses to keep working hour records for 'almost all members of the workforce'. The law firm Lewis Silkin presumes this is a reference to a 2019 European Court of Justice (ECJ) ruling that EU member states must require employers to set up an 'objective, reliable and accessible system' for recording the amount of time worked each day by employees. This is to ensure workers do not work more than 48 hours per week – the maximum amount permitted under the EU Working Time Directive. Rolled-up holiday pay and merged leave entitlement The second proposal is to allow 'rolled-up' holiday pay and to merge employees' two separate leave entitlements into one statutory pot. 'Rolled up' holiday pay, which is not	**Impact:** EU case law on recording working hours The UK government claims that removing the retained EU case law related to working hours could save businesses £1bn per year - through reduced 'red tape' around record-keeping - yet it is unclear how that calculation has been made. Moreover, Lewis Silkin point out that the UK has never implemented the requirements of the 2019 ECJ ruling: 'it does not require employers to record the actual time worked each day by their workers'. Therefore, it is questionable whether the disapplication of EU case law will make much material difference to business practices (and thus provide any cost savings). Further, many workers who are at risk of exceeding the 48 hour limit sign an opt-out from the limit anyway. It is possible that some companies may feel empowered to stop recording working hours, because the risk of legal action from workers – who can no longer refer to the ECJ ruling - is reduced. However, Lewis Silkin also note that employers should 'be careful before taking this to mean that no records are going to have to be kept, because national	**Timeline/region:** The government is consulting on its proposals and is yet to bring forward legislative proposals for how it will reform the Working Time Regulations.

permitted under EU Working Time regulations, means a worker is not paid when they take holiday, but instead has an additional sum, equivalent to the amount of annual leave they are entitled to, added to their standard pay. So, for example, a worker entitled to 5.6 weeks of holiday each year (the legal minimum – equivalent to 12.07% of the year) would receive a 12.07% top-up to their normal pay.

The other proposal, to merge the two leave entitlements, in effect neatens up a situation where, at present, workers have a right to four weeks' leave under retained EU law, and an additional 1.6 weeks which is specific to UK law.

TUPE
A final change relates to Transfer of Undertakings (Protection of Employment) (TUPE) Regulations. TUPE protects employees from dismissal or changed contract terms when their employer changes owner, or a service provision moves to a different provider.

TUPE also requires the employer to consult with employees on any measures proposed as part of a transfer: for example redundancy or restructuring proposals. Under the current framework, employers (unless they have fewer than ten

minimum wage rules will still require record-keeping in many cases.'

Ultimately, however, the disapplication of the case law would reduce the safeguards for workers' right not to work more than 48 hours. The government says the reform will 'protect [sic] the rights of workers' yet gives no explanation of how this will be ensured.

Rolled-up holiday pay and merged leave entitlement
Rolled-up holiday pay has historically been used for short-term and casual workers working irregular hours, who can find it difficult to work out how much holiday pay they should be entitled to, or who may not even know they are entitled to paid leave in the first place. However, the flipside is that rolled-up pay can discourage workers from taking their leave entitlement, if they have not budgeted properly for their holidays (as they will not be paid during that time).

In 2006 the ECJ ruled that rolled-up holiday pay was unlawful because it deterred workers from taking holiday, and stipulated that holiday pay should be given when holidays were taken. Despite this, the UK has not

	employees) cannot consult employees on the transfer process if they do not have union representatives in place – and the employer must help facilitate their election before consultation can take place. The government is proposing removing this requirement 'for businesses with fewer than 50 people and transfers affecting less than 10 employees'. It is not entirely clear whether this refers to two separate exemptions, or whether businesses must meet both separate criteria to qualify for an exemption.	implemented legislation to prohibit rolled-up holiday pay, and many employers do still use it in practice. The government proposal to re-legalise it would, however, likely lead to the practice becoming more widespread. Some law firms have advocated for such a change, arguing that it should be an option for casual workers or those with irregular hours, pointing to a similar recommendation in the Taylor Review of Modern Working Practices. However, the Taylor Review also makes clear that individuals should have a choice over whether to have their pay rolled-up, and that '(a)dditional safeguards would have to be built in to ensure individuals did not simply work 52 weeks a year as a result' (for examples mechanisms to ensure workers take the time off they are entitled to). Thus, much will depend on the details of the proposals for rolled-up pay, which government is yet to outline: for instance whether it applies to all workers or only selected groups like casual workers; and what safeguards are in place to ensure workers take their holiday entitlement and have their pay properly rolled-up. A poorly-designed system could result in significant numbers of workers working excessive hours; being obliged to take rolled-up pay even where they	

would rather not; or companies in effect reducing workers' pay as they move to rolled-up contracts.

There are similar risks around poor legislation design when it comes to the merging of the two leave allowances. Lewis Silkin argue that it is 'sensible' to merge them into one allowance, 'although the government will then need to clarify and simplify the rules on, for example, what should be included in holiday pay and when holidays missed due to sickness can be rescheduled, because the rules currently vary depending upon the type of holiday being taken.'

TUPE

The government says removing the TUPE consultation requirements for small-scale transfers 'will save businesses red tape and improve engagement with workers'. This has been supported by a range of law firms as a sensible adjustment, yet they have simultaneously noted that it is a very limited change, when there were possibilities to consider more significant reform – such as extending rights to workers (rather than just employees) and ensuring benefits for transferred employees are harmonised with those already at the company.

7. Food Standards ACTIVE DIVERGENCE INTERNAL IMPACT *Consultation on wine regulation in England and Wales.*	**Summary:** Defra has outlined a range of proposed changes to rules, inherited from the EU, on wine production and marketing in England and Wales. The proposals, subject to consultation with industry, cover a wide range of areas. Hybrid varieties and certification One proposal is to amend retained EU law (Regulation 1308/2013 Article 93) to allow wines with 'Protected Designation of Origin' (PDO) status to be made from hybrid grape varieties. PDO wines have distinctive characteristics which link them to a specific region, granting them exclusive rights to a name (champagne being the most famous example under the EU regime). The UK is still in the process of developing its own PDO regime, and the government appears minded to allow more flexible criteria for PDO status than under the EU regime. Defra also intends is to remove certification rules which permit only wines with PDO or Protected Geographical Indication (PGI) status to display a vintage and grape variety, unless the wine has been through an official certification scheme (managed in conjunction with the Food Standards Agency). Defra says this level of scrutiny is 'unjustified red	**Impact:** These reforms could have a range of fairly significant impacts on the domestic wine market. Contained within them is a tension between, on the one hand, boosting innovation and growth within the British wine sector and, on the other, upholding high consumer standards. One of the clearest opportunities for innovation is in allowing the production and sale of piquette. The EU banned its sale due to the risk of domestic winemakers being undercut by cheap wine-imitation alternatives. Yet these risks do not apply to the same extent in the UK, where homegrown wine is a much more niche product competing at a higher price point. Piquette is thus less of a threat to British producers, and indeed there are potential advantages for them in producing and selling piquette as a more bespoke, high-end product, as has been the trend in the US. Other reforms could also allow UK producers to diversify their product range: for example the greater flexibility to de-alcoholise wines, and permitting the use of reusable stoppers meaning a bottle need not be drunk in one go. There is greater concern, however, about the proposal to allow imported wines to be 'transformed' domestically. The	**Timeline/region:** The consultation closes on 21 July 2023. Reforms would apply to England and Wales only.

	tape', which creates a barrier to marketing wine and is not necessary as 'the relatively small size of the domestic production industry reduces any risks of falsification.' Piquette Another proposal is to allow domestic winemakers to produce and market 'piquette': an alcoholic drink made from the grape pomace left behind during the wine-making process. EU regulations only permit the production of piquette for distillation and consumption among the families of individual wine-growers. The regulation was introduced to prevent floods of cheap wine undercutting European producers, but in recent years it has become increasingly marketable – especially in the US – as a lower-alcohol, zero-waste natural wine. Blending and transformation It will also be permitted to blend wines after importation (under retained EU law, only the blending of EU-origin wines is permitted); and for imported wines to be transformed (i.e. carbonated, sweetened or de-alcoholised). Defra argues it is often more efficient for these processes to be done later in the production cycle, i.e. after importation, and that it	government says this will 'boost domestic industries' by allowing the creation of 'new product lines' for both the UK market and re-export. For example, domestic bottlers could sweeten and carbonate cheap imported white wines to create a cheaper 'sparkling Italian' alternative to Prosecco. Government may consider cheaper alcohol a positive for consumers (though its recent reforms to alcohol duty structures were premised on making more alcoholic drinks more expensive). However, the *Wine Anorak* journal argues that the reforms could allow wine importers to 'make very cheap wine, and make it look like more expensive wine', potentially misleading consumers. For example, under the relaxed blending rules, an importer could source the cheapest foreign Chardonnays, mix them together and repackage the blend as a distinct Chardonnay with – thanks to the looser certification requirements - its own variety and vintage information (implying a higher-quality product). They also note that a blended wine could be made from 80% Spanish grapes but marketed as 'made in England' (albeit not as 'English wine') which may confuse consumers. The government says the reforms are meant to be a 'major	

also allows domestic importers to create distinct new wine products, and thus income streams. It will be permitted to market these new products as originating from whichever country they were imported from, even after being transformed domestically (so Italian white wine carbonated in England could be sold as sparkling Italian wine).

The EU regulation stipulating that wine must have a minimum alcohol content of 8.5% (or 4.5% for PDO products) will also be reformed, so that wine can have an alcohol content as low as 0%; and the maximum level that a wine's alcohol content can be reduced by will increase from 20% to 100%. This is to enable a much greater production of low- and zero-alcohol wines – though these will have to have labels with a 'clear indication' about the alcohol reduction processes which have taken place.

Bottle shapes and stoppers

Another proposal is to remove the requirement for certain types of sparkling wine to be stopped with mushroom-shaped corks and for the neck to be wrapped with a foil sheath. Defra says businesses deem this an 'unnecessary cost' and argues that it can also make it harder to recycle bottles, and

opportunity for our bottling and re-export industry', while also creating a 'better quality and variety of products' – yet there appears to be a risk that the former may come at the expense of the latter, with new product ranges made up of lower-quality or dubiously marketed goods.

The government also claims that the reforms will provide a '£180m boost to our wine industry', opening the market to new products, and growing the economy. However, there is no explanation of how this figure was calculated. It is possible that a large chunk derives from the industry estimate that new UK-specific labels for EU wine imports would have cost importers £130m. However, if this is part of the calculation, it is an additional cost which has been *avoided* - not a net *boost* to the UK wine industry.

