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Eddy Wymeersch

Brexit and the Equivalence of Regulation and Supervision

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Abstract

After Brexit, the UK will become a third country. In the absence of a transitional agreement, its access to the EU markets will be conditioned on meeting the condition of „equivalence of regulation and supervision" as laid down in many EU regulations. Although in substance the UK regulations will be equivalent, the absence of a formal equivalence Commission decision may constitute a serious obstacle to the UK continuing to offer financial services on the EU markets. The consequences would be quite disruptive. An analysis of the different equivalence provisions reveals however a much more complex situation, indicating on the one hand that UK firms may continue to take part in the EU's financial markets through subsidiaries, on the other may offer their services to sophisticated investors, while in some cases equivalence will be in the hands not of the Commission but of the market supervisors, allowing for more flexible outcomes.

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Brexit and the Equivalence of Regulation and Supervision

Eddy WYMEERSCH, professor, Financial Law Institute, Ghent University

I. *Equivalence as a regulatory technique*

Within the context of the UK leaving the European Union, access to each other financial markets will become a point of crucial importance. If no transitional measures would be adopted, the UK will lose the benefit of the Treaty freedoms, in this case the freedom of establishment and the freedom to provide services throughout the EU. Reformulated in EU terminology, the UK will become a “third country”, which could only obtain access to some of the EU markets provided it would meet certain criteria, specified in each of the numerous directives or regulations. Among these conditions, the Commission’s decision – or absence of decision - that the third country legal and supervisory system is “equivalent” to the EU one, will often constitute the core condition for obtaining access to EU markets.

It is important to analyse the matter of equivalence in some detail focusing on the regulatory provisions on equivalence and on some of the already adopted equivalence decisions. Although equivalence has been mentioned in the EU-domestic context as well[1], it mainly is used with respect to the relations with third country legal systems. Only when the relevant aspects of these legal systems, as mentioned in the regulation, have been qualified as equivalent, will their operators be able to obtain access to the EU markets, or offer their services to EU firms.

Originally the equivalence requirement was developed as an investor protection tool, ensuring that especially retail investors in the EU are protected in the same way as they enjoy in their contacts with EU service providers[2]. As a consequence, the third country service providers are subject to requirements that are largely identical to the ones applicable in the host state. At the same time, the requirement has an undeniable effect of limiting service providers from the rest of the world to access EU investors and financial operators, without isolating EU markets from developments outside the EU. The Commission has stated a more political view on equivalence considering that equivalence is a tool for more efficient functioning and integration of the financial markets and reducing the supervisory and compliance burden. It would as contribute to less friction in cross border financial markets and support market integration[3]. However, in many cases equivalence decisions have a limited scope, apply to only one State, and do not always give access to the entire EU.

In more recent times, the equivalence requirement is increasingly assessed from the financial stability point of view: as markets have become increasingly interdependent, equivalence aims whether at restricting the importation of elements of instability from non-EU jurisdictions, or protecting against financial crises outside the EU. Several of the equivalence initiatives go back to the 2009 G 20 meeting in Pittsburgh[4]. Financial stability is therefore often explicitly mentioned.

This broader view is reflected in the Commission’s statement mainly relating to prudential subjects: “Equivalence is not a vehicle for liberalising international trade in financial services, but a key instrument to effectively manage cross-border activity of market players in a sound and secure prudential environment with third-country jurisdictions that adhere to, implement and enforce rigorously the same high standards of

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[1] See e.g. CSDR. article 48(8)

[2] See in that sense, Commission Staff Working Document, EU equivalence decisions in financial services policy: an assessment, 27 February 2017 SWD (2017) 102 final, p. 5 stating :” Equivalence is not a vehicle for liberalising international trade in financial services, but a key instrument to effectively manage cross-border activity of market players in a sound and secure prudential environment with third-country jurisdictions that adhere to, implement and enforce rigorously the same high standards of prudential rules as the EU.”

[3] According to the Commission: “it allows authorities in the EU to rely on supervised entities' compliance with equivalent rules in a non-EU country; it reduces or even eliminates overlaps in compliance requirements for both EU and foreign market players; it makes certain services, products or activities of non-EU companies acceptable for regulatory purposes in the EU; it allows less burdensome prudential regime to apply to EU banks and other financial institutions with exposures in equivalent non-EU countries”: Recognition of non-EU financial Frameworks (equivalence decisions). https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions_en

[4] See for the Pittsburg meeting: G20 Leaders Statement: The Pittsburgh Summit, http://www.g20.utoronto.ca/2009/2009communique0925.html

prudential rules as the EU"[5]. The reasoning applies also to market related matters, mainly in the field of securities.

The equivalence technique deals with the application of EU regulations to third country matters but only within the EU. In a few cases, there are reciprocity conditions to granting equivalence[6]. Access to the markets of the third country would be governed by the laws and regulations of that country, although access may be restricted by EU equivalence requirements. This implies that EU financial institutions intending to continue their activity outside the Union would have to apply for the status as applicable in the host state, but also meet the conditions applicable by EU regulations. Cooperation between the two jurisdictions, especially in terms of exchanging information, is often required.

The way the equivalence regime has been structured in the different EU regulations or directives present some considerable differences. The most significant difference relates to the designation of the internal EU body who will decide whether a foreign legal regime is equivalent: two main regimes coexist, calling for a detailed analysis of the conditions which have to be respected. In a certain number of cases, equivalence will be assessed by the national supervisory body to whom a certain transaction or matter is submitted for approval. In other cases, equivalence, as defined in the regulation, will be decided in a generally applicable decision, adopted by the Commission, whereby the national supervisory body is in charge of further determining the conditions of application of the regulation. In another series of cases, the regulation requires a formal equivalence condition, but the Commission has not adopted implementing decisions. Therefore a more detailed analysis of the different regime has to be undertaken.

II. Analysis of equivalence provisions in EU financial services regulations.

Most EU financial regulations contain references to equivalence, some dealing with detailed points which are of importance for the application of the regulation, others providing for essential characteristics for allowing activity in a certain field. Commission decisions mainly intervene in the second segment. The best available overview of the Commission equivalence decisions can be found in the attached Table, listing the equivalence decisions adopted by the European Commission.

Equivalence provisions can be found in the three main fields of financial regulation, i.e., banking, insurance and securities and markets. The decree of formalisation and the relative frequency of the use of the equivalence tool present considerable differences. The Commission considered that the equivalence tool "as such serves primarily prudential regulatory purposes and is a tool to reduce overlaps in compliance in the interest of EU markets" [7]. It is unclear whether this analysis is supported by the findings of the equivalence regimes below.

In the field of banking, the CRD IV does not mandate specific equivalence provisions, although the directive refers in several instances to the relationship with third countries[8]. The CRR refers in several cases to equivalence of third country elements that are relevant for prudential supervision- e.g. for risk weightings - , but leaves these matters to the appreciation of the credit institution, under the supervision of the national banking supervisor. Only in a few instances have formal implementing equivalence decisions been mandated and the Commission has made use of most of these delegations[9].

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[5] Commission Staff Working Document, n 2, p.5

[6] see e.g. Regulation (EU) No 600/2014, recital 44 and art 47(1) Regulation (EU) No 648/2012 recital 7 and art 25(6) ; see further n. 23

[7] Commission equivalence report, n.2 at 6

[8] See e.g. with respect to the "fit and proper" tests for directors, and significant shareholders (art 15 and 22). Collateral held in third countries shall be immediately available (article 86). The member state supervisory authority will assess the consolidated supervision to which third country entities are subject (article 127). See article 47 as to third country branches and the prohibition to grant these a more favorable treatment.

[9] See Commission and European Parliament, Third-country equivalence in EU banking legislation, 7 March 2017, PE, 587369 . The subject matters in CRR relate to exposures to different types of financial institutions in third countries (art 107(4). Risks weights at least equivalent under supervisory regulatory arrangement in third country (article 114(7) and 116(5). Under the IRB approach, definition of "large financial sector entity": equivalence on the basis of "at least equivalent" supervisory and regulatory arrangements (art 142). In these implementing acts have been adopted by the

In the insurance field, under Solvency II[10], three series of implementing decisions have been adopted: equivalence of treatment of third country reinsurers[11], equivalence for the calculation of EU insurance groups with third country subsidiaries[12], group supervision with a parent outside the EU[13].

Some sectors are excluded: the payments sector, credit and mortgage lending,

It is in the field of securities and markets that most equivalence provisions are encountered. This is logical as these are fields that often touch on cross-border relations and their effects. The number of equivalence decisions is concentrated in the following domains: accounting and auditing, credit rating agencies, transaction requirements under EMIR[14] and recognition of CCPs[15]. In each case the decisions are country specific and address the equivalence requirements as flowing from a clearly designated regulatory requirement. Also, the jurisdictions benefitting from equivalence are mainly the states with advanced financial markets[16]. In the future, the Commission is empowered to make use of its equivalence powers with respect to Mifid II, Mifir, benchmarks, CSDR and SFTR[17].

The Commission's equivalence decisions in the field of securities markets and securities trading are based on express delegations in the level 1 regulation. Most of these decisions result in a Commission implementing decision, addressing the regulatory system of a specific jurisdiction. In several other fields, the Commission has not adopted equivalence decisions, whether the regulation is still too recent to have led to formal decisions, or whether formal action has not been considered necessary, and no decisions have been adopted.

Equivalence decisions have been adopted by the Commission for the following fields[18]:

- Credit rating agencies: Australia, Argentina, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore, USA.
- Third country GAAPS: Canada, China, Japan, South Korea and US are the only equivalent countries
- Adequacy – equivalence of audit framework: 22 cases of Equivalence
- Regulated markets under EMIR: Australia, Canada, Japan, Saudi Arabia and US
- Mar: exemption for central banks and public bodies
- CRR: exposures to third country entities[19], to central banks and governments[20], large financial sector entity[21]. Exemption from large exposure own fund requirements[22]
- Solvency II (third country reinsurers, EEA subsidiaries, group supervision)
- Confidentiality regimes for exchange of information: several regulations[23]

Commission. More in general, see the Commission table listing the numerous third countries for which equivalence has been adopted: Recognition of non-EU financial frameworks (equivalence decisions) https://ec.europa.eu/info/sites/info/files/file_import/equivalence-table_en_0.pdf.; For the detailed list of equivalence decisions, see: Commission, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions_en.

