

Brexit and Equivalence

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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.

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,
 - but not further compliant after Brexit
 - UK Acts implementing Directives remain unchanged: But no ECJ check
 - EU Regulations will lose 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