Finally, there is another tension around the UK's new PDO appellation scheme. The law firm Gunner Cooke notes that this is a 'hot topic' because the UK is 'in the earlier stages of establishing an appellation system', and 'the balance needs to be struck' between removing barriers to obtaining PDO appellation for British producers, while ensuring it still connotes high-quality wine for consumers. The decision to

	hinders innovation in the development of, for example, reusable stoppers which can be placed back on the bottle once opened. A law defining what types of bottles certain EU wines must be sold in – for example the *Flute de Alsace* for Alsatian wine - is also set to be scrapped, as the UK has no wines subject to such protections. Labelling A final proposal is to allow wine labels to contain the address of the 'Food Business Operator' (FBO) responsible for the food information on the bottle – this could, for example, be the supermarket chain which will market it - rather than requiring the details of the specific importer. This aligns wine law with general food law, and simplifies labelling processes so wine can be marketed for GB, NI and the EU with the same label. Had it not been introduced, importers of EU wine would have needed to create separate labels for the UK – costing up to 50p per label – the cost of which may have been passed on to UK consumers.	allow hybrid grapes under PDO reflects a prioritisation of the former over the latter, yet the firm also notes that there is a consensus around this decision, because it allows the use of more climate- and pest-resistant grapes which thus require fewer pesticides, making wine production more sustainable and attractive investment. There are concerns, however, over the possible extension of 'sparkling wine' status to cover wines produced by traditional methods (like champagne is) and also through cheaper carbonisation processes (like prosecco is) - which would mean there was no discrimination in labelling between such products when made in the UK. The proposals cover England and Wales only, however Defra notes that the Internal Market Act 2020 and the Windsor Framework will allow for products produced in England and Wales to be sold in Scotland and Northern Ireland. Were the Scottish or Northern Irish governments to have concerns about new wine products made in England and Wales posing a threat to consumer standards, they would not be able to stop them appearing on their domestic markets, unless they sought an exemption under the UK Internal Market Act.	

8. Industrial Strategy **ACTIVE DIVERGENCE** *UK Semiconductor Strategy.*	**Summary:** The UK government published its National Semiconductor Strategy in May 2023. The plan offers British semiconductor firms £1bn over the next decade, to be targeted towards the UK's areas of strategic advantage in the sector: semiconductor design, compound semiconductors, and R&D institutions. The strategy lists three key objectives. First, it will seek to grow the domestic sector by increasing support for academic and commercial R&D; improving access to key infrastructure for semiconductor companies, such as design tools and prototyping facilities; and enhance technical skills and qualifications to meet the needs of the sector. Second, the strategy will attempt to reduce the risk of supply chain disruptions. Here, the focus will be on developing supply chain resilience, particularly for critical sectors, such as healthcare and defence. The strategy sets out plans to develop a baseline level of manufacturing of the chips required for critical infrastructure, as well as to increase collaboration with external chip suppliers of key sectors of the economy.	**Impact:** Securing supplies of semiconductors (also called microchips) has become a priority issue for countries worldwide, because they are integral to the manufacturing of everyday electronic devices, the technologies required to reach net zero (like solar panels, wind turbines and electric vehicles), and advanced technological innovations such as AI and quantum computing. Recent developments have highlighted the fragility of semiconductor supply chains. The Covid-19 pandemic caused a surge in demand for electronic goods and disruptions to freight routes and ports, resulting in a significant increase in waiting times for chip orders. The Russian invasion of Ukraine added to short-term disruption, as Ukraine produced 50% of the world's chip-grade neon gas (used to control lasers that etch chips). Moreover, there is a large global dependence on Taiwan, which produces over 90% of the most advanced semiconductors and more than 60% of all semiconductors, meaning a Chinese invasion of Taiwan could cause huge disruption to semiconductor supplies. The UK has been slower to respond to these risks than the EU and US. The EU outlined its 'Chips Act' in February 2022, with the aim of mobilising over €40bn in public and private	**Timeline/region:** The strategy sets a number of objectives, which entail a range of elements to be delivered over differing timescales.

This can be seen as building on the partnership that the UK agreed with Japan days before the release of the strategy. The deal establishes R&D cooperation and skills exchange between the countries, in order to combine Japan's strength in manufacturing with the UK's design capabilities.

Third, the plan aims to fortify UK national security. The strategy acknowledges that the acquisition of chip firms and technologies by 'hostile states' can present national security issues. As a result, it sets out plans to make use of the National Security and Investment Act as well as export controls to protect the 'most sensitive' areas of the sector.

A 'UK Semiconductor Advisory Panel' made up of government figures as well as industry and academic experts will be responsible for delivering the strategy.

investment to double its global market share of chip production to 20% by 2030. Similarly, the US last year announced $52bn of government funding to support semiconductor manufacturing. The slowness of the UK response led industry leaders to complain that the UK was falling behind, with some major chip designers and manufacturers threatening to leave the UK or eschewing it as a place for investment.

Though the UK has now outlined its strategy, a key criticism has been the comparably small sums being invested (£1bn over a decade) compared to the US and EU. Yet this is consistent the UK's wider industrial strategy. It has not sought to match US and EU subsidies on offer for green technology, on the grounds that it wants to avoid entering a 'subsidy race' with much larger economies. Moreover, full semiconductor self-sufficiency has yet to be achieved anywhere in the world and many see it as an impossible ambition for most countries, leading some to argue that the EU's investment in onshoring mass-scale chip production is a misplacement of resources. The UK strategy, by contrast, aims to increase security of supply through trade and interdependence: targeting domestic investment in areas

where the UK already has expertise, and building alliances with other countries in areas where it does not.

Nonetheless, there are still questions over whether this strategy can adequately reduce the UK's dependence on Taiwan. Another criticism of the UK strategy is that there is no clear blueprint for how it will meet its core objectives: for instance there is little-to-no detail on plans to recruit skilled workers, how funding will be allocated, or how decisions will be made on acquisitions by 'hostile actors' in sensitive sectors.

We can thus see, in theory, how the UK and EU are addressing the issue of semiconductor supply from different angles, but we are yet to see how the respective schemes work in practice. Given the need to cooperate with likeminded partners to secure semiconductor supplies, there could be grounds for the UK and EU to form strategic partnerships in future.

9. Maritime Transport ACTIVE DIVERGENCE INTERNAL IMPACT *UK revocation of EU Port Services Regulation.*	**Summary:** The UK government has outlined plans to revoke EU-derived regulation which establishes common rules on the provision of services in ports. The central regulation being removed is (EU) 2017/352 as well as an associated statutory instrument (Port Services Regulations 2019). The regulations apply to 43 maritime ports in the UK, and cover a range of port services: bunkering, cargo-handling, mooring, passenger services, collection of ship-generated waste and cargo residues, pilotage and towage. In effect, it mandates ports to grant fair and non-discriminatory access for service providers to their facilities, creating a level playing field in the competition to provide services. For example, it sets out the minimum performance requirements (in terms of qualifications, financial capacities, equipment and availability) which ports can refer to when granting or refusing a service provider with access to its facilities. It also sets out the reasons why a port may limit the number of service providers it grants access to, and requires them to publicise such intentions numbers in advance of doing so.	**Impact:** Lord Frost, on behalf of the UK government, first announced the intention to revoke the Port Services Regulation (PSR) in September 2021, which he said is 'a very good example of a regulation that was geared heavily towards EU interests and never worked properly for the UK'. The central argument for revocation, long-pushed by UK ports since Brexit, is that the EU PSR is ill-suited to the operating model of British ports. It was designed to increase fair and open competition for providing services within ports, in an environment where many EU ports are publicly owned or subsidised, and thus not subject to the same commercial pressures as private entities. Major UK ports, on the other hand, are privately owned, which, proponents of revoking the PSR contend, means they are already 'highly efficient and commercially autonomous' given the 'healthy competition' between them for services. Were the PSR to be scrapped, they claim it would not be necessary to impose further regulations to promote competition for the provision of services between UK ports. On top of this, the government argues that the PSR imposes 'reporting and consultation requirements… which place unnecessary	**Timeline/region:** The PSR is set to expire, as part of the Retained EU Law Bill, on 31 December 2023.

	There are also regulations on financial transparency and autonomy, designed to encourage investment in port facilities. The regulation also stipulates that charges for certain services provided within a port, which are not subject to 'effective competition', must 'transparent, objective, non-discriminatory and proportionate'.	burdens on the predominantly private-sector UK port operators.' However, there are concerns about the fact that the legislation which would take its place (the 1964 Harbours Act) is less stringent, and could allow ports to discriminate in terms of who they allow to provide services on their site, and impose unreasonable access charges. They would also no longer be obliged to be transparent about the decisions they make in this regard, or to ensure their facilities are physically accessible and appropriate – potentially reducing integration with wider transport systems. The PSR is set to expire, as part of the Retained EU Law Bill, on 31 December 2023. It is one of the very few pieces of legislation covered in the Bill which is being removed because the government has identified a substantive reason for reform, rather than because it no longer has any meaningful effect.	