[10] See Directive 2009/138/EC of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), on the basis of articles 172, 227 and 260.

[11] Article 172: Bermuda, Japan Switzerland

[12] Article 227: Australia, Brazil, Canada, Mexico and the United States, Switzerland, Bermuda, Japan Bermuda, Switzerland

[13] Article 260: Bermuda, Switzerland

[14] Article 13, Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (Emir) as amended

[15] Article 25(6) Emir

[16] I.e. essentially the G20 countries

[17] For an overview, see the: Table of Equivalence decisions European parliament, Third-country equivalence in EU banking legislation. http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf

[18] On the basis of the table as attached.

[19] Article 107(4) For the list of equivalent countries see: Commission and European Parliament, n. 9

[20] article 114, 115 and 116

[21] article 142

[22] Article 400(2)(c), CRR. Exemption for exposures by decision of the national authority for exposures to subsidiaries or subsidiaries of the parent undertaking covered by the supervision on a consolidated basis to which the institution itself is subject according to standards on consolidation applicable in the third country equivalent to the EU consolidation directive 2002/87. The exemption is granted by the national authority for the full amount or part of it.

[23] EBA, On recommendations on the equivalence of confidentiality regimes 11 January 2017, EBA/REC/2017/01

No equivalence decisions have been adopted in the following matters:

- Prospectuses; transparency obligations, financial benchmarks
- Trade repositories under EMIR : no cases of equivalence
- Short selling
- AIFMD
- Emir: CCP access, regulated markets

Recent regulations

- Mifir-Mifid2: *Investment firms, trading venues*
- Emir: transactions *requirements, trade repositories*
- CSDR
- SFTR, reporting and trade repositories
- Mifir/Mifid, including trading venues and CCP access
- Financial benchmarks

The Commission equivalence decisions have to be situated on the background of other measures to be adopted to make the system work. By way of example, these are: Commission cooperation arrangements with third country authorities; ESMA guidelines for application of the Commission cooperation arrangements; RTS on the cooperation arrangements ensuring transmission of adequate information; RTS on the procedures for exchange of information between authorities; ITS on the form and content of information requests in case of non-compliance.

A. Accounting

Directive 2013/34 Directive on Accounting[24] states that all limited liability companies have to publish their accounts in accordance with their national accounting standards adopted in implementation of the EU directives. If organised as a group, they should also prepare consolidated accounts in accordance with the directive or with the international accounting standards [25]. If their shares are traded on a regulated market their consolidated accounts should be based of the International Financial Reporting Standards as declared" equivalent" in regulation 1606/2002[26]. States may also declare IFRS applicable to their national unlisted companies.

EU branches of third country companies must disclose their accounts according to their national law[27].

Third country issuers of securities are expected to prepare their consolidated accounts in accordance with IFRS[28]: on the basis of the prospectus directive the Commission has adopted a decision providing for the conditions under which the third country GAAP can be considered equivalent to IFRS[29]. With respect to listed companies Regulation 1606/2002 requires consolidated accounts to be drawn up in conformity with IFRS. This rule applies to companies governed by the law of a Member State, but also for non-EU listed issuers.

[24] Directive 2013/34/EU of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

[25] Reference is made to regulation (EC) No 1606/2002 of 19 July 2002 on the application of international accounting standards

[26] See for the list of IFRS standards endorsed by the Commission: Commission regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002.

[27] See 11th company law directive of 21 December 1989, article 7 e.s.

[28] Commission decision 2008/ 961 of 12 December 2008 on the use by third countries' issuers of securities of certain third country's national accounting standards and International Financial Reporting Standards to prepare their consolidated financial statements

[29] Commission regulation (EC) No 1569/2007 of 21 December 2007 establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities pursuant to Directives 2003/71/EC and 2004/109/EC of the European Parliament and of the Council (OJ L 340 22.12.2007, p. 66), as amended by Commission delegated regulation No 310/2012 of 21 December 2011 and Commission delegated regulation (EU) 2015/1605 of 12 June 2015.

Under the transparency directive applicable to listed companies, the securities supervisory authority may exempt a third country issuer of certain accounting and disclosure requirements provided the statements are prepared in according with IFRS, as referred to in regulation 1606/2002. The Commission will adopt implementing measures[30].

With respect to the application of the prospectus directive and the transparency directive, a Commission regulation establishes the mechanism for establishing equivalence of a third country GAAP with IFRS.[31] This would be the case if the third country rules would enable investors to assess the financial statements on the same basis as if these had been drawn up under IFRS, and to adopt the same decisions with respect to their securities[32]. The decision will be country specific, may be temporary, and adopted on the initiative of the Commission, or of the supervisory authorities concerned.

The Commission reports that equivalence decisions have been adopted on the basis of the transparency directive with respect to the accounting standards of Canada, China, Japan, South Korea and the US.

The 2013/34 directive[33] introduces an obligation to publish a consolidated report on payments to governments: companies that publish reports based on third country reporting requirements which have been considered equivalent, will be exempted from establishing a report (article 46). The Commission will lay down in a delegated act the "criteria for assessing the equivalence of third –country reporting and the requirements of this chapter". The Commission will also identify which third country's reporting requirements are equivalent (Article 47). One equivalence decision has been adopted relating to Canada[34].

B. Auditing

EU auditors engaging in audit assignments should follow the international auditing standards (ISAs), as adopted by the Commission. National auditing standards will only be accepted by national authorities as long as the Commission has not adopted an international standard on the subject[35]. Audit procedures or requirements in addition to the international ones will only be accepted under limited conditions[36]. The audit of EU companies will be executed by EU registered auditors, whether nationals or not. Third country auditor acting as a statutory auditor must be approved by the national authority and meet similar requirements

Official audit reporting relating to a listed company can only be undertaken by third country auditors provided the auditor has been registered in the host state and is subject to the local systems of oversight, quality assurance and investigation and penalties. Quality assurance may also be undertaken in a third country provided the country's audit framework has been assessed as equivalent under article 46 i.e. with respect to public oversight, quality assurance and investigations and penalties37. Equivalence will be determined by Commission implementing act, or by the Member State authority as long as the Commission has not acted38.

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[30] Article 23. DIRECTIVE 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

[31] Commission Regulation (EC) No 1569/2007 of 21 December 2007, n. 29

[32] Article 2, Commission Regulation (EC) No 1569/2007 of 21 December 2007, n. 29

[33] Article 41, Directive 2013/34/EU of 26 June 2013, n.24

[34] Commission implementing decision (EU) 2016/1910 of 28 October 2016 on the equivalence of the reporting requirements of certain third countries on payments to governments to the requirements of Chapter 10 of Directive 2013/34/EU of the European Parliament and of the Council, on the basis of the article 41 and 43 of directive 2013/34. [35] Article 26(1) Directive 2006/43/EC of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

[36] See article 26 (4); article 9, Regulation (EU) No 537/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC.

[37] Equivalence decision were adopted by the Commission relating to Guernsey, Indonesia, Isle of Man, Jersey, Malaysia, Taiwan, Thailand , Australia, Canada, China, Japan, Korea, Singapore, Africa, Switzerland. Provisional: Bermuda, Cayman Islands, Egypt, Russia.

[38] Article 46(2) Directive 2006/43/EC of 17 May 2006, n 34

Different conditions apply to audit *firms,* such as the requirements that the members of their management should by majority meet requirements equivalent to the directive requirements and apply the international audit standards and other operational requirements, the equivalence of which will be determined in Commission implementing acts, while delegated acts will determine general equivalence criteria for assessing audits.

These rather strict conditions may be set aside – in whole or in part - for third country auditors who are subject to equivalent systems of oversight, quality assurance and investigation and penalties in their home state, for which the Commission has received powers to assess their equivalence. Reciprocity is a precondition. As long as this assessment has not taken place, the national authorities may assess the equivalence. On most of these points[39], the Commission may also adopt general equivalence criteria[40].

The Commission has adopted many equivalence decision relating to auditors[41]

C. Financial disclosures by publicly traded companies ("Transparency") 2004/109

On the basis of directive 2004/109, securities market supervisors may exempt third country issuers from certain disclosure requirements[42] laid down in the transparency directive provided that the third country has whether adopted equivalent requirements or that the issuer complies with the requirement the authority considers equivalent. In both cases the member state authority decides whether the issuers comply with the third country information requirements which have been declared equivalent by the Commission. This approach also applies to accounting standards, for which the Commission "shall" adopt equivalence decisions, or a transitory regime if there was no equivalence[43]. In addition, the Commission may adopt general equivalence criteria applicable to several third country jurisdictions[44]. The Commission has not adopted equivalence decisions on the basis of the transparency directive.

D. Shareholder Rights Directive

The amending Shareholder Rights Directive[45] contains some provisions declared applicable to third country parties, especially financial intermediaries or proxy advisors. Third country intermediaries should report to the companies the identity of the holders of shares deposited on their books, provided these are companies registered in the EU and traded on EU regulated markets[46]. The rule is applicable on an extraterritorial basis, and is likely to raise issues of enforceability[47]. A comparable rule applies to third country proxy advisors, which

[39] i.e. public oversight, quality assurance and investigation and penalties. These criteria shall be used by national authorities acting in this fields, in the absence of a Commission individual equivalence decision.
[40] Article 46 of directive 2006/43/EC, n.34; in article 47(3) of directive 2006/43/EC, this is extended to the Commission's power to recognise third country authorities as being "adequate to cooperate with the competent authorities of Member States on the exchange of audit papers". On this basis equivalence decision have been adopted relating to :
Brazil, Dubai, Guernsey, Indonesia, Isle of Man, Jersey, Malaysia, South Africa, South Korea, Taiwan, - Canada, Japan and Switzerland, Australia and the USA
[42] Article 23, DIRECTIVE 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.
[43] On the basis of article 23 (4) §2 by Commission delegated act; transitional derogations can also be decided by the Commission.
[44] art 23 (4) § 3, Directive 2004/109/EC., n.39
[45] Directive (EU) 2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.
[46] The principle extends to the following rules: shareholder identification, transmission of information, facilitation of shareholder rights and transparency and non-discrimination with respect to costs.
[47] See article 3(e) of the amending directive 2017/828; article 3 (ea) expresses these doubts which might lead to a political process and a negotiation with the third country. When reporting, these intermediaries will have to follow the requirements to be adopted by the Commission on the format of information, the security and interoperability requirements and the deadlines for transmission: article 3 a directive 2017/828. However, on the basis of the standards to

will be held to the obligations imposed by the directive, but only if they have an establishment within the Union[48]. The directive contains no equivalence requirements on this point.

