Brexit and Equivalence

Eddy Wymeersch

Context of Equivalence

- Within EU: passport access to all 28/all services in regulation
- 3rd country: No access, except if 3rd Country is equivalent
- Equivalence for financial institutions, differentiation for financial services
- Inward equivalence: 3rd country firms can access EU markets
- Outward equivalence: EU firms can access 3rd Country markets: see CH case
- Objectives
 - Protect EU investors: same protections as dealing with EU firms
 - Limiting streamlining access to the EU limit regulatory arbitrage
 - Financial stability concerns: avoid 3rd country firms/products to destabilise the EU

How "equivalence functions"

- Legal basis in Directive or Regulation if no legal basis, no equivalence – but may be a nationally granted access
- Formulation is important: wide variety per Regulation
 - Reference to external source: reference to IFRS; to IOSCO standards
 - Decision by NCA
 - Prospectus: 2003/71
 - prospectus has been drawn up in accordance with international standards set by international securities commission organisations, including the IOSCO disclosure standards;
 - the information requirements, including information of a financial nature, are equivalent to the requirements under this Directive.

Equivalence decisions adopted (1)

Equivalence Decisions adopted by the European Commission Date: 03/10/2017	Abu Dhabi	Argentina	Australia	Bermuda	Brazil	Canada	Caymans	Chile	China	Dubai International financial centre	Egypt	Faroe Islands	Greenland	Guernsey	Hong Kong	India	Indonesia	Isle of Man	Israel	Japan	Jersey	Malaysia	Mauritius	Mexico	Monaco	New Zealand	cides ipies	Saudi Alabia	Singapore	South Africa	South Korea	Switzerland	Thailand	Turkey	Sn	United Arab Emirates
Directive 2013/34/EU - Accounting Directive																																				
Art.47 - Country-by-country reporting						Υ																														\Box
Directive 2004/109/EC - Transparency Directive																																				
Art.23(4)[third] - Third country GAAP/Transitory regime																Y (1)																				\Box
Art.23(4)[third] - Third country GAAP with IFRS						Υ			Υ											Υ											Υ				Υ	
Art.23(4)[first (ii)] - General transparency requirements																									T											
Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (Statutory Audit)																																				
Art.46(2) - Equivalence of audit framework	γ		Υ		γ	Υ			Υ	Υ				Υ			γ	Υ		Υ	Υ	Υ	Υ			Υ		١	Y ,	Υ	Y,	ΥY	/ Y	/ Y	Υ	
Art.46(2) - Equivalence of audit framework/Transitory regime				γ			Υ				Υ															١	/									
Art.47(3) - Adequacy of competent authorities			Υ		γ	Υ				Υ				Υ			γ	Υ		Υ	Υ	Υ							1	Υ	Y,	ΥY	/ Y		Υ	
Regulation (EC) n° 1060/2009 on credit rating agencies, as amended by Regulation (EU) n° 462/2013 (CRAs)																																				
Art.5(6) - Legal and supervisory framework		Υ	Υ		γ	Υ									Υ					Υ				Υ				١	Υ						Υ	
Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories (CSDR)																																				
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Equivalence adopted (2)

Regulation (EU) No 648/2012 on OTC derivatives, central counterparties																					
and trade repositories (EMIR)																					
Art.1(6) - Exemption central banks and public bodies		Υ		Υ				Υ			Υ		γ		Υ			γ		Υ	
Art.13(2) - Transaction requirements																					
Art.25(6) - CCPs		Υ	Υ	Υ		γ		Υ	γ		γ		γ	Υ	Υ	Υ	Υ	γ		Y (2)	Y
Art.2a - Regulated markets		Υ		Υ							Υ				Υ					Υ	
Art.75(1) - Trade repositories																					
Regulation (EU)2015/2365 on transparency of securities financing																					
transactions and of reuse																					
Art.2(4) - Central bank exemption																					
Art.19(1) - Trade repositories																					
Art.21(1) - Reporting regime																					
Regulation (EU) N° 600/2014 on markets in financial instruments (MIFIR)																					
Art.1(9) - Exemption central banks		γ	Υ	Υ				Υ	Υ		Υ		γ		Υ		Υ	Υ	γ	γ	
Art.23 - Trading venues for the purposes of trading obligation for shares																					
Art.28(4) - Trading venues for the purposes of trading obligation for derivatives																					
Art.33(2) - Derivatives: trade execution and clearing obligations																					
Art.38(3) - Trading venues and CCPs-access to benchmarks and licences for the purposes of clearing and trading obligations																					
Art.47(1) - Investment firms providing investment services to EU professional clients and eligible counterparties																					