10. Trade & Customs ACTIVE DIVERGENCE *UK-US 'Atlantic Declaration'.*	**Summary:** In June 2023 the UK and US published the 'Atlantic Declaration': an agreement to enhance economic ties across five distinct 'pillars'. Of particular note was the announcement within it that negotiations are set to begin immediately on a 'critical minerals agreement'. This will see five materials (cobalt, graphite, lithium, manganese, and nickel) sourced or processed in the UK – which are integral to electric car batteries - count as local content under the US Inflation Reduction Act (IRA). Having a sufficient level of local content in an electric vehicle (EV) entitles a manufacturer to tax credits. There is also a commitment from President Biden to ask the US congress to add the UK as a 'domestic source' within the meaning of Title III of the Defense Production Act, which apparently allows for faster cooperation on the development of new military technology. On AI, cooperation will be accelerated, 'with a focus on ensuring the safe and responsible development of the technology', with the US also welcoming UK plans to host a Global Summit on AI Safety.	**Impact:** The Atlantic Declaration is not a UK-US trade agreement, and the tangible impacts on trade are likely to be modest, with much of the document made up aspirations to collaborate rather than concreate actions. However, it arguably reflects a change in the UK's strategic approach to trade relations with the US – accepting that the chances of a fully-fledged trade deal are close to zero for the time being, and instead looking to enhance cooperation, where possible, in specific areas. Of most immediate potential economic significance was the agreement to count five materials used in EV battery making as 'local content' - thus counting towards tax credits under the US IRA - if they are sourced or processed in the UK. The IRA represents a significant shift in US industrial policy towards subsidising domestic green industry, and has prompted major concerns in Europe about their own industries being put at a competitive disadvantage. The decision on the five materials is a boost for UK-based extractors and processors, whose products will now be more attractive on the US market. However, this offers no benefit to British EV and battery makers, only those extracting and refining materials,	**Timeline/region:** The declaration contains a range of ambitions, most of which have no defined agenda or timeframe.

		because the materials must still be assembled in the US. The US is negotiating a similar agreement with the EU (as well as Japan and South Korea). The UK is pushing for its agreement to go further by covering UK-assembled cars and batteries, though the US appears unlikely to relent on this. Rishi Sunak will also be satisfied to have got an endorsement in the agreement for his plan to hold a Global Summit on AI Safety in the UK this autumn. This forms part of his strategy to make the UK an international leader in AI regulation. However, the level of UK-US cooperation on AI remains more limited than at the EU-US level, where coordination on regulation is discussed at the joint Trade and Technology Council (see entry #13) and both sides, along with Canada, are endeavouring to establish a joint code of conduct. UK proposals for a similar structure have been rebuffed by the US. The autumn summit thus represents a UK effort to establish a different leadership role outside of the US-EU forum, helping to amplify the voice of other likeminded parties like Japan and South Korea, and to establish a reputation for expertise and leadership on the long-term threats of AI (while the US and EU focus more on the immediate risks).	

11. TRADE & CUSTOMS **ACTIVE DIVERGENCE** *GB Border Target Operating Model.*	**Summary:** The Cabinet Office has published its draft Border Target Operating Model, which sets out a new approach to managing imports at the UK border, beginning from October 2023. It implements processes which were meant to begin when the UK-EU Trade and Cooperation Agreement (TCA) took effect in January 2021, but which have been repeatedly delayed. From 31 October 2023, health certification – signed at the point of dispatch by a qualified professional - will be required for imports of many sanitary and phytosanitary (known as 'SPS') goods. These are: 'medium-risk animal products, plants, plant products and high-risk food and feed of non-animal origin from the EU.' Irish exporters of Irish goods directly to Great Britain (not via NI) will also newly face full checks and controls. A risk-based categorisation scheme will determine which goods are medium- or high-risk and thus subject to checks. The majority of food (fruit, vegetables and cupboard staples), by volume, will be categorised as low-risk, however most meat, fish and dairy is expected to be medium-risk.	**Impact:** Trade bodies like the National Farmers' Union (NFU) have welcomed the new model, because it addresses a trade imbalance where – ever since the TCA took effect – British exporters to the EU have faced more rigorous administration and customs controls that their EU counterparts exporting to Great Britain (GB). The NFU also says the enhanced border checks will reduce the risks of counterfeit or diseased food being brought into the UK, which can be a threat both to public health and farmers' livelihoods. However, while the border model addresses the trade imbalance, it could significantly impact EU exports to GB. Around one third of British companies stopped exporting to the EU in the first year following the implementation of the TCA. The volume of trade did not fall significantly, as those who stopped exporting tended to be smaller companies who could not afford the new administrative costs. Should a similar pattern now play out in the other direction, many smaller European businesses might stop exporting to GB - meaning the supply of some more niche products may decrease or disappear - and larger EU exporters may pass on the new administrative costs (estimated to be £420m) to British consumers in the form of higher food prices.	**Timeline/region:** The new model comes into effect, in stages, from October 2023.

	From 31 January 2024, documentary and risk-based identity and physical checks will be introduced for those same SPS goods, from both the EU and the rest of the world. Inspections of high-risk plants and plant products will start taking place at border control posts (within or close to the port/airport of arrival) rather than at the port/airport itself. From 31 October 2024, EU imports will require 'safety and security' declarations. A new 'Single Trade Window' also comes into effect, which seeks to minimise the duplication of pre-arrival data entry across different declarations (such as safety and security, sanitary and phytosanitary, and customs), and reduce the number of mandatory fields down from 37 to 24 (with the rest optional).	To illustrate the challenges European exporters are set to face, Shane Brennan of the Cold Chain Federation has outlined what, for example, an Italian buffalo mozzarella or Spanish chorizo producer would be required to do from 31 October 2023: • train up on the complex international and UK rules; • find a local vet that is willing to certify the goods, at site (at a cost of €200-700 a time); • find a specialist haulier, usually on a lorry carrying goods from other local food producers with the same compliance burdens; • employ an agent to ensure the data entries onto the UK's food import IT system, alongside customs declarations, at maybe €50-200 a time; and • as of January 2024, pay a new border inspection charge of up to £43 irrespective of whether the consignment is physically inspected or not. This could severely disrupt supply chains for meat and dairy in particular (60% of cheese consumed in the UK comes from the EU) and could lead to goods shortages or price increases. Food companies and the gardening industry have already	

		warned they may have to pass the new administrative costs involved with importing onto consumers. It also creates uncertainty for businesses, who cannot be sure of the scale of disruption in the run-up to Christmas. In some cases, they also do now know exactly which of their imports will be categorised as medium-risk, and businesses have complained that government has not given them all the information they need to prepare.	

12. AGRICULTURE PASSIVE DIVERGENCE INTERNAL IMPACT *EU Regulation on the Sustainable Use of Plant Protection Products.*	**Summary:** The European Commission's proposal to halve the use of pesticides by 2030 has been stalled by growing opposition from member states and MEPs. Back in June 2022, the Commission adopted a proposal to overhaul its 2009 Directive on the Sustainable Use of Pesticides into a new Regulation on the Sustainable Use of Plant Protection Products, aligned with the ambitions of the EU Green Deal. The proposed legislation includes a legally binding target to reduce the use of chemical pesticides by 50% by 2030. All member states will be required to develop national reduction targets within defined parameters. The proposal would also ban the use of all pesticides in sensitive areas, including public parks and gardens, playgrounds, recreation and sports grounds, public paths, and areas protected to support threatened species and pollinators. It will also 'ensure' that all farmers and other professional pesticide users practice Integrated Pest Management (IPM), which the EU says is 'an environmentally friendly system of pest control which focuses on pest prevention and prioritises alternative pest control methods, with chemical pesticides only used as a last resort.' Member states will have to set	**Impact:** On one level, the battle over the pesticides proposals reflects a much wider division in the EU over the pace of proposed agricultural reforms (including over issues like nitrogen emissions and nature restoration). Opposition among farmers has been mounting, reflected in both public protests and the success of the 'FarmerCitizenMovement' in recent Dutch provincial elections. However, there are separate implications for the UK - and Northern Ireland in particular. Northern Ireland remains, under the terms of the Northern Ireland Protocol, subject to EU pesticides regulation, which no longer applies in Great Britain. This means that the EU proposals seemingly open up the potential for divergence in farming practices between Northern Ireland and the rest of the UK. Northern Irish farmers would have to significantly reduce their pesticide use in order to reach the 50% reduction target by 2030, and to conform with the requirement to only use chemical pesticides as a method of last resort. This could lead to changes in practices or a reduction in yields, potentially making it harder for them to compete with farmers in other parts of the UK. The issue could also potentially extend beyond agriculture, for example to sports	**Timeline/region:** The EU proposals are set for a final vote in the European Parliament in October 2023, but could be subject to amendments before then.

	positive targets for increasing the use of alternative pest control methods, with professional pesticide users required to obtain independent advice on such methods. However member states' agriculture ministers have since requested that the Commission carry out a further impact assessment on the 50% pesticide reduction target, which the Commission has agreed to, due to the 'exceptional circumstances' affecting the EU's food system since the original assessment was carried out. This effectively stalls the approval process for the legislation, which was slated to be voted on by European Parliament's agriculture committee in July, followed by a final parliamentary vote in October. The European People's Party (EPP) – the largest bloc in the European Parliament – has also agreed to a resolution calling on the Commission to drop the pesticides target which it claims will lead to a significant drop in agricultural yields and threaten investments in the industry. By contrast, a recent European Parliament report has called on the reduction target to be increased to 80% for the most hazardous pesticides.	grounds in Northern Ireland, which would be subject to a total ban on the use of pesticides under the proposals. This could be a significant new compliance challenge for certain sports like football and golf, where the use of pesticides remains widespread. If the Northern Ireland Assembly is restored, it could potentially exercise the Stormont Brake, vetoing the application of the updated regulation in NI, because it amounts to an update of existing legislation rather than something entirely new. The barriers to using the brake are high, however, and a significant and persistent impact on everyday life would have to be demonstrated to justify its use. There is also a question of who would set the reduction targets in Northern Ireland, and be accountable for their implementation, given this is supposed to be done at member state level (and NI is not an EU member state).	

13. Artificial Intelligence PASSIVE DIVERGENCE *Amendments to EU AI Act.*	**Summary**: The European Parliament has approved the EU's draft AI Act, following a set of amendments widening its scope to cover, among other things, 'generative' AI technologies such as the much-discussed ChatGPT. It is now subject to negotiation between the Parliament, Council and Commission before it takes its final form. As covered in a previous divergence tracker, the EU is opting for an extensive approach to AI regulation, which seeks to identify a wide range of risks related to AI use, and categorise them within a four-tier risk level framework. The given risk level entails specific obligations for developers, deployers and users of that AI application. For example, 'high-risk' applications include AI used in critical infrastructure which could put lives at risk (like self-driving trains); and these are subject to - among other things - obligations to complete risk assessments and impose mitigation measures before they can be put into practice. The MEPs' recent amendments expand the list of activities categorised as an 'unacceptable' risk (the highest level, and subject to an outright ban). This group already includes systems that deploy subliminal or purposefully manipulative techniques, exploit people's vulnerabilities or are used for	**Impact**: The amendments reflect a growing concern within the EU over the threats which AI poses to individuals' privacy through technologies like facial recognition and predictive policing techniques (which have repeatedly been shown to be biased against Black people in particular). However, the amendments also highlight a fundamental difficulty for the EU in its approach to regulating AI: that technology is moving faster than the legislative process. For example, concerns about 'foundation' AI models like ChatGPT have grown significantly since the draft legislation was first published in 2021 - and this technology poses risks which the draft legislation does little to confront. It is thus having to be hastily rewritten even before it has taken effect, and it is questionable whether the legislation will be sufficiently robust. Similar problems could occur in relation to future technological developments within the AI field. Nonetheless, the final EU Act will have major international implications because companies will want to be able to sell their AI-based goods and services on the EU market (in a similar manner to how the EU's onerous GDPR regulation has become a global norm). Indeed, OpenAI - the firm behind ChatGPT - has publicly expressed its intention to establish a	**Timeline/region:** The Act is now subject to negotiation between the Parliament, Council and Commission - meaning its final form could still change.

social scoring. The amendments extend this to cover 'intrusive and discriminatory uses of AI systems', including live biometric identification systems (such as facial recognition) in public spaces, and their retrospective use (except when investigating serious crimes); biometric categorisation systems based on sensitive characteristics (for example race, gender or religion); predictive policing systems (which use algorithms to predict crime or identify suspects); the use of emotion recognition systems in a variety of contexts; and indiscriminate scraping of biometric data from social media or CCTV to create facial recognition databases.