As to the effect of this directive amending the Shareholder Rights directive, it will depend whether the amending directive will become binding on June 10, 2019, or after the Brexit date. As a consequence, the subjects dealt with in this directive will not further be affected by EU law.

E. Prospectus

Due to the recent adoption of a new regulation on prospectuses to be published upon the public issue of securities or their admission to trading on a regulation market, two regimes have to analysed; the previous one, laid down in directive 2003/71, still in force at the moment of writing[49], and the recently published regulation[50], applicable from 21st July 2019. The latter date is important as by then the UK will already have left the EU.

With respect to the prospectuses to be used for the public issues or listing of securities to regulated markets, the prospectus directive 2003/71 gives the power to approve a prospectus from a third country issuer to the Member State authority where the transaction – issue or listing - will take place. This authority will verify whether the prospectus has been drawn up in accordance with standards set by international securities commission organisations, including the IOSCO disclosure standards. However, the Commission 'may" adopt an implementing measure stating that a specific third country "ensures equivalence of prospectuses" by reason of its national law or practices based on international standards including IOSCO standards[51]. The Commission "shall" further adopt implementing measures relating to concept of "equivalence" to be applied for granting exemptions to operations by third country issuers[52]. The Commission has adopted an implementing regulation relating to the information to be contained in the prospectus generally, including in prospectuses used in the EU, where applicable taking into account the requirements enacted in third countries. There are no country specific Commission decisions on third country equivalence of prospectus information. The equivalence assessment is part of the approval process and therefore in the remit of the national supervisor approving the prospectus, complying with the implementing regulation.

In addition, the regulation has granted equivalence to the consolidated accounts established according to the GAAP as applied in certain specific countries[53]
The 2010 amending directive contains a provision granting an exception from the prospectus obligation for issues even of companies located outside the Union when the issue relates to stock option plan for directors and employees. In this case the exemption is conditional on the Commission decision that the third country market concerned is equivalent. This Commission equivalence decision "shall" refer to a certain number of conditions of equivalence relating to the legal and supervisory framework of the third country, including the rules on insider trading and transparency and providing for effective supervision and enforcement. The directive further defines what conditions have to be fulfilled to consider the third country framework to be equivalent; that decision is adopted by the competent authority [54]. As several other provisions refer to this

be introduced in the Commission delegated act, communivation may be part of the contractual conditions under which securities are held by third country custodians.

[48] See article 3(j) directive 2017/828.

[49] On the basis of Directive 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC

[50] 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

[51] Article 20, Prospectus Directive 2003/71/EC

[52] Article 4(3) Prospectus directive 2003/71, which constitutes the basis for the equivalence decisions .

[53] COMMISSION REGULATION (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements; COMMISSION DELEGATED REGULATION (EU) No 311/2012 of 21 December 2011 amending Regulation (EC) No 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards elements related to prospectuses and advertisements . With respect to the GAAP of Japan, the US, China, Canada and Korea. In addition, a certain number of items of the standard prospectus disclosure were declared not applicable to India.

[54] Authorisation of market, effective supervision, rules on admission period and ongoing information, market transparency and integrity.

definition of an equivalent third country framework, it seems that it is to be considered as an organic provision[55].

The 2017 regulation, adopted in the framework of the Capital Markets Union, has simplified the prospectus regime in many respects. The new regime repeats the exemption for third country issuers offering securities in the context of employee stock option plans, including in the case that the company is located in a third country[56].

According to the 2017 regulation, a facilitating allowance for third country issuers has been introduced: it allows these issuers to draw up a prospectus whether according to the EU regime, or to their home regime. In the first case, it will be approved in the EU state, the issuer becoming subject to the regulation and supervised in this host state.[57] If the prospectus has been drawn up according to the issuers' national regime, it may be approved by the EU supervisor provided the requirements are equivalent, and a cooperation agreement has been concluded among supervisors concerned. The Commission has received the power to establish general equivalence criteria and on the basis of these it "may" adopt an implementing decision declaring the third country information requirements equivalent. This would hen allow issuers from that jurisdiction to freely issue on the EU markets. Cooperation arrangements will (" shall") be concluded among supervisors in both jurisdictions involved.

The prospectus regime grants a wide freedom of decision to the national supervisor concerned. Under the regime, once a framework has been adopted, issuers may freely issue.

For offerings of securities under the private placement regime, see further under Mifir[58]

F. credit rating agencies

The regulatory regime applicable to credit ratings agencies was introduced immediately after the first phase of the financial crisis. The extraterritorial issue was particularly difficult to solve as the three major, worldwide agencies were headquartered in the US and offered ratings in the EU which often were not produced there.
The directive is based on the idea that EU financial institutions may only use ratings that have been issued by agencies established outside the EU if the rating has been whether endorsed by an EU agency or has been issued by a third country agency certified as subject to an equivalent regime.

The recognition of these foreign ratings was achieved through the so-called "endorsement" procedure, for which agencies with entities established in the EU could qualify as issuers of ratings after having been registered with ESMA. These ratings were then considered ratings by an EU rating agency. Other agencies could opt for a registration process[59].
According to the "endorsement" conditions, the rating developed by a third country rating agency can be endorsed[60] for use by its EU registered establishment if (i) the rating was developed in the group, often in the US; (ii) the head office meets requirements which are "at least as stringent" as the requirements of the EU regulation, (iii) that ESMA is able to assess and monitor compliance in the third country with these requirements (iv) that ESMA concludes a cooperation arrangement with that home state supervisor[61]. A

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[55] See point 4 of Directive 2010/73/EU of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market; see about this analysis, part III (c).
[56] See Recital 17, Regulation (EU) 2017/1129, n.50
[57] Article 29, Regulation (EU) 2017/1129 This is the "home member state" as defined according to a regulatory technique relating a foreign issuer to an EU state, normally the state in which it originally issued securities; see article 2(1)(m)(iii)
[58] See 8(b), and article 46 Mifir e.s. See : Moloney, N., Brexit, the EU and Its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market, LSE Law, Society and Economy Working Papers 5/2017 , SSRN 2929229
p. 29 referring to private placements mainly in France and Germany
[59] COMMISSION DELEGATED REGULATION (EU) No 449/2012 of 21 March 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to regulatory technical standards on information for registration and certification of credit rating agencies.
[60] ESMA, Update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation, Consultation, 4 April 2017, ESMA33-9-159
.https://www.esma.europa.eu/sites/default/files/library/esma33-9-159_consultation_paper_update_of_the_guidelines_on_the_application_of_the_endorsement_regime_under_article_43_of_the_credit_rating_agencies_regulation.pdf
[61] Article 4(3) Regulation 1060/ 2009 as modified by regulation 513/2011, where coordination of supervisory activities has

specific condition referring to the prevention of interference by the foreign state is not applicable to agencies from states that were declared equivalent[62]. A formal equivalence exercise was introduced listing – in a non-exhaustive way - the main points for verification by the Commission[63]. The first exercises with the US were prepared by CESR and led to adjustments in the US regulatory system[64].

"Certification" is a regime reserved for an agency to publish ratings, although it does not have an establishment in the EU, provided the agency meets a certain number of conditions[65] and equivalence with its home state legal and supervisory system has been established. The provisions of equivalence are similar to those applicable to endorsement[66].

Originally the rating agency supervision was exercised by the national securities supervisor in the state where the agency has its registered office. However, two years later, it was decided to centralise this type of supervision in the hands of ESMA, as the national supervisory system was referred to as "not the most appropriate structure for supervising CRAs"[67].

According to the CRA regulations, equivalence is determined by a Commission decision on the basis of requirements that are "at least as stringent" as the EU ones. The 2013 regulation clarifies that the equivalence does not imply that the third country regime should have identical rules as the EU ones, but that it is sufficient that the same objectives and effects are achieved in practice[68]. Cooperation agreements will be entered into between the ESMA and the authorities in the third country. The number of countries which have been considered "equivalent" is quite considerable[69].

After Brexit, a UK based credit agency would have to apply for the endorsement regime if it has an establishment in the EU. If not, it would qualify for the "certification" regime. At present the UK regulators have not been conveyed special supervisory tasks relating to CRAs. They would have to organise themselves if the UK rating activities were to be continued and used for endorsement or certification.

G. Investment Funds : UCITS and AIFs

1. UCITS

UCITS are open-ended investment funds organised in accordance with the EU directives and regulations and located and managed in the EU. The funds and their management companies[70] enjoy the EU passport and can

been as a condition for EU registration of the CRA; see ESMA, Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Agencies Regulation No 1060/2009, Final Report, 11 May 2011, https://www.esma.europa.eu/sites/default/files/library/2015/11/esma_2011_139.pdf; The guidelines may be up for revision: ESMA , Update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation, Consultation Paper, 4 April 2017.

[62] Article 4(3) (g) Regulation 1060/ 2009, modified in article 4(6); REGULATION (EU) No 462/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies.

[63] Article 5(6); The regulation provides that these requirements should be "legally binding", initially an innovation: See E. Ferran, The UK as a Third Country Actor in EU Financial Services Regulation, Journal of Financial Regulation, 2017, 3, 40–65, at 50

[64] Equivalence decisions have been delivered with respect to: Argentina, Australia, Brazil, Canada, Hong-Kong, Japan, Mexico, Singapore, and the United States: see https://ec.europa.eu/info/sites/info/files/cra-regulation-equivalence-decisions_en.pdf

[65] The exemption regime is more liberal than in case of endorsement, taking into account the size and the nature of its business (e.g. ratings without systemic importance): article 5 (4)

[66] Compare articles 4(6) and 5(6) of regulation 1060/2009. See e.g. for the Japanese equivalence report COMMISSION DECISION of 28 September 2010 on the recognition of the legal and supervisory framework of Japan as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies.

[67] See regulation 513/2011; recital 8 and 46. "single point of entry for several legal entities"

[68] See recital 48 to the regulation (EU) No 462/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies. Originally the Commission required full "rule per rule" equivalence.