Equivalence Decisions adopted by the European Commission Date: 03/10/2017	Abu Dhabi	Argentina	Australia	Bermuda	Brazil	Canada	Caymans	Chile	China	Dubai International financial centre	Egypt	Faroe Islands	Greenland	Guernsey	Hong Kong	India	Indonesia	Isle of Man	Japan	Jersev	Malaysia	Mauritius	Mexico	Monaco	New Zealand	Russia	Saudi Arabia	Singapore	South Africa	Switzerland	Taiwan	Thailand	Turkey	SN	United Arab Emirates
Regulation (EU)No 596/2014 on insider dealing and market manipulation																																			
(MAR Market Abuse Regulation)																																			
Art.6(5) - Exemption public bodies and central banks			Υ		Υ	Υ			Υ						Υ	Υ			Υ				Υ					Υ	Υ	Y			Υ	Υ	
Art.6(6) - Exemption for climate policy activities																																			
Regulation (EU) No 236/2012 on short selling and certain aspects of Credit																																			
Default Swaps (SSR)																																			
Art.17(2) - Requirements for markets																												T	Т						
Regulation (EU) 2016/1011 on indices used as benchmarks in financial																																			
instruments and financial contracts																																			
Art.30(2) - Requirements for benchmark administrators																												Т	Т						
Art.30(3) - Specific administrators or benchmarks																													T						
Regulation (EU)2017/1129 of 14 June 2017 on the prospectus to be																																			
published when securities are offered to the public or admitted to trading																																			
on a regulated market, and repealing Directive 2003/71/EC																																			
Art.29(3) - Prospectus rules																												Т	Т	Т					
Regulation (EU) No 575/2013 on prudential requirements for credit																																			
institutions and investment firms (CRR)																																			
Art.107(4) - Credit institutions			Υ		Υ	Υ			Υ			Υ	Υ	Υ	Υ	Υ		Υ	Υ	Υ			Υ	Υ	Υ		Υ	ΥY	Υ	Υ			Υ	Υ	
Art.107(4) - Exchanges			Υ		Υ	Υ			Υ							Υ	Υ		Υ				Υ				Υ	ΥΥ	ΥΥ					Υ	
Art.107(4) - Investment firms			Υ		Υ	Υ			Υ						Υ		Υ		Y (3)			Υ				Υ	ΥΥ	ΥΥ					Υ	
Art.114(7) - Exposures-Credit institutions			Υ		Υ	Υ			Υ			Υ	Υ	Υ	Υ	Υ		Υ	Υ	Υ			Υ	Υ	Υ		Υ	ΥΥ	Υ	Υ			Υ	Υ	
Art.115(4) - Exposures-Credit institutions			Υ		Υ	Υ			Υ			Υ	Υ	Υ	Υ	Υ		Υ	Υ	Υ			Υ	Υ	Υ		Υ	ΥΥ	Υ	Υ			Υ	Υ	
Art.116(5) - Exposures-Credit institutions			Υ		Υ	Υ			Υ			Υ	Υ	Υ	Υ	Υ		Υ	Υ	Υ			Υ	Υ	Υ		Υ	ΥΥ	Υ	Y			Υ	Υ	
Art.142(2) - Credit institutions			Υ		Υ	Υ			Υ			Υ	Υ	Υ	Υ	Υ		Υ	Υ	Υ			Υ	Υ	Υ		Υ	ΥΥ	Υ	Y			Υ	Υ	
Art.142(2) - Investment firms			Υ		Υ	Υ			Υ				1		Υ		Υ		Υ				Υ				Υ	ΥY	ΥY	1				Υ	

Equivalence decisions

Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) as amended by Directive																			
2014/51/EU (OmnibusII)																			
Art.172 - Title I-for third country reinsurers in the EU: equivalent treatment of their activities			1								Υ					١	1		
Art.227 - Chapter VI of Title I-for EU insurers in third countries: solvency rules for calculation of Capital Requirements and Own Funds		Y	′ ′	ΥY	'						Υ		Υ			١	1		Υ
Art.260 - Title III-for third country insurers in the EU: equivalence of group supervision by third country supervisory authorities		,	1													١	1		

Y= Covers full or partial equivalence or adequacy, not limited or limited in time Footnotes

Processes for establishing equivalence

- NCA regime:
 - no formal process, part of authorisation decision; based of NCAs information and insight
- Commission equivalence regime
 - Complex procedure: prepared by ESMA
 - Negotiation with candidate countries, sometimes implying changes in their regulation
 - Final Commission decision: is this a political decision?

Equivalence pre-Brexit

- Who decides: 3 cases
 - NCAs for the older instruments
 - Commission equivalence decision; patchwork
 - No decision: who is in charge? National authorities?
- Additional conditions
 - ESMA adopts supervisory coordination measures
 - Information obligations
 - FATF— OECD Tax
- Equivalence is temporary:
 - Depends on legal or regulatory regimes compared changes end equivalence
 - Withdrawal is sometimes expressly provided (insurance)

Some equivalence mechanisms

- Admission to listing- directive 2001/34
 - Equivalence of information
 - Transparency 2004/109
 - Commission decision on equivalence of accounting standards
 - Commission will set up mechanism ensuring equivalence of information
- But decisions remain in the hands of the NCAs