The 'high-risk' category has also been expanded to cover harm to people's health, safety, fundamental rights or the environment, systems used to influence voters in election campaigns; and content recommendation systems used by the very largest social media platforms.

New obligations have also been established for the providers of 'foundation' AI models like ChatGPT. These differ from earlier forms of 'machine learning', where AI is trained to carry out very specific, repeatable tasks, such as translating or summarising human speech. Foundation models, by

European office, as will be necessary for ChatGPT to be operable in the EU once the AI Act takes effect.

This has implications for the UK, as British companies will also have to comply with EU regulation to sell their AI-based products in its single market. Moreover, even non-EU buyers of British AI-based products will likely want them meet EU standards because, if they use that AI to generate a product – for instance a credit scoring system – it must have generated from EU-standard AI, in order to be sold in the EU.

The UK government recently launched its own consultation into AI regulation, covered in the previous divergence tracker, which addresses, among other questions, how to manage the risks and capabilities of generative AI like ChatGPT (though questions have been raised about whether the government white paper says enough on the matter). The UK appears in less of a rush than the EU to impose regulation, however, with the Chief Executive of the Competition and Markets Authority stating it would be monitoring 'how the markets around those models are

	contrast, train AI ‘unsupervised’ on a wider range of data, which allows the same AI to carry out a wide range of different tasks (for example translating, summarising, analysing and more beyond) simply by ‘fine tuning’ it on a small amount of additional data. These models also have a ‘generative’ capability to produce something new, for example predicting the next word in a sentence. This is the model which allows ChatGPT to create an essay or image using only a short prompt from a user. These generative capacities make foundation models more of a potential threat, because their behaviour is more unpredictable and they have significant potential to deceive humans. There have been several notable cases of AI-generated images being mistaken as real and even awarded photography prizes. The European Parliament has thus imposed requirements for providers to guarantee ‘robust protection of fundamental rights, health and safety and the environment, democracy and rule of law’, based on risk assessment and mitigation, and design requirements. There are also ‘additional transparency requirements, like disclosing that the content was generated by AI, designing	developing’, with a view to realising ‘opportunities’ as well as establishing ‘guardrails’. This is consistent with the UK’s wider approach to AI regulation, where it has not sought to impose an EU-style comprehensive framework of risks and obligations, on the basis that the field is rapidly developing and these rules and definitions can become quickly become outdated. The UK is instead seeking to establish principles to guide regulators’ decision-making, which is intended to allow them to respond more quickly and flexibly to technological developments as they occur. The hope is that this makes the UK an attractive environment for early-stage AI development, even if there is a recognition that finished goods will need to align with EU regulatory norms to aid their sale internationally. The countervailing risk is that regulation is inconsistent or contradictory across sectors, or that certain threats fall through the gaps between regulators, which could leave citizens more exposed to the risks which AI can pose. The UK also plans to host an international AI summit in the autumn. Ultimately, the EU and US will set the key international norms on AI regulation, with discussion on joint standards already taking place at their Trade and	

	the model to prevent it from generating illegal content and publishing summaries of copyrighted data used for training.' Other amendments seek to promote the use of regulatory sandboxes – allowing innovation in controlled, lower-regulation environments – within member states; and to establish clear systems for citizens to file complaints about AI systems, and receive explanations for decisions made by high-risk AI systems which might 'significantly impact their rights' (like exam-scoring technology).	Technology Council (in which the UK does not participate). However, Huw Roberts of the Oxford Internet Institute notes that the UK summit will focus on types of harms 'that received less attention in the EU AI Act', i.e. 'longer-term AI Safety issues, with explicit mention of threats that could "endanger humanity"'. This, he adds, 'is a major U-turn in UK policy, which under a year ago was asking regulators not to focus on this type of "hypothetical risk"'. He argues it creates 'scope for synergistic leadership roles from the EU and UK', with the EU focused on more foundational harms like AI bias while the UK looks at the longer-term risks from cutting-edge systems; but that there is a risk that 'excessive [UK] focus on longer-term risks without supporting regulators in tackling present harms could undermine domestic governance efforts. This threatens the UK's international credibility as an AI leader.'	

14. Climate & Environment / Consumer Rights	Summary	Impact	Timeline/region
14. CLIMATE & ENVIRONMENT / CONSUMER RIGHTS **PASSIVE DIVERGENCE** **INTERNAL IMPACT** *Updated EU consumer rules on environmental claims and ban on 'greenwashing'.*	**Summary:** The EU has outlined proposals for new and updated consumer rules on environmental claims. A central aim is to stop companies making baseless or ambiguous claims about their products' environmental characteristics, for instance: 'sustainable', 'recycled', 'eco-friendly' or 'carbon neutral'. The European Commission says that over half of the claims it assessed in 2020 included 'vague, misleading or unfounded information'. The Consumer Rights Directive will be revised to cover 'green' claims. Traders will also be obliged to provide consumers with 'clear and comprehensible' information on the durability of a product - to help them make more informed choices about the sustainability of goods; and must inform consumers if a product's guarantee lasts for less than two years, or if no guarantee of durability is provided. 'Relevant information' on the reparability of a good (such as the reparability 'score' and availability of spare parts) must also be made available. For digital products and services, this includes information on software updates which will be provided. The information may be included on the packaging, or the online product description.	**Impact:** Campaign groups have raised concerns that the proposed legislation on assessing green claims may be of limited effect. Earlier drafts suggested that the Commission would propose a standardised framework for assessing claims, yet the final proposal contains no methodology. The Commission says it will present further legislation in future, which the Environmental Coalition on Standards says is 'too vague with too much left for later'. Some are concerned that, if the final framework for assessing claims is not robust enough, the legislation could backfire, by giving dubious claims about sustainability a veneer of legitimacy. UK regulators have also turned their attention to issues of greenwashing, with the Competition and Markets Authority (CMA) in 2022 commencing a review of potentially misleading green claims by certain fashion brands. If they are found in breach of consumer law, the CMA says enforcement action could include 'securing undertakings' that the companies will change the way the operate, or taking them to court. The CMA is also conducting a review into green claims made about everyday household goods like food and drink, cleaning products and toiletries which, again, could end in enforcement action.	**Timeline/region:** The Commission's proposals will be discussed by the Council and Parliament.

	There will also be an expansion of the Unfair Commercial Practices Directive. Environmental or social impact will be added to the list of product characteristics about which a trader cannot mislead a consumer. It will be considered misleading to make claims about future environmental performance without clear, objective and verifiable commitments and targets. And a range of newly prohibited unfair commercial practices will be introduced, including: • Not informing consumers about features which limit durability (e.g. software which downgrades functionality); • Making 'generic, vague' claims about environmental performance which cannot be demonstrated (e.g. 'environmentally friendly' or 'green'); • Making environmental claims about an entire product when it relates only to a specific element; • Displaying a sustainability label not based on public or third-party verification; • Failing to inform consumers that a good has limited functionality if used with spare parts or accessories.	This highlights how the UK and EU are both alive to the issue of greenwashing, but have taken different approaches to tackling the matter. The EU is trying to explicitly define greenwashing under consumer law, and implement a system to block misleading claims *before* they are allowed on the market, whereas the UK prefers to rely on existing consumer protections, alongside non-binding guidance, with the CMA required to spot claims after they are made. The European Commission will also have stronger enforcement weapons, in terms of fines and exclusions from procurement and subsidy processes, whereas the CMA can fall back on the fairly ambiguous threat of taking companies to court. In theory, the EU approach should more comprehensively prevent greenwashing. Yet there is a risk that the EU is slower to take regulatory action in the short-term, as it must first establish a new regulatory framework, including a methodology for assessing green claims, and ensure it is sufficiently robust. By contrast, the CMA, relying on existing consumer rights law, has been able to move more quickly to open cases against companies. Once the EU regime is established, there could be knock-on effects British exporters, who will have to meet new EU	

	Companies which make unsubstantiated environmental claims could be fined at least 4% of their annual turnover (in the member state(s) concerned) or face a ban of up to one year from public procurement processes or subsidies. Moreover, a proposed Directive on Green Claims will set the rules for how environmental claims should be substantiated and verified. Critically, it seeks to prevent the application of misleading claims *ex ante* (i.e. before being placed on the market) by requiring environmental claims on labels to be assessed against a specified set of criteria, which must be independently verified, before being permitted for sale. The directive will only apply to claims which are not already covered by other, more specific, EU rules (such as the energy efficiency or organic farming label). A major focus of the directive is likely to be claims about carbon offsetting and products being carbon neutral.	labelling requirements if they want to carry on exporting to the EU. This could create significant new administrative requirements, in terms of having any claims they want to use verified by an independent accreditor and producing new labels for products. The EU estimates that the total administrative cost to EU businesses stemming from its new regulations will be €9-10bn. Moreover, any new UK-based labels would not be permitted on products for export to the EU, unless approved by the Commission. The EU new directive on green claims will presumably take effect in Northern Ireland (though the EU has not confirmed this), or else there would be a risk of goods with unsubstantiated claims crossing into the EU via the Irish border. This means businesses in NI are likely to face additional compliance costs, around having claims verified, compared to competitors in the rest of the UK. Moreover, GB companies exporting to NI might also have to meet the new labelling requirements and, if some deem the adaptation costs entailed by the directive to be too expensive or complicated, they may simply stop exporting to NI, risking diminished supplies of certain goods.	