[69] Argentina, Australia, Brazil, Canada, Hong-Kong, Japan, Mexico, Singapore, US

[70] Branches of the management company will however be subject to the host jurisdiction authority as far as conduct of business and investor communications including prospectuses are concerned Recital 64 and article 17(4) of DIRECTIVE 2009/65/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

be marketed in all Member States[71]. Marketing UCITs located in another Member State should follow certain procedures relating to notification and disclosures, the manager having to be located in a Member State. Member States should ensure equal treatment and free circulation should be guaranteed: no additional provisions may be applied to UCITs from other Member States although additional requirements may be applied to its domestic UCITS.[72] Ucits should be managed and administrated in the EU: however specific functions can in part[73] be delegated to other authorised investment management entities[74], even to third country entities[75] provided in that case that cooperation between the authorities has been secured[76].The investment policy of UCITs cannot be restricted to EU assets: Ucits can invest in third country securities, e.g. investment funds, but the UCITs supervisor will to have consider whether that fund's regulation is equivalent to EU law while cooperation with that supervisor is secured[77].Similar conditions apply for investing is securities traded on foreign markets[78]. ESMA may develop RTS to ensure harmonisation as to the categories of assets in which UCITS may invest[79].

Investment funds which do not meet the EU definitions, or which originate from third countries may not avail themselves of the UCITS regime: they will qualify under the considerably more complex and restrictive Alternative Investment Fund rules(AIFs) [80]. Ucits functions, such as the investment management or depositary may be delegated to other authorised investment management entities[81], including third country entities, provided in that case that cooperation between the authorities has been secured[82]. There are no explicit equivalence conditions. The UCITS regime has been declared applicable, with modifications, to the Money Market Funds[83]. These too are confined to the EU legal area.

[71] Article 5 Directive 2009/65/EC, consolidated version; certain investments such as in other investment companies are subject to equivalent conditions with respect to supervision and investor protection, to be appreciated by the UCITs supervisory authority: article 50 (1)(e), directive 2009/65.

[72] Article 1(6) and (7) Directive 2009/65/EC,

[73] Recital 16, Directive 2009/65/EC: no letter-box entities would be accepted, effective supervision should be safeguarded and liabilities unchanged.

[74] See article 13, Directive 2009/65/EC

[75] A large number of UCITS have delegated their asset management function to London based managers, raising questions about the legal status of these funds. See de Juvigny, AIMA Global Policy & Regulatory Forum - 4 Avril 2017, AMF

[76] Article 13(1)(d). One could also mention article 7(2), according to which a percentage of the own funds can be delivered under the form of a guarantee, provided that party is subject to prudential provisions considered equivalent to EU rules as appreciated by the competent authority (article 7 (1) 2009/65/EC)

[77] Article 50 (1)(e) Directive 2009/65/EC,

[78] Which operates regularly and is recognised and open to the public provided that the choice of stock exchange or market has been approved by the competent authorities or is provided for in law or the fund rules or the instruments of incor•poration of the investment company; a specific case is the one in which an interest in a specific country cannot be acquired except through securities which do not meet that condition. Comparable conditions apply for deposits with third country banks (article50 (1) (f) Directive 2009/65/EC)

[79] Article 50 (4) Ucits directive, consolidated version

[80] Subsidiaries of UCITS are allowed as investments for specific purposes and should always be managed in the interest of the investors: Recital 48, Directive 2009/65/EC,

[81] See article 13 Directive 2009/65/EC; conditions are equivalence of the functions exercised

[82] Article 13(1)(d) Directive 2009/65/EC and Recital 16. One could also mention article 7(2), according to which a percentage of the own funds can be delivered under the form of a guarantee, provided the guarantor is subject to prudential provisions considered equivalent to EU rules as appreciated by the competent authority.

[83] See the future regulation on money market funds, 26 April 2017, PE-Cons 59/16, article 12, mentions that MMFs may hold deposits at third country bank, provided these meet the regulatory and supervisory requirements at least equivalent to the ones applicable in the Union, and this in accordance with the provision of article 107 (4) CRR 575/2013.

The delegation of the custody function is subject to a more elaborate regime[84]. The principle is that the depository will be registered in the Ucits home member state[85] and be subject to its prudential regulation and supervision. Non-EU institutions cannot act as principal depositories for UCITS, however, the directive allows to delegate certain functions to a "third party", including certain custody tasks[86], which must be an entity subject to a prudential regime and supervision, and the UCITS assets have to be clearly segregated.
Subdelegation is allowed. The main depositary remains held to strict liability for the assets under custody and this covers the assets held by a third party under the delegation system[87].

After Brexit, UK investment funds and management companies registered in the UK will lose their EU status, and will not be allowed to manage UCITs or to market their securities to the retail investors, but only by way of private placement, only addressed to professional clients[88]. Advertising will not be allowed. Negotiations for these securities which are offered on an ongoing basis may have to be terminated. Ucits and their management companies may consider to apply for a new registration conforming to all conditions imposed by EU directives or regulations, especially by establishing a UCITs management company within the EU[89].
Otherwise they will be qualified as non-EU AIFs managed by a third country AIFMD.

2. *Alternative Investment Funds (AIFs)*

The AIFM regime is based on the regulation of the investment manager, and indirectly of the funds he manages or offers for sale. Only authorised AIFMs are entitled to manage AIFs[90]. EU AIFMs have to be authorised in their home state, become subject to that supervisor's authority. Unless the Member state decides differently AIFs cannot only be marketed to professional investors[91]. The EU- AIFMs can manage and market both EU and non-EU AIFs complying with all the requirements of the directive, the latter being applied to the non-EU AIFs where applicable[92]. In the latter case, there is no express condition relating to supervision by the home state of the non-EU AIF, but the Commission will adopt a delegated act dealing with the cooperation arrangements including exchange of information, for which ESMA will adopt further guidelines. When distribution takes place under a passport regime, the other member states where the AIFs are marketed can object and submit their arguments to the ESMA conflict resolution procedure[93] .

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[84] See: Directive 2014/91/EU of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions; see further Commission delegated regulation (EU) 2016/438 of 17 December 2015 supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries

[85] If this is not the case, an agreement on the information to be made available to the management company should be concluded.

[86] See article 22a of the directive 2009/65 as amended by directive 2014/91

[87] See 3.2.11, Explanatory memorandum to the delegated regulation of 17 December 2015, C (2015) 9160 final

[88] See article 46, MIFIR. The "execution only regime" (article 25(4)(a)(iv) of Mifid II would not be accessible, as the former UK UCITs would lose that status.

[89] ESMA has issued a statement on "Principles on supervisory approach to relocations from the UK", applicable to all financial activity subject to its jurisdiction, 31 May 2017, https://www.esma.europa.eu/press-news/esma-news/esma- issues-principles-supervisory-approach-relocations-uk. The risk of evasion and use of letter box companies is especially addressed. Some UCITS duplicate the asset management strategy developed by a foreign equivalent fund, managed by the same asset management group. The ESMA Principles would be fully relevant here. Outsourcing should in same cases be treated the same way.

[90] Smaller AIFMs managing not more than 100 million are merely registered and have to inform the authority where they are registered; these AIFMs may be subject to stricter rules imposed by the national authority. It is questionable whether this exemption applies to third country small AIFMs.

[91] This could also apply to non-EU AIFs

[92] Article 35 introduces a passport-like regime. For the distribution of non-EU AIFs by an EU-AIFM, the additional requirements mainly relate to the cooperation arrangements and relative framework, and the conditions for the exchange of information as laid down in ESMA guidelines, the adherence to the FATF rules and to the OECD tax model act, but there is no strict equivalence regime for the third country legal and regulatory regime. The Commission is not involved except for fixing the conditions for the cooperation arrangement in a delegated act (article 36(11), the minimum context to be determined by ESMA. ESMA will develop guidelines for the cooperation arrangements

[93] Article 19 of the ESMA regulation. The passport regime for EU-AIFMs offering Non-EU AIFs will be considered the definitive one after a three-year transition period after the Non-EU AIFMs have received a passport; see Recital 63 referring to a separate Commission decision.

The management or distribution by non-EU AIFMs of EU or non EU-AIFs is subject to more demanding conditions: the AIFM will have to fully comply with the directive and be authorised by an EU supervisory authority, the authority of the "Member State of reference " being a substitute to the home state [94]. ESMA will give advice on the assessment by this Member State. The issue of incompatibility of host and host regulatory requirements is dealt with in detail (article 37 (2).

Additional conditions relate to: the designation of a representative, the adherence to FATF rules and compliance with the OECD Model Tax Convention and the signature between home and host supervisor of cooperation arrangements for which ESMA will determine in a RTS the minimum content, to be approved by the Commission. The Commission will adopt a delegated act in which a framework for the cooperation with third countries will be laid out[95]. ESMA will further organise the exchange of information and act as a general coordinator between the two authorities and act to ensure uniform application.

Delegation of AIFM functions is an important issue in this field: it may take place for EU but also for non-EU service providers[96]. The delegation of the more sensitive functions calls for supervision: with respect to the delegation of portfolio management, risk management and the custody function, special safeguards apply. For delegation to third country service providers, and apart from the conditions applicable to delegation to an EU service provider, cooperation arrangements between the supervisors in home and host state must be ensured. The Commission "shall" adopt a delegated act further specifying the conditions for delegation, applicable to intra- and extra EU delegation. The Commission delegated act also identifies the conditions under which delegating functions will lead to the qualification that the AIFM is a letter-box company[97].The directive provides for general agreements with third countries, further detailed in the implementing regulation[98].

The depository function is strictly regulated in the AIFMD. Depositories located in third countries should be supervised entities, subject to comparable authorisation and capital requirements, to operating conditions and specific duties in terms of organisation, all formulated with reference to the comparable EU provisions.[99] The depository should have its registered office in the same state as the AIF; for non-EU AIFs he may be located in a third country, subject to certain conditions, as laid down in a Commission delegated act. On the basis of the general criteria of the directive, the Commission "shall' adopt implementing acts about the equivalence of individual countries' enforcement[100]. The depository function can be delegated to a third party under the responsibility of the first line depository. This third party should meet similar obligations as applicable to the first line custodian, e.g. on client assets segregation or prudential supervision. He will be held to the same strict liability[101], except for the cases provided in the directive[102]

In some circumstances, the subdepository can be located in a third country when the law of that country requires a local depository: this depository should meet the requirements of the directive[103], and if that is not possible, the first depository could select a custodian but "only to the extent required by the law of the third country" [104]. Further subdelegation is allowed respecting the same conditions. For some- unclear - reasons, securities settlement systems will not be considered for legally valid delegation of the depository function.