Article 41 Mifid 2

- Mifir article 46 not yet in effect
 - Access for 3rd Country investment firms with passport
 - Legal and supervisory arrangements equivalent
 - 3rd country has binding prudential and conduct requirements with equivalent effect
 - Specific conditions for legal and conduct framework such as: authorisation, legal capital, organisational requirements, internal controls, conduct of business rules etc.
- AIFMD Non –EU AIFs managed by non–EU AIFMD (article 40)
 - AIFM subject to all requirements as for EU AIFM- = extraterritoriality
 - Cooperation arrangements involving ESMA
 - FATF cooperative country
 - OECD Tax model convention in all states of marketing

Third country CCPs

- Recognition of third country CCPs- EMIR 648/2012
 - Commission Implementing Act
 - That the legal and supervisory arrangements of a third country ensure that CCPs authorised in that third country comply with legally binding requirements which are equivalent to the requirements laid down in Title IV of this Regulation, that those CCPs are subject to effective supervision and enforcement in that third country on an ongoing basis and that the legal framework of that third country provides for an effective equivalent system for the recognition of CCPs authorised under third-country legal regimes.
 - Recognition By ESMA, cooperation arrangements, FATF

No Equivalence regime

- Banking- CRD IV Article 47
 - Subsidiaries of 3rd country firms: full national regime ECB authorises
 - EU passport
 - Branches of 3rd country firms
 - National regime only local activity
 - No more favorable treatment
 - Consolidated supervision: by agreement

UCITS

- No third country regime: all to be incorporated/managed in EU
- But: delegation of functions; conditions part of NCA authorisation procedure
 - Asset management delegation large flexibility
 - Depositary: strict requirements strict liability

No Equivalence regime

- Subsidiaries of Investment firms
 - Are EU legal entities, subject to full EU law; passport, but often economically not feasible Workable for Existing subsidiaries, too expensive for new entrants
- Third country investment services through a branch art. 39 Mifid II
 - In one EU member state; no passport
 - No provision of "only services", but branch necessary
 - No Commission implementing act
 - Conditions assessed only by NCA
 - FATF + OECD Model tax convention
 - Sufficient "capital" in the branch
 - Same conduct regime as applicable to local firms.

Access conditions according to ESAs

- ESAs require full compliance with existing requirements
 - No grandfathering: existing firms will be checked as to compliance on the basis of new business plan/activity
 - Requirements on Authorisation, Governance, Internal Controls and Delegation and outsourcing fully applicable and sharpened
- Clear concern about UK firms being "empty shells" "Letter Boxes", "Brass plates" etc.
 - Assessment on overall business no transaction per transaction scrutiny
 - Increased requirements, stronger follow-up, access refused in case of derecognition

Equivalence as a political tool?

- Commission states clearly
 - "The decision is a unilateral and discretionary act of the EU "
 - "The Commission ultimately exercises its discretion as conferred upon it by the relevant empowerment."
- 212 equivalence decisions adopted (febr 2017)
- See recent decision on the Swiss Stock exchange: 1 year equivalence
 - Limits due to lack of progress on the Framework file EU-CH.
 - What would be the liability aspects if equivalence came to an end?
- Similar case in the field of AIFM recognition: positive proposal by ESMA for 12 non-EU states, but no Commission action

Equivalence as a political tool?

- Legal concern: the equivalence decision is based on a technically defined delegation of power to the Commission. The criteria in the delegation do not mention political considerations
- Differentiation between "may" and "shall"
- What in case the Commission has not adopted an equivalence decision?
 - No access to EU markets?
 - Could NCAs exercise their judgment, in cases where the Commission has not exercised its mandate?
- If it is a political matter:
 - Should be expressly mentioned in the empowering Regulation

Equivalence Post-Brexit

- Importance for the UK: it will condition access by the UK, but also by the EU
- Substantive equivalence
 - ➤ UK legal regime compliant before Brexit,
 - <u>▶ but</u> not further compliant after Brexit
 - UK Acts implementing <u>Directives</u> remain unchanged: But no ECJ check
 - EU Regulations will loose their legal force
 - ECJ not further competent
 - UK Withdrawal Act restores regulation at UK only level, but not for EU purposes

Could equivalence offer a solution for Brexit? A proposal

- EU could use the existing powers on Equivalence
- Declares certain matters equivalent = opens EU access
- No detailed investigation necessary: substantive equivalence
- Accept ECJ jurisdiction is under consideration
- Not an unlimited commitment
 - Upon changes by EU or UK: equivalence lapses
 - UK as "rule taker": but not binding
 - Allows to postpone negotiations
 - Selection of subject matters may stir controversy

Could equivalence offer a solution for Brexit?

- In case of a hard Brexit, equivalence decisions for certain points may protect the EU interests, e.g. access to markets; validity of contracts.
- Unilateral: UK has no interest to refuse
- Temporary
- Could help to avoid major disruption in the EU markets
- Decision can be postponed to the last minute, but prepared beforehand