15. Competition			
PASSIVE DIVERGENCE *EU finds Google to have breached its antitrust rules in relation to digital advertising.*	**Summary:** The European Commission has informed Google of its preliminary finding that the company is in breach of EU antitrust rules 'by distorting competition in the advertising technology industry' (known as 'adtech'). Adtech is an umbrella term for software and tools which facilitate online advertising, helping advertisers to deliver their material to specific target groups. The European Commission opened an investigation in 2021 over concerns that 'Google is present at almost all levels of the supply chain for online display advertising'. Google owns two ad buying tools (used by advertisers looking to place digital advertising materials), one publisher ad server (used by publishers to manage advertising space), and one ad exchange (where publishers and advertisers meet to buy and sell ads in real time). The Commission's preliminary finding states that Google has a dominant position in the European Economic Area's ad buying and publisher ad server markets; and that it has abused this position to favour its own ad exchange platform (called AdX) over competitors. For example, it contends that Google's ad buying tools have placed most of their bids on AdX, making it the most attractive site for ad exchanges; and that Google's publisher ad server has informed AdX in	**Impact:** The Commission's decision could have a significant financial impact on Google, which makes around 80% of its income from advertising revenue. It currently has a 28% share of global advertising revenue, which could be significantly dented by having to divest an element of its ad tech services. The decision also has implications for the UK, whose Competition and Markets Authority (CMA) has also launched an investigation into whether Google has abused a dominant position in adtech. Launched in May 2022, information gathering is set to continue until early next year. The European Commission's findings, and indeed Google's response to them, could have some bearing on the CMA's investigation. The parallel investigations also underline the extent to which the UK and EU's competition regimes are interdependent post-Brexit. The Google case highlights that the CMA and Commission are often interested in the same competition issues – but that more could be done by both sides to support one another in such cases, through more aligned investigations. This could involve, for example, pre-notifying each other of investigations (allowing them to	**Timeline/region:** Google has an opportunity to respond to the Commission's preliminary findings before a final decision is issued. The CMA's investigation into Google is likely to conclude in 2024.

	advance of the value of bids placed by rival ad exchanges, helping AdX to win auctions for the provision of services. The Commission 'is concerned that Google's allegedly intentional conducts aimed at giving AdX a competitive advantage and may have foreclosed rival ad exchanges. This would have reinforced Google's AdX central role in the adtech supply chain and Google's ability to charge a high fee for its service' and, if confirmed, would infringe Article 102, Treaty of the Functioning of the EU, which prohibits the abuse of a market dominant position. The Commission also deems a behavioural remedy likely to be ineffective in preventing such conduct in future, and will thus force Google to divest one part of its services, if the charge is upheld. Now that the Commission has informed Google of its objections, Google can examine the documents in the investigation file, reply in writing and present its response at an oral hearing. Once Google has presented its defence, the Commission will make a definitive conclusion, after which it can impose a fine (up to 10% of annual worldwide turnover) and ask it to divest one part of its adtech services.	proceed in a more coordinated manner); the sharing of evidence, information and expertise during investigations; and coordinated enforcement action where infringements are identified. Indeed, the EU has set out a negotiating mandate for deeper cooperation with the UK on competition regulation (see entry #23), which could lead to many of these practices being adopted.	

16. Financial services / environment PASSIVE DIVERGENCE *Expanded EU Taxonomy; and proposal for regulation on ESG ratings.*	**Summary:** The European Commission has outlined new proposals to expand its sustainable finance framework: which aims to use financial policy to advance sustainable practices. The two latest measures are an extension of the 'EU Taxonomy' criteria, and a proposal for a regulation of ESG (Environmental, Social and Governance) ratings providers. The EU Taxonomy defines what types of financial investments are considered 'environmentally sustainable economic activities', with the aim of directing firms to make more investments in such activities. An environmentally sustainable activity must contribute to at least one of six climate-related criteria, and not do significant harm to any of the others. The latest proposal expands this to include four 'non-climate environmental objectives': • sustainable use and protection of water and marine resources; • transition to a circular economy; • pollution prevention and control; • protection and restoration of biodiversity and ecosystems.	**Impact:** The two measures both represent the EU moving faster than the UK on green finance regulation. The International Organization of Securities Commissions (IOSCO) called for regulation of ESG ratings providers in 2021, due to the dominance of the market by a few very large firms, and the EU is one of the first major economies, after India, to set out a regulatory framework. The EU's framework is now likely to have a significant shaping effect on the UK, with the Financial Conduct Authority (FCA) currently developing a voluntary code of conduct for ESG ratings agencies in the UK, which it says will be consistent with IOSCO's recommendations and 'developments in jurisdictions such as Japan and the EU'. Unlike the EU's regime, this code of conduct will not be binding, though it is in effect a stopgap while the Treasury consults on a fully-fledged ESG regulatory regime. Moreover, because the EU regulation will apply to ratings agencies from non-EU countries which provide ratings within the bloc, UK-based firms wanting to offer their services on the EU market will have to comply with the new, bulked-up requirements. The EU's faster movement could also hand its financial services sector an advantage over the UK. There is a general	**Timeline/region:** The updates to the EU Taxonomy are subject to scrutiny by the European Parliament and Council and are expected to be applicable from January 2024. The proposals are EST ratings are now set for discussion between the European Commission, Parliament and Council. On the UK side, the Treasury

	The manufacturing and transport sectors will also be newly counted as 'economic activities' which can be invested in as part of efforts towards climate change mitigation and adaptation (two of the six original criteria). ESG ratings provide information to investors on the impacts of an investment or entity, in relation to environmental, social or governance factors. Ratings can be aggregated, focused on only one factor, or solely on a sub-factor (like climate); and they can also be based on different risk perspectives and assessment methods. This is meant to help financial institutions make sustainable choices as part of their investment strategies. The European Commission takes the view, however, that the 'ESG rating market suffers from a lack of transparency' around the characteristics, methodologies and data sources behind ESG ratings. This limits the usefulness of ESG ratings for investors, because they do not provide a consistent benchmark against which to compare the sustainability criteria of different investment products. Therefore, the EU has proposed a range of changes to ESG regulation. ESG ratings providers in the EU will have to be	recognition that ESG ratings, in both the UK and EU, are not currently sufficiently informative or transparent, limiting their use to investors as guides on making green investments. Should the UK be significantly slower than the EU in introducing ESG regulation to improve the quality of ratings, there is a high likelihood that it becomes a less attractive market for sustainable finance investment. One UK legislation comes forth, there is likely to be some technical divergence with the EU, which could make it harder for firms to operate in both markets simultaneously, as they must comply with separate processes/criteria for each. Indeed, the consultancy firm KPMG ranks ESG ratings and sustainable finance as the top divergence challenges within the financial sector, and there is a risk that either the UK or EU market loses investment as a result of firms not wanting to comply with both regimes. The UK regime is not set to cover UK firms providing ratings for firms operating overseas, which could avoid conflicts where a firm is subject to conflicting requirements under the UK and EU regimes. The UK is also planning its own 'Green Taxonomy', after announcing late last year its intention to repeal the EU Taxonomy – copied over during the Brexit processes – as part	consultation on ESG ratings closed on 30 June, and it is ultimately up to the FCA to develop a regulatory framework, though the timeline remains unclear. The UK consultation on a Green Taxonomy is set for this autumn.

	authorised and supervised by the European Securities and Markets Authority (ESMA). They will also have ‘to use rating methodologies that are rigorous, systematic, objective and subject to validation’ and ongoing review. To this end, they will have to ‘disclose information to the public on the methodologies, models and key rating assumptions’, with more detailed information for subscribers to its services, and rated agencies. They will also face fines for any conflicts of interest they hold regarding their ratings. The regulation of smaller ESG rating agencies will be ‘proportionate’ to their size, which could include ESMA exempting smaller agencies (with a turnover of €8m a year or less) from certain requirements.	of the Financial Services and Markets Bill. As with ESG ratings, progress has so far been slower than on the EU side, with the latest update coming in the March 2023 Green Finance Strategy, which says a consultation will be held in Autumn 2023. The general direction of travel on Taxonomies is similar – however there are (again) likely to be divergences in how the UK and EU regimes operate. The UK Taxonomy, like the EU’s, will include nuclear technology – a decision which caused controversy in the EU due to the fact that many see it as detracting from investment in renewable energy projects. The UK does not appear to have explicitly endorsed the inclusion of gas in its Taxonomy – which was another major point of contention on the EU side. The recent inclusion of transport sectors within the EU Taxonomy has also caused some controversy because it allows certain fossil-fuel intensive activities to qualify as sustainable economy activities, for example: investment in and development of ‘best-in-class fuel efficient aircraft’.	

17. Medicines / Competition PASSIVE DIVERGENCE *EU reforms to pharmaceutical licensing rules.*	**Summary:** The EU has published plans for an overhaul of its pharmaceutical licensing system, including plans to create a new 'Single Market for medicines' which aims to reduce the cost of medicines and boost their supply across all member states; while also incentivising a greater supply of new and innovative medicines. The measures will be implemented through a new Directive and Regulation, replacing existing legislation. A key change is reducing the number of years that a new drug has market exclusivity from ten years to eight, meaning competitors will be able to sell generic, non-branded versions of a drug – which drives market prices down - two years earlier than at present. This is intended to reduce the overall cost to member states of procuring medicines (which stood at an estimated €230bn, or 1.5% of EU GDP, in 2021). However, the EU is also introducing a new incentivised structure where the protection period is extended, if the drug company meets certain needs around availability and innovation. They can gain two additional years of market protection if they launch the product in all member states. This is designed to address the significant disparity in access	**Impact:** A central aim of the licensing reforms is to bring down the price of drugs and ensure greater availability across EU member states. At the moment, EU member states individually procure supplies of drugs (once approved by the European Medicines Agency), which can lead to disparities in availability between the poorest and wealthiest member states. The Financial Times reports that, of new drugs approved between 2015 and 2017, over 100 were launched in Germany, Austria and Denmark by 2018; compared to just 11 in Latvia. By opening new drugs up sooner to competition from generic versions, the EU is hoping to bring the average price of drugs down; while the offer off an extended exclusivity period if the drug is available in every EU member state is a way of incentivising companies to increase distribution across the bloc. The new incentive structure also aims to push companies to develop more novel products, which address unmet medical needs, rather than to invest in tried-and-tested product lines that treat conditions for which drugs are already available. The reforms have, perhaps unsurprisingly, elicited criticism from large pharmaceutical companies who claim they cannot	**Timeline/region:** The proposals are to be discussed by the European Parliament and Council 'as soon as possible', but the EU says it 'cannot predict the timing for adoption at this stage'.

to drugs across member states, with the EU predicting it will increase overall access to new medicines by 15%.