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[94] This EU authority is the one referred to by the notion of the "Member state of reference", a construct allowing to technically relate the AIFM to one EU supervisor. Article 37(3)(4) AIFMD. Special provisions apply for third country regulations for which no equivalent provisions exist in the EU: article 37(2), AIFMD. See: COMMISSION IMPLEMENTING REGULATION (EU) No 448/2013 of 15 May 2013 establishing a procedure for determining the Member State of reference of a non-EU AIFM pursuant to Directive 2011/61/EU of the European Parliament and of the Council

[95] Article 37 (7)(d) and (15) AIFMD, relating to the three-party cooperation arrangements, including the member state of reference

[96] See article 20, AIFMD; see regulation 231/2013, article 75 e.s. regulating the delegation in detail. The ESAs have adopted elaborate "opinions" on the limits to the use of delegation for EU firms in favor of their UK affiliates, and this in order to limit circumvention of EU regulations: see e.g.: ESMA issues principles on supervisory approach to relocations from the UK, 31 May 2017, ESMA 71-99-469

[97] Article 20 (7) AIFMD; see for the criteria: article 82, regulation 231/2013

[98] Article 113, 213/2013

[99] See art 83 tot 102 Regulation 213/2013

[100] article 21 (6) AIFMD; no decisions have been adopted.

[101] This responsibility is one for the restitution of the lost security, hence an objective liability.

[102] See article 21(12) and (13) AIFMD for the principle, and article 21 (14) for the exception for third country depositories; article 102, regulation 231/2013

[103] Recital 95 AIFMD; See article 84, regulation 231/2013

[104] Article 20(11)

A Commission delegated act will further specify the conditions or consequences relating to delegation of the depository function.

Up to now the Commission has not adopted individual "equivalence" decisions, although one has been in preparation by way of a cooperation agreement at the level of ESMA relating to AIFMs located in twelve third countries. As a consequence, non-EU AIFM can only offer their AIFs to eligible and professional investors on a private placement basis[105].

Brexit will strongly affect the status of the former UK AIFM. As third country AIFMs they have to apply for new authorisation and obtain access to the different Member States, probably under a future passporting regime, while agreements with the UK supervisors will have to be concluded by all EU supervisors where AIFM are active, whether for the distribution of their securities or as managers.

The situation after Brexit would be different depending on the location of the AIFM or the AIF in the EU: the establishment of a AIFM in an EU Member State – e.g. in Dublin or in Luxembourg - would open access to the other EU markets, for distribution of EU AIFs, or under certain conditions for non-EU AIFs as well. Delegation by a newly created EU-AIF(M) by the former UK asset managers and custodians may be a simple approach, but is likely to raise objections. Reciprocity has been suggested[106].Third country AIFMs would not obtain access to the EU markets, except by way of the private placement exception. The adoption of an "equivalence" decision by the Commission is likely to be postponed due to the changed position of the UK[107].

The "private placement regime" of non-EU AIFs would continue to apply allowing for offering these AIFs without equivalence requirement, but applying almost the entire AIFMD regime, and provided cooperation arrangements have been agreed[108].

The Commission has not established a third country equivalence regulation or decision.

ESMA has adopted principles calling the attention of national authorities to the strict application of the applicable EU rules, and assessing the justification for the establishment of a new management company or a UCITS in an EU Member State[109]. The ESMA principles stated that the UK parent company's decision should not result in the UCITS management company becoming a "letter box" company[110].

H. Financial Institutions

In this section, the conditions for establishing credit institutions and investment firms are analysed. Before entering into the details of the regulation it is important to mention that third country firms can establish themselves whether as subsidiaries or as branches. As subsidiaries, the third country firms will have to conform to all the rules applicable to local firms, although there will be some indirect differences due to their activities in relation to their third country parent. The EU regulation contains no provisions on the right of third country firms to establish a subsidiary; this matter would be dealt with in international treaties and is otherwise left to the decision of each Member State.

[105] See for details: IRSG, p. 75 and the case study p. 104. E. Ferran, n.61 at 55

[105] see about this exception infra on the basis of article 46, Mifir. The exception will come to an end once the Commission decision has been adopted: article 68(6) AIFMD.

[106] Benoît de Juvigny, n.75

[107] See Preamble (4) This act should intervene 2 years of the Directive coming into effect.

[108] Article 36 and 42 AIFMD; references are made to FATF rules and the OECD tax code, and cooperation arrangements to be developed by the Commission. But there are no equivalence decisions.

[109] See: ESMA issues principles on supervisory approach to relocations from the UK, 31 May 2017, ESMA71-99-469

[110] Article 13(2) Recital 16. Directive 2009/65. A similar position has been adopted by the ECB, see S. Lautenschläger Caution should be the life of banking, Speech 22 March 2017.; Sabine Lautenschläger, "The clock is ticking" speech 16 August 2017; more generally: D. Nouy, Gaming the rules or ruling the game? – How to deal with regulatory arbitrage, speech, 5 September 2017.

As to branches, being part of the third country firm, different set of rules will apply, leaving the establishment of a branch entirely to the discretion and power to the host state.

1. *Credit institutions*

Third country credit institutions may establish themselves in the Union whether as a subsidiary – in which case the rules applicable will be the same as for local institutions – or as branches. Subject to contrary provisions in international treaties, the law of Member States may allow to refuse the establishment of a subsidiary of a third country bank on the basis of policy considerations, such as overbanking, or on the basis of the identity of the shareholders or directors. Subsidiaries of third country banking groups will have to conform to all the rules applicable to local banks, although there will be some indirect differences due to their activities in relation to their third country parent. They will enjoy the EU passport. Most banking groups have followed this approach, whether by activating their existing subsidiaries, or creating new ones.

For branches of third country banks, the situation is comparable: the authorisation to open a branch will be in the remit of the host Member State, the CRD IV only providing that Member States will not treat third country branches more favorably than those of EU established banks[111]. Branches will not enjoy the EU passport, having to limit their activity to the Member State of establishment, and being only subject to local supervision[112]. The CRD IV [113] calls on Member States to conclude agreements with third countries to agree on the identical rules for branches in all Member States. The change of branches into subsidiaries is however quite costly, in terms of additional capital, staffing, and operational needs[114]. In the future, this trend may be reinforced as under the proposed revision of CRD IV, third country banking groups with significant activities[115] in the EU through two or more third-country institutions will have to set up an intermediate holding company, or a fully authorised EU credit institution, subject to the requirement of the CRD and CRR[116]. This evolution likely to reduce if not eliminate the use of branches for these groups.

The CRR empowers the Commission to adopt implementing acts on specific subjects of banking regulation dealing with third country banks, such as the treatment of exposures on third country central banks, firms, or third country collective investment undertakings[117]. On consolidated supervision, the Council may conclude

[111] Article 47 CRD IV

[112] On the basis of article 39 Mifid II, for services, to be combined with the private placement exemption of article 46 Mifir.

[113]Recital 23 CRD IV

[114] The cost of restructuring could be as much as €15 billion, with the cost for each individual bank depending on its current geographical footprint and client focus. Amortised over 3 to 5 years, this could reduce return on equity for affected banks by 0.5 to 0.8 percentage points, a material impact. AFME, BCG, Clifford Chance, Bridging to Brexit: Insights from European SMEs, Corporates and Investors" 3 July 2017; For a comparative study: Eugenio Cerutti, Giovanni Dell'Ariccia, and Maria Soledad Martinez Peria, How Banks Go Abroad: Branches or Subsidiaries**?** World Bank Policy Research Working Paper No. 3753(2005); Moloney, n.56, 13. Ferran,n.61 p 6. Moreover , there is no regular follow up on the activity of the branches by the host state, except for collection of information; only in case of infringements can the authorisation be withdrawn: article 43, Mifid II.

[115] On the basis of 30 Bn euro assets in the EU, the group being qualified as a G-SII.

[116] Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures , 23 November 2016 , 2016/0364 (COD)

[117] Articles 107(4); 114 to 116; 132, 142, CRR. CRR based Equivalence decisions: see https://ec.europa.eu/info/sites/info/files/crr-equivalence-decisions_en.pdf . In these cases, equivalence will be determined in a Commission implementing act,. However, if no such act has been adopted before 2015, the previous regime will remain applicable, as the relevant authorities had approved them. For the list of third countries considered equivalent under the mentioned provisions, including exposures to exchanges : Australia, Brazil, Canada, China, Guernsey, Hong Kong, India, Isle of Man, Japan, Jersey, Mexico, Monaco, Saudi Arabia, Singapore, South Africa, Switzerland, USA (2014),see Commission and European Parliament, Third-country equivalence in EU banking legislation https://ec.europa.eu/info/sites/info/files/crd4-equivalence-decisions_en_0.pdf

cooperation agreements with third countries[118] . Their activity will be defined by and limited to the State where they have received their authorisation[119]. Certain reporting requirements will apply[120].

The reverse situation will present itself in the UK, where subsidiaries or branches of EU banks will not further enjoy freedom of establishment and will have to authorised by the PRA, the Prudential Regulation Authority. The branch will be considered a separate entity and have to meet requirements in terms of i.a. governance, liquidity and recovery and resolution. The UK grants exemptions to "overseas persons" beings a third country person active in the UK for certain regulated activities, with or through an authorised person, but without a permanent place of business in the UK[121]

In the future, this may change as under the proposed revision of CRD IV, third country banking groups with significant activities[122] in the EU through two or more institutions will have to set up an intermediate holding company, or a fully authorised EU credit institution, subject to the requirement of the CRD and CRR [123]. This evolution likely to reduce if not eliminate the use of branches for these groups.

2. *Investment firms*

Third country investment firms may establish themselves as subsidiaries, in which case, as separate legal entities, they will have to conform to all applicable EU rules and enjoy the freedom of establishment. They may establish branches in other Member States[124]. But if the subsidiary wants to propose products originating from its parent company, the specific rules on offering third country products will have to be followed.