Six months of additional protection will be granted if the medicine addresses an unmet medical need, and another six months if comparative clinical trials are conducted. A year of exclusive rights to the data behind the drug's manufacture will be granted if the drug can treat additional diseases. A similar structural reform to market protections, based on slightly longer time periods, is also being introduced for medicines for rare diseases. There are also new incentives for the development of novel antibiotics that can treat pathogens with antimicrobial resistance (alongside measures to ensure the prudent use of antibiotics).

Further changes seek to speed up regulatory approval process for new medicines. The European Medicines Agency(EMA) will have 180 days, instead of 210, to complete its assessment (and only 150 days for medicines of major public health interest), and the authorisation period for the Commission will drop from 67 days to 46. Administrative processes will be simplified, with the removal of most marketing authorisation renewal requirements, and the digitisation of application and product information

be sure of obtaining extended periods of exclusivity, making it harder to predict their costings. Industry lobbyists have also argued that price negotiations with member states - which companies will have to conduct with all 27 to trigger a two-year exclusivity extension – often hold up the launch of products.

Regardless, the EU attempts to increase and diversify its supply of drugs, coupled with the measures around compulsory licensing during emergencies, are part of a growing emphasis on 'strategic autonomy' across a range of policy areas. This is the idea that the EU should not be dependent on others in critical areas, and the drive towards it in medicines was prompted in large part by the Covid-19 pandemic (where key drugs and equipment were in short supply due, for example, to India banning the export of key drugs and a lack of sharing between member states). Since then, the global energy crisis has further highlighted the fragility of supply chains and driven up manufacturing costs.

Eighteen member states, however, have suggested that the proposals need to go further in a position paper calling on the EU to create a 'Critical Medicines Act', which promotes the domestic manufacture of key medicines and ingredients,

	processes. The EMA will also provide 'rolling reviews' of data as it becomes available, to speed up processes, and will be able to grant temporary emergency marketing authorisations for health emergencies. Regulatory sandboxes will support the development of innovative medicines and the EMA will provide 'tailored scientific support' to SMEs. Another focus is boosting the security of medicines supply, responding to the challenges of the Covid-19 pandemic. National authorities, coordinated by the EMA, will impose new requirements on companies – namely earlier deadlines for reporting shortages and withdrawals; a requirement to keep up-to-date shortage prevention plans; and an obligation to address critical shortages and report on the results of measures taken. An EU-level list of critical medicines will also be created, with these subject to assessments for supply chain vulnerabilities. Specific recommendations will be made to manufacturers and companies in the supply chain on measures they need to take; and the Commission will gain powers can impose measures to strengthen the security of supply of such stocks (for example the creation of contingency stocks). A network of vaccine manufacturers,	in a similar manner to the EU's Chips Act and Critical Raw Materials Act. They note that 40% of global pharmaceutical ingredients are sourced from China, with many produced at only five sites, meaning the EU is vulnerable to supplies being suddenly curtailed, especially if tensions with China increase. There is also a proposal for a solidarity mechanism allowing the rapid exchange of supplies between EU member states in periods of shortage. The EU's prioritisation of strategic autonomy stands in contrast to the UK's recent approach to medicines regulation. As covered in the previous divergence tracker, the UK medicines regulator is looking for ways to speed up the approval of new medicines by automatically permitting drugs which have been approved by other trusted regulators (like the EU). This approach is predicated on trust in the regulatory capabilities of others, whereas the EU approach wants to be more autonomous in its decision-making. It appears that, like the EU, the UK is focused on faster access to novel and innovative medicines, but is comparatively less concerned about security of supply in relation to potential future emergencies.	

	known as 'FAB', will also be set up, and will collectively reserve the necessary manufacturing capacity to produce emergency supplies. Alongside these measures, the EU has published a proposal for a Regulation on compulsory licensing, which would give it powers to force companies to share the intellectual property rights for critical items during an emergency. This would, for example, allow other drugs companies to manufacture replicas of a patented vaccine, in order to boost supply in response to the emergency. The licenses would be time-limited, permitted only for crisis-related activities, and granted only to those able to manufacture the product and renumerate the intellectual rights holder. Products made under the licence would not be exportable outside the EU.		

18. Trade & Customs PASSIVE DIVERGENCE *European Economic Security Strategy.*	**Summary:** The European Commission has published a joint communication with the EU High Representative on a 'European Economic Security Strategy'. It aims to reduce economic ties to hostile third countries (though not stated explicitly, this is primarily China and Russia) in relation to sensitive technologies like microchips or quantum computers. To do this, the EU will develop a new 'comprehensive approach' for 'identifying, assessing and managing risks to its economic security.' This will focus on four risk areas: supply chains, including energy security; physical and cyber security of critical infrastructure; technology security and technology leakage; and the weaponisation of economic dependencies or economic coercion. Risks will be continuously assessed through a common methodology, to be carried out primarily by the Commission and member states, in cooperation with other bodies as necessary. The Strategy paper calls on member states to now develop this framework, including establishing a list of technologies which are critical to European economic security, and assessing their inherent risks.	**Impact:** It is the proposals on outbound investment which have attracted the most media attention because, as one Politico headline states, it could allow the EU 'to ban companies from making sensitive tech in China'. According to EU officials, this is because EU intellectual property and national security may be put at risk critical technologies are developed in authoritarian countries where the government could gain access to it. Politico writes that, effectively 'it would be the end of unchecked globalization of supply chains that drove economic internationalisation over the past decades' and could force European countries to significantly remodel their supply chains. However, it should also be understood as an attempt by the EU to push what it sees as a more balanced approach to trade with China, based on 'de-risking, not decoupling'. That phrase, agreed on at the G7 and driven in particular by the EU, conveys an ambition to curtail the most sensitive ties with China, rather than ending the majority of trade links. It also ties in with EU measures, covered in the previous divergence tracker, to reduce dependence on third countries for the production of goods and materials vital to the most critical sectors.	**Timeline/region:** The strategy document will act as the basis for a 'strategic discussion' between EU member states and the European Parliament, to develop a 'comprehensive approach'. This is set to be built through a wide range of steps with different structures and deadlines.

The Strategy then proposes taking steps to mitigate risks identified, which to a large extent relies on determining which existing EU instruments are required to address which particular risks. For example, the Critical Raw Materials Act and Chips Act are expected to help promote the domestic manufacture of components key to modern technologies, reducing reliance on foreign imports from countries like China.

However, the strategy also proposes some new policy measures. By the end of 2023, the Commission will review its Foreign Direct Investment (FDI) Screening regulation and member states which have not yet implemented such mechanisms are exhorted to do so ‘without further delay’.

The Commission will also propose an update to its export controls regime (which limits the export of critical technologies to countries like Russia) to ensure greater coordination in measures between member states, thus increasing the effectiveness of the regime. And it is also to examine what risks can result from outbound (i.e. overseas) investment by member states, and propose new measures to address security risks by the end of the year.

However, the EU proposals remain in the very early stages, and a lot of work remains to be done before a ‘comprehensive approach’ to identifying and managing risks is established. As the think tank Bruegel points out, coordination on security policy is a new matter for the EU, and it may be challenging for member states to find agreement on what they key risks are, let alone what measures to take in response.

Moreover, Alan Beattie in the Financial Times notes that some member states (i.e. France) have much more appetite for de-risking than others, and this lack of unanimity is part of the reason why the EU has a history of underutilising trade instruments which it creates for itself.

For the UK, the question is to what extent it wants to align with EU proposals. The EU’s Strategy document makes clear that the EU ‘is vastly expanding its bilateral and plurilateral cooperation instruments’ to support its ambitions. For example, it is pursuing a Critical Raw Materials Club, for the common provision of certain materials vital to the production of goods like semiconductors. It also says it will ‘pursue full implementation while also working to expand’ its free trade agreements – meaning there could be grounds

	This could result in the Commission being granted powers to block companies from moving supply chains for 'advanced technologies' to certain countries – due to concerns over those governments gaining access to sensitive information about those technologies.	to address such matters by building on the UK-EU Trade and Cooperation Agreement. Though the UK has publicly backed the 'collective approach to the economic threat posed by China' agreed at the G7, it has not been as forthcoming as the EU with proposals to reduce its strategic dependencies, either on a unilateral or multilateral basis.	

19. TRADE & CUSTOMS PASSIVE DIVERGENCE INTERNAL IMPACT *EU Customs Reform.*	**Summary:** The European Commission has outlined proposals for its 'EU Customs Reform', which it calls 'the most ambitious and comprehensive reform of the EU Customs Union since its establishment in 1968.' The existing customs IT infrastructure in member states will be replaced by a new EU Customs Data Hub and Customs Authority. The EU Customs Data Hub will be a central, online location, where actors from across the supply chain can log all the required information about goods being imported into the EU. One designated importer or exporter will be responsible for each consignment, rather than multiple businesses or people with liabilities for different parts of the customs process. 'Stable information' relating to supply chains, which is not expected to change short-term, can be provided once and automatically reused for subsequent consignments. This could significantly simplify customs processes for businesses. An existing 111 IT systems for customs declarations, across the 27 member states, will be merged into the single Hub, and many businesses will no longer have to repeatedly input the same information for each consignment. The most trusted traders (who meet operational requirements and supply real-time data on their	**Impact:** The EU claims that its reforms will ultimately save EU member states up to €2bn a year in operating costs and deliver an 'improved EU approach to risk management'. It also claims the Hub is a 'powerful new tool to support EU businesses [and] trade', by simplifying administrative procedures and customs interventions. It argues that the changes have been made necessary by the surge in EU standards (such as forthcoming carbon border tariffs and restrictions on goods linked to deforestation) which it must enforce, and the exponential rise in low-value e-commerce consignments. The House of Lords European Affairs committee has written to the UK government's Minister for Europe, 'noting that the proposal could substantially impact bilateral trade between the United Kingdom and the European Union'. In one sense, it should simplify administrative processes for British businesses trade with the EU, though the extent of this impact has not been definitively quantified. In another sense, however, it could pose challenges for British online platforms which sell to customers in the EU. They will now become the 'deemed importer' for goods they sell, responsible for ensuring that the correct customs duties	**Timeline/region:** The Commission's legislative proposals will now be sent to the European Parliament and the Council of the European Union for agreement, and to the European Economic and Social Committee for consultation. Under the proposals, the Data Hub will open for e-commerce consignments in 2028, and for all