Whether third country firms are allowed to offer investment services in the EU is subject to the regime which the individual Member States will have adopted. For soliciting retail or professional clients, Member State may require a branch to be established which activity will be limited to that Member State[125]. The branch will be subject to a certain number of conditions, but not to a full equivalence regime: the conditions are imposed by that Member State, and followed up but not actively supervised[126]. The conditions are formulated in the directive in general terms: home state authorisation, adherence to FATF and OECD standards, cooperation arrangement, initial capital at the branch, adherence to investor compensation scheme, exchange of information. The requirement to have sufficient initial capital seems somewhat extraordinary as it relates to a branch; it may rather refer to stable funding. On that basis, the firms will be authorised in that Member State and be subject to a series of provisions of the directive. This regime applies without a structured equivalence decision, and is entirely up to the discretion of the Member State of activity. Offering investment services without a branch would not be allowed, as this would limit the exercise of adequate supervision. In this case, a "no more favourably treatment restriction" applies.

One should remind that this quite favourable local regime is subject to the condition that the products or services on offer may also have to meet also equivalence conditions if they originate from non-EU jurisdictions: if the subsidiary wants to propose products originating from its parent company, the specific rules on offering third country products will have to be followed.

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[118] Article 48 CRD IV to be dealt with in Council decisions for negotiation with the third country; article 127 CRD IV and article 18, Financial conglomerates directive 2002/87/EC of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate; no decisions on the basis of the conglomerates directive have been reported. CRD IV based equivalence decisions: see https://ec.europa.eu/info/sites/info/files/crd4-equivalence-decisions_en_0.pdf

[119] The reference to the "List of activities subject to mutual recognition". Annex I to CRD 4 is not applicable.

[120] See: http://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2013_484

[121] See FCA, Handbook, PERG 5.12 Link between activities and the United Kingdom, https://www.handbook.fca.org.uk/handbook/PERG/5/12.html See for further details ISRG, The EU's third country regimes and alternatives to passporting, 23 January 2017, at 10.12. Norton Rose Fulbright, Examining Regulatory Equivalence, 12 January 2017 *p 13*

[122] On the basis of 30 Bn euro assets in the EU, the group being qualified as a G-SII.

[123] There is no regular follow up on the activity of the branches by the host state, except for collection of information; only in case of infringements can the authorisation be withdrawn: article 43, Mifid II.

[124] Article 6(3). Mifid II.

[125] Article 39, Mifid II

[126] The Member state will verify whether its conditions for establishment are fulfilled.

For the more professional side of the investment activity, this regime was considered too restrictive. Mifid II has to be read on the background of the more liberal regime in Mifir, which is limited to professional clients and eligible counterparties but may apply Europe wide, provided an equivalence decision has been adopted by the Commission.

With respect to the offering of investment services to professional clients and eligible counterparties (often referred to as the "private placement" regime) third country firms may extend their activity throughout the EU, without the necessary establishment of a branch if the legal and supervisory regime to which they are subject has been declared 'effectively equivalent' in a Commission decision[127]. The firm will be registered with ESMA, but is not further subject to its supervision. The registration can only be granted if the third country firm originates from a jurisdiction that has been considered "effectively equivalent" in a Commission decision, based on the criteria mentioned in the regulation[128].

ESMA will negotiate cooperation arrangements with the third county jurisdictions, providing for the exchange of information on the firm or its branches and related to the applicable obligations. ESMA can withdraw the authorisation in case of serious infringements. This activity may be undertaken without establishing a branch. But if the firm has validly established a branch in a Member State, it may use this branch for offering the same private placement services throughout the Union, under the regime of the local branch[129]. As that branch is subject to light touch supervision by the authority of the state where it is established, it will be subject to its home state supervision. ESMA as the EU supervisor will organise the exchange of information, and agree to alert the home supervisor in case the firm act in breach of its conditions of establishment, or of "the other law to which it is obliged to adhere"[130]. ESMA may withdraw the registration if the third country authority abstains from taking appropriate measures.

When a third country investment firm wants to cover several EU markets, it can act by way of provision of services or by establishing a branch, but in the last case the third country should meet the equivalence requirement which the Commission "may" adopt[131]. This limited form of passporting is restricted to the defined investment services and to eligible counterparties and professional clients. As no equivalence decisions have yet been adopted, this will in principle prohibit this type of activity to third country investment firms. However, by way of a transitional measure, the Regulation provides that in case no equivalence regime is adopted, or is no longer in effect, third country firms may further be active in the territory of the member state of its registration, but then limited to the applicable national regime[132].

Third country firms may respond to genuine service requests from investors, acting on their own initiative, as this is not regarded as a provision of services by third country branches[133]. In that case, the Mifir regulation will not apply and the service will be deemed not to have been rendered in the Union[134]. To avoid circumvention, the regulation provides that the service has to remain limited to the requested service and activity, and should not allow the firm to solicit demands or market other products[135]. As this activity is considered not taking place in the EU[136], the rules on "product intervention" would not be applicable[137]. This exception may be important

[127] Article 47 Mifir. The firm's right to further offer its services as before will continue to apply until three years after the equivalence decisions: article 54 (1) Mifir. The equivalence regime will be submitted to the European Securities Committee (regulation 2001/528/EC), "a body for reflection, debate and advice for the Commission in the field of securities" composed of Member State representatives. ESMA is obviously not involved

[128] Article 47 (1) Mifir. In addition, the third country firm will commit to submit disputes to the courts or to an arbitration tribunal in the host state: article 46 (6) Mifir

[129] Combination of articles 39 Mifid II and 47(3) Mifir.

[130] Article 47(2) Mifir

[131] Article 46 Mifir where it is clarified that this decision is a precondition to start activity.

[132] Article 46 (4) 5th § Mifir. In this case it seems likely that the requirement to establish a branch, according to Mifid II, article 39 (1), would be applicable.

[133] Article 42 Mifid II; the "reverse solicitation" exception benefits both retail investors and professional clients.

[134] See Recital 111, Mifid II

[135] See N. Moloney, n 56, p 13, referring to "reverse solicitation"., Norton Rose Fulbright, n.121, *p. 12.* M Arnold, 'Banks Study Loopholes to Enable UK Branches to sell to EU Clients,' Financial Times, 2 February 2017 mentions at least four techniques which could be used as loopholes. Some supervisors – the ECB i.e. -have already stated that they intend to closely supervise this condition; see n.106-107

[136] Recital 43 Mifid II, article 46, Mifir,

[137] Article 40 to 42, Mifid II. The 2017, Prospectus regulation (EU) 2017/828 of 17 May 2017 contains a similar choice for the third country regulatory regime; see n. 150

for the reception of "execution only" orders which are to be merely executed in a third country's market: the third country market is to be considered equivalent to a "regulated market"[138] to be defined according to the criteria of the prospectus directive[139]. These are cases in which the need for investor protection according to the regulation are not considered a high priority.

The decision to establish a local branch of an investment firm is entirely in the hands of the host authority, who can therefore limit access to its territory or limit its activities. This regime especially calls for cooperation agreements between the two supervisory authorities involved.

After Brexit, UK firms are likely to establish subsidiaries in the most attractive financial centres in the EU, granting them full access to the EU. Operating through branches, or by freedom of services would be preferred for cost reasons. Until the Commission adopts equivalence decisions, these branches should remain confined to the local market in which they are established, and could engage in the private placement activities if allowed by that member State.

Some flexibility would be offered by "reverse solicitation" referring to the case where financial services are delivered at the exclusive request of the counterparty of the bank or investment firms[140]..

I. Access to Securities markets

The definition of an equivalent regulated market is important as EU investment firms are obliged to execute trades on EU recognised trading venues or on third country trading venues assessed as equivalent [141]. This obligation applies to equity[142] and derivatives admitted to trading and aims at transparent price discovery[143]. It would mean that EU investment firms are not entitled to directly execute orders on a third country market unless the equivalence of that market has been established[144]. The provision equally applies to "execution-only" transactions[145]. Some transactions which have no impact on price discovery may be exempted on the basis of an RTS, defining the regulated market by reference to the prospectus directive[146]. However, EU investment firms could transmit order to firms which are entitled in the third country market to execute orders on that local trading facility. Conversely, third country firms are allowed to access EU regulated markets to the extent that they may engage in investment services or activities or meet certain other conditions[147].
There are no equivalence conditions for access to the EU markets [148].

The Commission has not adopted specific equivalence decisions for equity markets. However, in both these cases, equivalence for third country trading markets may be determined by reference to the "organic" equivalence provision laid down in the prospectus directive 2003/71, as amended by directive 2010/ 73. In that provision, the four conditions for considering a market as equivalent are laid down, but it is unclear

[138] Article 25(4)(a) Mifid II
[139] See Directive 2003/71, amended by Directive 2010/73, exempting issuers of third countries from the disclosure obligations, if adequate information is available, and provided a Commission equivalence decision has been adopted relating to the third country's market (see article 24 a, directive 2010/73). The conditions have been laid down in the directive 2010/73, n. 52.
[140] See for an analysis: Norton Rose Fulbright, n.121, p 12 -13 referring to the limitations of this praxis
[141] Article 23(1) and 28 (1)(d) Mifir, referring to regulated markets, MTFs, systematic internalisers or third country trading venues
[142] see article 23 Mifir, referring to the prospectus directive as amended by Directive 2010, and to be further detailed in an equivalence decision of the Commission (article 23(3). It is unclear from the latter provision to what extent the definition of an equivalent market is subject to a Commission decision.
[143] On the basis of article 28 Mifir.
[144] article 23 Mifir
[145] See article 25(4) Mifid 2 referring to the prospectus directive as to the criteria for equivalence of markets, see about this reference to the prospectus directive; see also: part II. 10 (c) ; sub article 13, EMIR.
[146] Article 23 (3) Mifir
[147] Article 53 Mifid II; article 47 (1) Mifir A few cases excepted, the regulations do not contain reciprocity conditions, thereby reflecting the protective function of the equivalence technique.
[148] Article 23 Mifir, making reference to article 25(4)(a) of Mifid II.

whether the Commission could adopt an equivalence decision on that basis[149]. Although the prospectus directive will be abolished soon, this provision will be maintained[150]. It provides for mandatory equivalence ("shall") once the four conditions are fulfilled.

This example illustrates that equivalence does not only restrict the activity of third country firms in the EU, but that it may also affect EU firms dealing with third country entities, in this case trading on these countries' markets. In the absence of an equivalence decision and as no direct access will be available to EU investors, alternative venues may be organised in the EU: execution on these markets would still be subject to the best execution provisions, which have priority as being clearly designed for the protection of investors.

After Brexit, the immediate disruption in the securities markets and especially in the derivatives markets may be the strongest.[151]All parties involved will be confronted with considerable challenges[152]

It seems that the European regulators have the intention to allow access to the UK equity market.

J. Derivatives trading and clearing

1. Derivatives subject to a trading obligation

Derivatives declared subject to a trading obligation[153], can only be traded on regulated markets, on MTFs, on OTFs or on a third country trading venue[154]. The trading obligation applies to all market participants, including commercial companies, investment funds, insurance companies. It also applies to certain transactions concluded with third – country financial institutions or other third-country counterparties which would be subject to the obligation if they were established in the Union[155], or the activity of which would create significant risks in the EU[156]. The operators in these regulated markets will ensure that these derivatives are cleared through a CCP[157].

Access between trading venues and CCPs are important safeguards for the efficient functioning of the markets on an international basis. If one of these belongs to a third country, access will only be granted if the third country has been considered equivalent in a Commission decision. This relates first to markets where tradeable derivatives must be traded: when these markets are third country markets, the regulatory requirement will only be met if the Commission has adopted a decision providing that market to be

[149] The difficulty relates to the question whether the equivalence decision would only apply to the subject mentioned in (e) of the preceding paragraph, i.e. relating to securities offered to employees and directors or has a broader meaning. Literally, the first alternative is the most convincing. For this Commission, this is a matter on which it "shall" act.
[150] Article 44(3) of the Prospectus Regulation 2017 states "Reference to the third and the fourth subparagraphs of Article 4(1) of Directive 2003/71/EC in the second subparagraph of point (a) of Article 25(4) of Directive 2014/65/EU shall continue to apply for the purpose of defining the notion of equivalent third-country market under Directive 2014/65/EU"
[151] See the analysis by AFME, BCG, Clifford Chance, Bridging to Brexit: Insights from European SMEs, Corporates and Investors" 3 July 2017
[152] AFME, Implementing Brexit: Practical challenges for wholesale banking in adapting to the new environment, pointing i.a. to the challenges for the supervisory authorities, April 2017
[153] According to article 28, Mifir, referring to the decisions adopted under article 32; clearing is imposed by articles 4 a.s. of EMIR.
[154] These have been declared subject to the trading obligation by virtue of article 28 Mifir. The obligation only applies to trades between financial counterparties and some non-0financial counterparties as referred to in article 10(1)(b) EMIR.
[155] Article 29 (3) provides for RTS relating to this clearing obligation. Also: article 8, EMIR. There is however no equivalence requirement as to this aspect. There are 17 CCPs in the EU, https://www.esma.europa.eu/sites/default/files/library/ccps_authorised_under_emir.pdf
[156] Commission delegated regulation (EU) No 285/2014 of 13 February 2014 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on direct, substantial and foreseeable effect of contracts within the Union and to prevent the evasion of rules and obligations
[157] Article 29 (3) provides for RTS relating to this clearing obligation. Also, article 8, EMIR. There is however no equivalence requirement as to this aspect. There are 17 CCPs in the EU, https://www.esma.europa.eu/sites/default/files/library/ccps_authorised_under_emir.pdf

"effectively equivalent[158]. A similar rule applies to CCPs, on which securities have to be cleared: the access to the EU CCPs or trading venues is limited to third countries venues or CCPs[159] which have been declared "effectively equivalent"[160].

The Commission "may" determine whether that country's legal and supervisory regime is effectively equivalent and is subject to effective supervision and enforcement[161]. In order to obtain access rights for third country trading venues or CCPs to their EU counterparts, the Commission may adopt a similar decision relating to the equivalence of the third country's legal and supervisory framework[162]. The Commission has adopted a series of implementing decisions dealing with the recognition of third country trading markets[163].

Unless a decision has been adopted stating that the UK trading venues for derivatives are considered equivalent, that part of the derivatives activity would be off limits for EU intermediaries.

Under transitional provisions a three-year transitional regime might allow third-country firms to continue to provide services according to the national regimes of the Member States; however the three year period only starts after the Commission has adopted an equivalence regime for the legal and supervisory arrangements relating to that third country[164].

2. OTC derivatives cleared through a CCP

Derivatives not qualifying for the trading requirement will be considered OTC derivatives[165]. Their development– including their contractual conditions - remains largely contractual, the ISDA master agreement being the most frequently followed default framework. The considerable financial risks these derivatives entail has led to a system of safeguards, partly consisting of the obligation to clear these contracts through a Central Counterparty or CCP. The CCP acts as a buyer against the sellers of the derivative and as a seller against the buyers, thereby replacing the risk for both parties by a risk on the CCP, at least for the part of the transaction that could not be netted in the CCP's multilateral netting process[166]. The resulting liabilities for the CCP are very considerable and are covered by different means but especially by collateral or margin, constituted by the clearing members, and adaptable depending on the changing value of the underlying risk[167].

The clearing takes place whether on an EU CCP, or on a third country CCP as recognised by ESMA[168]. The recognition of a third country CCP must comply with the conditions which are equivalent to those applicable to EU CCPs, as determined by the Commission in an implementing act[169]. ESMA will establish cooperation arrangements and RTS specifying the information to be provided to ESMA with respect to the recognition.

Normally it is up to the financial counterparty to decide on which platform the derivative will be cleared. For an EU intermediary, clearing on a third country CCP is only possible when that CCP is recognised by ESMA, acting on the basis of the Commission implementing equivalence decision. Mifir contains a "simplification mechanism to avoid duplicative or conflicting rules": on the basis of a third-country equivalence decision, the Commission could adopt a decision according to which the clearing obligation is considered to be met if only

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[158] Article 28 Mifir
[159] Under article 25 EMIR
[160] Article 25, EMIR, Article 38 Mifir in which case an equivalence decision has to be adopted by the Commission (article 38(3); Here again the equivalence criteria refer to article28(4) of Mifir, and indirectly to the prospectus directive.
[161] Mifir, article 28(4) lists 5 criteria for declaring the third country-rime effectively equivalent: authorization, admission process, ongoing information transparency and market abuse rules
[162] Article 38, Mifir, providing for reciprocity.
[163] The Commission has adopted equivalence decisions with respect to regulated markets in Australia, Canada, Japan, Singapore and the US.
[164] Article 54(1) Mifir.
[165] The definition of OTC derivative is amended by article 32 REGULATION (EU) 2015/2365 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012, clarifying that it also applies to third country execution provided that the market is recognised as equivalent; equivalence will be decided by Commission implementing acts.
[166] Or by compression mechanisms: see article 31 Mifir.
[167] See for these safeguards, articles 41 e.s. EMIR.
[168] The Commission has adopted 22 equivalence decisions relating to third country CCPs. https://ec.europa.eu/info/sites/info/files/emir-equivalence-decisions_en.pdf. The scope of the different decisions may be different and include not only CCPs.
[169] See: article 25(6) EMIR, stating that the Commission "may" adopt an equivalence decision, but making its substance mandatory.

one of the counterparties is established in that third country[170]. This would allow CCP clearing in the UK for most EU derivatives intermediaries provided one of the counterparties is an EU firm.

Conversely, EU clearing at the request of a third country trading venue or CCP is only possible if the applicant has met the conditions of equivalence decision adopted by the Commission and has met the conditions for access to EU clearing as mentioned in the regulation[171].

The status of third country CCPs has been one of the main examples where the Commission has consistently adopted equivalence decisions: decisions for the clearing of EU derivatives in third countries through equivalent third country CCPs, has been adopted with respect to numerous jurisdictions[172]. In addition, cooperation arrangements have been concluded between ESMA and the third country supervisory authorities.

In the absence of a Commission decision, the UK, as third country state, would technically not further qualify for this regime at the moment of leaving the EU. As a consequence, these derivatives would have to be cleared on EU CCPs, if they are presented for clearing by the regulated market or the CCP. This condition would imply that the Commission has adopted a decision on equivalence of the UK CCP or market, including meeting the conditions relating to benchmarks data. EU CCPs would have to organise the clearing facilities for the large volumes that would be presented for clearing, and which are not available today[173]. Moreover, by dividing the market over several CPPs, the advantages of netting the respective positions would be considerably lost. The advantage of a possible common or regulatory legal basis should also be mentioned. UK intermediaries would have to clear through clearing members admitted to clear on the EU CCP.

It was proposed to obtain recognition that the UK would organise a derivatives regime that fully meets the requirements of the different directives and regulations, on which derivatives qualifying to EU status could be traded and cleared [174]. It is unclear whether that approach would eliminate the need for recognition of equivalence, as the legal basis would be different and the jurisdictional guarantees would not be available.

Derivatives which are cleared through a recognised CCP – referred to as a QCCP, located inside or outside the EU - are subject to a favourable treatment in terms of own funds for the banks involved; the risk weight is limited to 2% of the exposure values, while those that have not been so cleared will be taxed 40 times more[175]. In the case that the UK CCPs would not further be recognised, this would exclude EU banks to clear through these CCPs. Solutions have been suggested; clearing on a non-recognised third country CCP through third country clearing members has been proposed. Dealing with the existing positions and transferring them to a recognised CCP would cause considerable stress. Extending the present recognition regime may therefore be a more valid alternative[176]

ESMA will develop RTS identifying the contracts subject to the trading obligation of third country institutions[177]. On clearing through a CCP, ESMA will develop a regulatory technical standards(RTS) dealing with the conditions according to which CCPs will be able to process these derivatives.

With respect to euro-denominated derivatives, the issue whether these can be cleared though a UK facility has stirred concerns from the European monetary and supervisory authorities,[178]

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170 Article 33(3) Mifir

171 Article 38, Mifir , allowing the Commission to make a finding that the third country follows an "effective equivalent system for permitting CCPs and trading venues authorised under foreign regimes access to CCPs and trading venues established in that third country". Reference is also made to the articles 35 and 36 on access rights to CCP in general. It requires reciprocity.

172 On the basis of article 25(6) requiting "equivalent legally binding requirements" Australia, Brazil, Canada, Dubai International Finance Centre (DIFC), Hong-Kong, India, Japan (commodities, financial derivatives), New Zealand, South Korea, Mexico, Singapore, South Africa, Switzerland, UAE, US (CFTC).