	consignments' movements) may also be able to have their goods released without any active customs checks. The Hub is expected to be open for e-commerce traders (i.e. those selling goods online) from 2028, and all other businesses from 2032. This represents a move away from a 'declaration-based' model of clearing every individual consignment, towards a 'data-led' system for identifying risks. The data submitted into the Hub will generate an 'overview' of trade flows, which will be analysed, using AI, to predict potential issues – for example the arrival of unsafe or illegal goods, or those which fail to comply with 'EU values', e.g. not having paid the correct carbon border tariff, or being linked to deforestation. The new EU Customs Authority will centrally pool and assess this data, which member states have access to, and be able to order interventions, like checks and inspections by authorities, where risks are identified. The reform also creates new responsibilities for e-commerce platforms to comply with customs obligations. Currently, the purchaser and deliverer of the good have been responsible for ensuring customs and VAT are paid at purchase; but this responsibility will shift to the online platform, which	and VAT are paid. This increases the administrative cost of selling into the EU, which could make it harder for some companies to do so. Moreover, duties will newly be applied to goods worth under €150 being sold into the EU, which increases the overall export cost. Under the terms of the Protocol, Northern Ireland has to enforce the EU's customs code, meaning it will presumably have to newly apply VAT and customs duties on e-commerce imports worth under €150. This could ultimately increase the price of such which meet these criteria into NI because a) they have to pay additional tariffs and b) the EU believes many such imports are presently undervalued so as to deliberately avoid the €150 threshold. This could be of benefit to Northern Irish businesses, who will be less vulnerable to being undercut by underpriced imports from abroad (though imports from the GB will not be subject to the tariff if remaining in NI). NI will presumably not participate in the new Customs Hub, meaning customs declaration processes will continue as before – though this has not been officially confirmed.	other businesses in 2032.

	becomes the official importer. This also means it is responsible for ensuring a good meets EU environmental, safety and ethical standards. The threshold where imported goods under a value of €150 are exempt from customs duty will also be abolished – the EU says this is ‘heavily exploited by fraudsters’ with ‘up to 65% of such parcels’ being ‘undervalued, to avoid customs duties on import’. Customs categories for low-value goods will be reduced from thousands to four, to simplify the import process.		

20. Trade & Customs PASSIVE CONVERGENCE INTERNAL IMPACT *EU-Kenya Economic Partnership Agreement.*	**Summary:** The EU and Kenya have concluded the political negotiations for an Economic Partnership Agreement (EPA). This will allow for 'asymmetric removals of tariffs': whereby the EU removes tariffs and quotas on all imports (except arms) from Kenya, while Kenya gradually opens up its market to EU imports (with some sensitive products exempted). The equivalent of 83% of the EU's exports to Kenya, by value, will ultimately benefit from liberalised customs duties - though more than 50% of imports already have tariff-free access. The EU is Kenya's number one export destination, with horticultural products constituting the vast majority. Kenya will be allowed to trigger safeguards to protect sensitive agricultural products, in the case of unforeseen sharp increases in imports from the EU. The EU says it is 'the first agreement with a developing country in which the EU's new approach to trade and sustainable development is reflected', as it includes a chapter on agriculture 'geared towards sustainable development'.	**Impact:** The EU had since 2014 been negotiating an Economic Partnership Agreement with six East African states, but never came into effect as only Kenya ratified it. All the other members were able to benefit from duty- and quota-free tariff access under the EU's Generalised Scheme of Preferences for 'least developed countries' - but Kenya did not qualify, and instead obtained trade liberalisation under the less favourable 'Market Access Regulation'. The agreement broadly reflects steps which the UK took when it signed a similar agreement with Kenya in 2020, during its rolling over of trade agreements it was part of as an EU member. Because the UK did not roll over the EU Market Access Regulation, through which Kenya's trade with the EU was governed, it struck a separate agreement ensuring all companies operating in Kenya (including British ones) have duty-free access to the UK. Kenyan duties on non-sensitive UK imports are also being gradually reduced over time. The agreement can also be seen as part of the EU's strategy, underpinned by its Global Gateway initiative, to compete with China for economic spending in Africa.	**Timeline/region:** The EU-Kenya agreement will go through legal revision before it is formally adopted by the European Council. The EU and Kenya can then sign the agreement, and it enters fully into force once ratified by Kenya and the EU member states.

21. Food Standards PASSIVE CONVERGENCE INTERNAL IMPACT *EU proposal on New Genomic Techniques.*	**Summary:** The European Commission has adopted a proposal which would make it easier for farmers to use gene editing in the development of their crops. The Commission's proposals distinguish between two types of 'New Genomic Techniques'. 'Category 1' covers techniques which accelerate genetic changes in a crop which could have been achieved through classic breeding techniques like seed selection and cross-breeding (potentially halving the process time). This is also called gene editing, and is based on deleting genetic elements from a crop, or adding elements from a species it could be bred with. These would undergo a verification procedure and then exempted from existing regulations on genetically modified organisms (GMOs). Category 2 are 'more complex modifications' which could not have occurred through natural breeding processes. This involves introducing material from a species which cannot normally be bred with the recipient. These would continue to be subject to GMO regulations. At present, both categories are subject to EU GMO regulations, which entail lengthy risk assessments,	**Impact:** This represents a rare case of EU aligning with a regulatory change which the UK has already embarked upon. The UK launched a consultation on liberalising gene editing regulations in January 2021 – identifying it as one of the chief potential regulatory benefits of Brexit. Its argument for reform is very similar to the one now being made by the EU. However, divergence could still occur depending on exactly which genetic editing techniques are permitted by the UK and EU respectively; and what regulations they are subject to. The EU's reforms focus specifically on plants produced by two gene editing techniques in particular (targeted mutagenesis and cisgenesis). The UK government's Genetic Technology (Precision Breeding) Act became law in March 2023, and gives ministers powers to establish a new authorisation process for food and feed products derived from precision-bred plants and animals – but the exact legislation is yet to be outlined. The Act applies only to England. One clear difference, however, is that the UK government will permit the use of precision breeding for animals, whereas the EU regime covers only plants. Should there be	**Timeline/region:** The EU proposals will be discussed by the European Parliament and Council, and are thus subject to change.

	authorisation and monitoring processes. As a result, these methods are barely used in the EU. However, proponents of genetic editing argue that it is substantively different to genetic modification, because it replicates results which can be achieved naturally. The Commission points to a range of benefits which could come from greater use of gene editing techniques, including 'developing improved plant varieties that are climate resilient, pest resistant, that require less fertilisers and pesticides and can ensure higher yields, helping to cut the use and risk of chemical pesticides in half, and reducing the EUs dependency on agricultural imports.'	divergence between the English and EU regimes, certain gene-edited crops (and food and feed derived from them) produced in England could not be exportable to the EU (or vice-versa). Moreover, it will likely be the case that English farmers producing gene edited crops which meet EU standards will need authorisation from the EU before they can export those goods into the single market – increasing the administrative cost of exports. Because the UK regulatory changes apply only in England, it will create divergence with the rest of the UK. This could put Scottish, Welsh and Northern Irish farmers at a disadvantage, because they will not be able to make use of the same new techniques as competitors in England. Moreover, because of the UK Internal Market Act, gene edited crops produced in England will be permitted for sale in the rest of the UK, unless the devolved governments successfully apply for an exemption. The Scottish government initially opposed the relaxation of gene editing regulations because it would hinder trade with the EU. It remains to be seen whether the legislative developments in the EU change this stance.	

22. Competition MANAGED DIVERGENCE *Proposed UK-EU agreement on cooperation and exchange of information in competition matters.*	**Summary:** The Council of the European Union has authorised negotiations with the UK on cooperation in competition matters. This would be a supplementing agreement to Article 2 of the UK-EU Trade and Cooperation Agreement (TCA) and would allow for cooperation between the UK and the European Commission/member states' national competition authorities. Provisions would allow for them to notify each other when enforcement action is taken, which could 'significantly affect the important interests of the other side'. Practically speaking, this could involve pre-notifying the other side about potential competition investigations, to enable coordinated action; coordinating enforcement activities; the possibility for members of UK competition authorities to attend EU competition law hearings (and vice-versa); and the possibility to organise meetings between both sides' authorities. The mandate also says the agreement should include provisions to enable mutual assistance in enforcement activities, particularly in relation to collecting information or carrying out inspections for one another; and that the EU	**Impact:** Such an agreement was first suggested by the European Commission two years ago, implying that the settling of disputes around the Northern Ireland Protocol has allowed the UK and EU to revive proposals for cooperation which had gone cold. Last summer, EU officials were instructed to stop sharing information on digital policy - including competition elements - with UK counterparts due to the wider political impasse. The TCA has only a limited component on competition, recognising 'the importance of free and undistorted competition in their trade and investment relations' and committing both sides to maintaining systems which address distortive practices, abuses of dominant positions, and anticompetitive mergers. On cooperation, it commits the parties to 'endeavour to cooperate and coordinate', where possible, enforcement activities on related matters, in particular through the exchange of information as permitted by each side's legal system. However, it notes that the parties 'may enter into a separate agreement… which may include conditions for the exchange and use of confidential information'. This is, in	**Timeline/region:** The UK and EU are yet to agree on a timeline for negotiations.

	and UK competition authorities should be empowered to share evidence for use in their own respective cases.	effect, what is proposed by the new negotiating mandate. It would allow the UK and EU to take more coordinated action, through the sharing of more information about their respective work, in a more systematic manner. Recent developments in competition policy may well have served to catalyse new cooperation efforts. As highlighted in entry #4, the UK is, post-Brexit, a new and significant global player on competition policy. It is no longer part of the EU's 'one-stop-shop' system where the Commission reviews mergers which cross national borders, meaning it is now the responsibility of UK Competition and Markets Authority (CMA) to review international mergers which affect the UK market. This led to a high-profile disagreement, where the CMA blocked Microsoft's acquisition of the video games company Activision. Despite the EU having approved it, the merger cannot go through without the CMA's approval. This division stemmed, in part, from the UK and EU basing their decisions on different regulatory priorities. This means there is potential for similar cases – where a UK regulatory decisions disrupts EU policy, or vice-versa – to occur in future. The proposed agreement could thus offer a means of	

		mitigating potential disruption, for example through pre-notification of investigations and more coordinated action early on. In other cases, the agreement might serve to augment common interests, rather than resolve potential differences. For example, both sides are taking similar steps to stem anti-competitive practices by big tech in digital markets (see entry #3), and their enforcement action could be more effective if cases are pursued in parallel. For example, one side might alert the other to a potential infringement, such as a tech company discriminating against third-party service providers in its app store. Their cases against said company could also be enhanced by evidence sharing, and agreement on common remedial measures could make them easier to impose and enforce. It remains to be seen how receptive the UK is to the EU's proposal and, if negotiations do take place, how far the agreement builds on the terms of the TCA.	

23. Financial Services MANAGED DIVERGENCE *Draft UK-EU Memorandum of Understanding on Financial Services Cooperation.*	**Summary:** The UK and EU have drafted a Memorandum of Understanding (MoU) on regulatory cooperation on financial services, creating a new framework for voluntary regulatory cooperation, outside of the structures of the TCA. This was committed to in a joint declaration published alongside the TCA, and was meant to be established by March 2021, only for discussions to become frozen due to wider political disputes. The MoU establishes a joint 'Forum' for structured dialogue which - the EU notes - is similar to that it has with the USA. The objectives are to improve transparency; reduce uncertainty; identify potential cross-border implementation issues; consider (as appropriate) working towards compatibility with each other's standards; promote (where relevant) domestic implementation consistent with international standards; share knowledge to aid common understanding of each other's regulatory frameworks; and exchange information and views on other issues of common interest. In practice, the Forum may be used: to discuss how both sides implement new international regulatory standards in a	**Impact:** The MoU creates a platform for closer UK-EU regulatory cooperation, and its ultimate impact will depend largely on the political will of the UK and EU. The House of Lords European Affairs Committee notes that the lack of an MoU 'does not appear to have caused major problems so far', as other MoUs on technical cooperation have been in place, but that it should nonetheless offer an opportunity for new forms of strategic dialogue on financial services. Financial commentators largely take the view that dialogue will focus on engagement over integration. That means working through common challenges and managing areas of divergence, rather than seeking increased alignment. For example, the Forum is likely to be used to discuss sustainable finance - where the UK and EU have similar ambitions but technical divergences are likely to emerge between their regimes (see entry #16) - and emerging issues like digital finance. It could also address the UK's Financial Services and Markets Bill, which is set to create greater divergence in areas such as insurance regulation. The MoU also notes that 'equivalence' decisions may be discussed at the Forum. Equivalence decisions provide	**Timeline/region:** The MoU is subject to approval by EU member states, and activities can begin as soon as it is signed by both parties.

	manner which respects the requirements of the TCA, or to share experiences on supervision and enforcement in key areas of cooperation; to discuss new regulatory or supervisory proposals by either side, so that the parties can identify potential cross-border implications, or significant impacts on the other side's financial services sector, and work through them; to discuss wider economic developments, regulatory issues, financial stability and anti-money laundering efforts; or to share positions on agenda items – for example sustainable finance - prior to international meetings at fora like the G20. The Forum will not address issues of UK firms' access to the EU market, or vice-versa, nor will it prejudge any equivalence decisions (though views on such decisions may be exchanged). Cooperation 'should not restrict the ability of either jurisdiction to implement regulatory, supervisory or other legal measures that it considers appropriate'. Meetings will be held at least twice a year, hosted alternately by the EU and UK, and will be supported by preparatory technical talks. A joint statement on outcomes may be released after each meeting, but the MoU itself does not commit the either side to new legal or financial obligations.	simplified access to the granting party's domestic financial services market, yet the EU has only granted the UK one equivalence decision (for UK-based clearing houses, running to June 2025), despite the UK having set up a temporary permissions regime, running to the end of 2023, which gives EEA-based financial firms comparatively far greater access to the UK market. The Forum could provide a platform for discussion of these decisions, and whether they can be extended beyond their current deadlines. Yet significant progress is far from guaranteed. The EU is planning to introduce a new regulatory framework which would give preferential treatment to EU-based clearing houses over third country competitors. Despite significant industry pressure, it recently rebuffed suggestions from some member states that the equivalence decision on UK clearing houses will have to be extended beyond June 2025 to protect market stability. This underlines how the UK and EU often have different political priorities on financial services regulation, which could limit how much new cooperation they are able to pursue, despite the creation of a new Forum.	

24. MIGRATION			
MANAGED DIVERGENCE *New UK and EU working arrangement on migration.*	**Summary:** The UK and EU have agreed to develop a new working arrangement between UK migration agencies and Frontex (the EU border and coast guard agency). The announcement was made following a meeting between Rishi Sunak and Ursula von der Leyen at a Council of Europe Summit in Reykjavík. Little detail has yet been provided on what this entails. The UK government stated that the agreement will enable the two sides to 'work together on critical operational and strategic challenges including the situation in the Channel', and added that 'UK and EU teams will now discuss the details and operationalisation of this new working arrangement.'	**Impact:** Until a formal agreement is outlined, it is hard to assess exactly what the implications will be. The Financial Times reports that the UK does not want to deploy Frontex officers on its territory, but to exchange information, resources and staff with one another. Though the UK has emphasised that this will help deal with challenges around 'the situation in the Channel' the EU may demand greater UK support on other migration issues, such as asylum seekers crossing the Mediterranean Sea to southern Europe. As an EU member, the UK was not a member of Frontex, but did have a closer operational relationship, attending management board meetings and participating in operations and exchanges of surveillance data; without making a financial contribution. The UK reportedly accepts that it will now have to contribute financially, and have more limited access (to data, intelligence and management meetings), with some MPs expressing concern that the government is prioritising speed over substance in the agreement. Part of the motivation for Rishi Sunak is likely to be the domestic political imperative to demonstrate control over migration. Yet the commitment to strengthen institutional	**Timeline/region:** The agreement is still subject to negotiation between the UK and EU.

ties over a sensitive matter also reflects a clear warming of political relations between the UK and EU. Indeed, an EU diplomat told the Financial Times that the agreement had been unlocked by resolving disputes around the Northern Ireland Protocol through the Windsor Framework: 'Improved relations open up the door to mutually beneficial partnerships like this.'

It could also be interpreted as a recognition on the UK side that it is dependent upon EU partners for managing migration flows, and it follows an agreement in March between the UK and France to take new joint measures to manage migration across the Channel.

25. ENVIRONMENT **INTERNAL DIVERGENCE** *Scottish Deposit Return Scheme - UK internal market exclusion.*	**Summary**: The UK government has issued a statement stipulating that the Scottish government's flagship 'circular economy' policy – a deposit return scheme (DRS) aimed at boosting recycling rates – will have to be watered down to exclude glass bottles. The DRS proposal, first covered in the previous divergence tracker, requires retailers in Scotland to add 20p to the price of single-use drinks cans and bottles, which the customer can then reclaim by returning the used item for recycling. However, it has run into difficulties around the UK Internal Market Act (IMA) which guarantees that a good which meets the regulatory requirements in one part of the UK can be sold in any part of the UK. The DRS' requirement for cans and bottles to have a special barcode would unfairly discriminate, under the principles of the IMA, against containers made elsewhere in the UK which lack such a barcode. The Scottish government sought an 'exclusion' under the IMA to enable it to launch the scheme, which has now been granted by the UK government. However, the decision states that the exclusion will only apply until similar in schemes are in place across the rest of the UK (these are currently in	**Impact**: The UK government decision not to permit glass bottles to be part of the DRS has led the Scottish government to accuse Westminster of deliberately sabotaging the scheme. This in turn raises questions about whether structures for managing internal divergence within the UK are functioning effectively. First Minister Humza Yousaf said that the decision not to apply the full exclusion was a deliberate attempt by the UK government to 'make it a constitutional fight' even though 'they didn't have to', and Scotland's circular economy minister Lorna Slater has since announced that the DRS 'cannot go ahead as currently planned', arguing that the sudden change severely hinders the impact of the scheme and creates too much uncertainty for business. The Scottish DRS will be delayed until October 2025 at the earliest (likely to coincide with the implementation of schemes in the rest of the UK). This has bred frustration in the Scottish government, given it legislated faster than the rest of the UK – on what it sees as a landmark proposal – but is now having to wait for the rest of the country to catch up before it can come into effect. Slater added: 'I remain committed to interoperable DRS	**Timeline/region:** The Scottish government says it DRS will now not come into effect before October 2025, which will likely coincide with the launch of similar schemes across the rest of the UK.

	development), 'at which point there will be maximum alignment and interoperability' between the two. To ensure maximum alignment, the UK government will not allow the Scottish DRS to cover glass bottles – either under the exclusion or in the future - because these will not be included in DRS schemes planned for England and Northern Ireland (Wales's proposals cover glass but an IMA exclusion has not so far been sought). Moreover, once schemes are up and running UK-wide, it must be possible to return a can or bottle in any part of the UK (meaning administration and payment schemes must be aligned), with one barcode used across the whole of the UK. The UK government says it has excluded glass bottles from the Scottish scheme because 'this type of permanent divergence would be a very significant step for businesses and consumers' and 'would add cost and complexity to the schemes in particular to hospitality and retail sectors, as well as adding consumer inconvenience'. Some Scottish businesses had raised concerns about the administrative costs entailed by adaptation to the DRS, which will not be faced by competitors in other parts of the	schemes across the UK provided that we can work in a spirit of collaboration not imposition.' This is not the first time Westminster has moved to block elements of Scottish legislation, following a dispute earlier this year over a Scottish bill on gender recognition. UK in a Changing Europe's Alex Walker argues that these high-profile disputes raise questions about whether the new intergovernmental relations (IGR) structures for managing regulatory divergence within the UK are working as intended. Walker notes the joint agreement on the IGR says it will be 'built on principles of mutual respect and trust… facilitating dialogue… and resolution mechanisms where necessary'; and contrasts this with the very public and recriminatory way in which disputes have instead played out: 'constructive dialogue is still being subordinated to point-scoring on the constitutional question'. He also notes that, even where the new structures are being used, there are concerns about the balance of powers. Indeed, the Scottish government used the new 'common frameworks' structure to make an official request for an exclusion to the IMA, which the UK government responded to. However, the decision to offer only a partial exclusion	

	UK. It also means companies in other parts of the UK will no longer able to sell drinks on the Scottish market unless they comply with the new marking requirements – potentially harming intra-UK trade and consumer choice in Scotland.	‘serves to reinforce the asymmetry of the relationship, with the UK government setting the final parameters of the policy’. Indeed, Welsh First Minister Mark Drakeford has also said he ‘dispute[s] the use of the internal market act for these purposes’. Walker concludes that ‘the UK government needs to do more to demonstrate that it can work as a team with the devolved governments – otherwise, they may lose faith in the new processes before they’ve had a chance develop.’	

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