173 Deutsche Börse is developing an initiative to attract more derivative clearing on its Ph.Stafford, Deutsche Börse intensifies efforts to pull euro clearing from UK, 9 October 2017

174 IRSG, CCPs post-Brexit, p 10. This seems comparable to the "Parallel regulatory requirements" proposed by E. Ferran, n 61, 289

175 See article 306 CRR.; half as much for indirect clearing members.

176 See for further details: IRSG, CCPs post-Brexit, Implications for the users of financial markets in the UK and EU27, 20 February 2017.

177 Article 28 (4) Mifir. The types of contracts that qualify under this trading obligation will be further defined in an ESMA RTS, with respect to derivatives which have a substantial and direct effect in the EU; including cases aimed avoiding evasion of a provision of the Mifir.

178 See about the subject infra 10.4

3. OTC derivatives not cleared through a CCP

These derivatives as defined in article 11 Mifir, are subject to strict requirements in terms of due diligence, risk management and procedures , daily marking-to-market, capital requirements for financial counterparties, etc. Certain intragroup transactions with non-financial counterparties established in a third country will be exempted from the requirement to constitute collateral, after notification to the competent authority.

This regime applies to OTC derivatives between two third-country entities that would be subject to the regime if they were established in the Union, provided the transactions have a direct, substantial a foreseeable effect within the Union, or where such obligation is necessary to prevent evasion[179]. ESMA will monitor the application of this regime and the conditions of its application will be laid down in an RTS, to be developed by ESMA and adopted by the Commission.

On the basis of the EMIR provision on "avoidance of duplicative or conflicting rules [180] the Commission has adopted an implementing decision, stating that the legal supervisory and enforcement arrangements in the US under the supervision of the CFTC will be considered equivalent to the requirement applicable in the EU[181]

4. Trade Repositories

A comparable regime applies to the Trade Repositories located in third countries. The Commission "may" adopt an implementing act about the legal position of third country repositories[182]. In addition, the Council, acting on the recommendation of the Commission, may have signed an international agreement relating to mutual access to the data held in the TR, in a way that continuous immediate access is guaranteed. ESMA will conclude cooperation arrangement, involving the competent EU authority and the equivalent authority in the third country jurisdictions, also providing for the exchange of information and coordination of supervisory activities.

The recognition of the TR itself will be decided by ESMA and is conditioned on the Commission implementing act, the specific international agreement and the cooperation arrangements [183]. On that basis ESMA will proceed to the recognition of the third-country CCP. It can also withdraw the recognition e.g. in case of infringements. Use can be made of the Regulations' provisions for avoiding duplicative or conflicting regulation[184]. In case no trade repository is available, there will be trade reporting to ESMA[185]

Both with respect to the third country CCPs and the Trade Repositories, the procedure is very much dependent on the Commission ability to reach an agreement with the relevant third countries regarding mutual access[186], while the additional matters will be agreed in cooperation arrangements to be concluded by ESMA and the third country authorities. However, a transitional provision may allow recognition before most of the RTS have entered into force[187].
A mention should be made of the use of trade repositories- the same or different ones as under Mifir - in the context of the regulation on securities financing transactions (SFTR)

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[179] Article 11 (11) Emir
[180] Article 13, Emir
[181] Commission implementing decision 2017 / 1857 of 13 October 2017 on the recognition of the legal, supervisory and enforcement arrangements of the United States of America for derivatives transactions supervised by the Commodity Futures Trading Commission as equivalent to certain requirements of Article 11 of Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories
[182] Concerning legally binding requirements, effective supervision and enforcement, and professional secrecy.
[183] Article 77, Emir. The agreement with the US authorities does not contain a reference to the position of trade repositories: COMMISSION IMPLEMENTING DECISION (EU) 2016/377 of 15 March 2016 on the equivalence of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the Commodity Futures Trading Commission to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council.
[184] Article 33(3) Mifir.
[185] article 9(3) EMIR
[186] Article 75(2) EMIR
[187] Article 89(3) EMIR

No legal regime applicable to third country trade repository has up to now been recognised as equivalent.

As far as the post-Brexit situation is concerned, the EU trades will not further be reported to the UK trade repository, the latter has not been recognised as equivalent[188]. The Mifir provision for avoiding "duplicative or conflicting regulation"[189] may reduce the impact of the non-recognition of the regulation applicable to third country trade repositories.

5. The Commission Proposal on the Recognition of Third Country CCPs [190]

In the field of Central Clearing Counterparties for derivatives, the Commission has recently proposed some significant changes in the supervisory regime. Among the aspects of the reform, only the proposal to change the supervisory system for CCP with systemic relevance will be dealt with here. The new approach is intended to deal with third country CCPs which may have a considerable influence on the financial stability and systemic risk in countries other than the one where they are located. In fact, the proposals aim to deal with the concerns which have been formulated by the ECB and several supervisory authorities according to which the UK CCPs, which occupy a predominant position in this field, might have a considerable influence on the financial stability and systemic risk in the EU, in clear after Brexit. Risks may be transmitted due to the identity of the clearing members and other parties, or due to their impact on the position of the euro, whether through clearing euro-denominated derivatives and/or clearing in euro.

The proposal which proposes to modify EMIR in a very substantial way, distinguishes two classes of CCPs: CCPs representing a low to medium risk profile, called Tier 1 CCPs, will remain authorised under the previous regime, essentially based on the action of the national supervisors and coordination by ESMA, and the "tier 2 CCPs", which incorporate high intensity systemic risks, authorised by ESMA, and involving the central bank of issue. The classification will be made and regularly reviewed by ESMA, on the basis of criteria established by the Commission. Tier 2 CCPs located in a third country would be subject to a double regime of supervision, one in the state of origin, where they have been authorised, on top of which EU based supervision would be exercised by ESMA, acting through a newly organized internal body within ESMA, bearing the name of" Board of Supervisors in Executive Session (CCP Executive Session)[191]. Although legally still belonging to ESMA, this Board will have separate representation, own powers[192], a separate organisation and staff. Important is the participation of the central bank of issue, for the euro the ECB, as a non-voting permanent member, intervening from the angle of both its monetary policy and the operation of the payment system. The effective supervisory role will be assumed by ESMA, with co-decision – by prior consent- of the central bank of issue for matters proper to its remit. The proposal is not explicit on the relationship with the third country supervisory authorities: a key decision will be made at recognition, whereby the Commission, on a proposal by ESMA, could decide that a CCP will not be recognised if additional requirements would not sufficiently ensure financial stability in the EU[193]. The resulting decision would be that the CCP should be established in the EU[194]. If the CCP is authorized both in its state of origin and in the EU, the third country supervisory authority will be first in line, but ESMA will also have the right to require that the CCP meets certain supervisory measures[195].

Coordinating the action of both supervisory authorities will be undertaken in the "college of supervisors"[196], chaired by the head of the CCP executive session for EU CCPs. How this will apply to non-EU CCPs is not clear.

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[188] Article 77 EMIR

[189] Article 33 Mifir, see supra n. 170.

[190] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs , 13.6.2017 COM(2017) 331 final 2017/0136 (COD); OPINION OF THE EUROPEAN CENTRAL BANK of 4 October 2017 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 and Regulation (EU) No 648/2012 with regard to the procedures and authorities involved for the authorisation of central counterparties and the recognition of third country central counterparties (CON/2017/39)

[191] Article 44 a, Proposal.

[192] Article 48 a Proposal.

[193] Article 25 2 c Proposal.

[194] See Recital 33 Proposal.

[195] Such as capital requirements (article 16 Emir), organisational measures; Title IV and rules on interoperability; Title V: compliance with central bank requirements; protection of its function in monetary policy

[196] Recital 6 with reference to supervisory convergence intra EU

The new regime does not provide for an explicit equivalence regime. It starts from the assumption that the third country CCP will "comply on an ongoing basis with binding requirements which are equivalent to" those of EMIR and that the third country will effectively supervise the CCP[197]. In fact, this implies that the third country CCP will have to largely comply with EMIR[198]. Subsequent changes in the third country regulatory regime, possibly leading to unlevel playing field, should also be subject to the regulatory recognition and might lead to "derecognition" in case of divergence. The precise ambit of ESMA's action will further be defined in a Commission delegated act. ESMA should be able to rely on the home state supervision while also being in charge of the supervision of the CCP[199], effectively monitoring the activity of the CCP and this on the basis of the cooperation agreement to be concluded with the third country supervisor[200].

The involvement of the central bank of issue (i.e. the bank which currency is involved) will be extended, both as part of the supervisory structure of ESMA and in its own right, exercising supervisory powers within its remit. Certain draft decisions will be submitted to the bank[201], other will have to obtain prior consent, i.,e. when involving monetary policy tasks, and cannot be implemented if the bank opposes [202]. The ECB has proposed an amendment to its Statute conferring regulatory powers on clearing and payment system, especially on clearing systems within the Union and with third countries[203].

With respect to supervisory tools, ESMA will strive at "comparable" compliance by EU and third country CCPs[204]. ESMA is entitled to obtain all necessary information, has the right to launch investigations – the third country should be informed and could object – on-site inspections, possibly with the assistance of the third country officials, may impose fines or periodic penalty payments[205] and disclose these measures to the market, adopt different supervisory measures, and ultimately withdraw the recognition.

If ESMA, in agreement with the relevant central banks, makes a finding that the CCPs organization does not sufficiently ensure financial stability in the Union, recognition should be refused. The decision will be taken by the Commission, on the recommendation of ESMA meaning that it cannot further be used by EU located clearing members. Market disruption should be minimized. The consequence would be that firms in the EU could not further clear on the third country CCP and would have to divert their clearing to an EU located CCP.

The system of supervision as laid down in the proposed regulation constitutes an interesting innovation in the field of supervision of cross border financial activities. A few aspects are worthwhile to be mentioned. The proposed system results in a supervisory regime to be applied to a foreign entity which, although remaining subject to its own regulatory system, is superimposed by the EU on the basis of the trading activity with that entity by firms located in the EU supervisor's jurisdiction

This model constitutes an innovation in the field of cross-border financial supervision, different from models like "substitute compliance" or "enhanced equivalence ".[206] It might have found its source in the practice of the supervisory colleges, but results in a significant shift in supervisory power to the EU supervisor. Whether

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[197] Article 25(6) The Proposal contains a reciprocity requirement.
[198] Recital 36 Proposal.
[199] For the fields mentioned in article 25 2b (a) i.e. capital requirements art 16, and Title IV and V measures
[200] Article 25(6) Proposal.
[201] The central bank would be consulted on matters that may impact its monetary policy. It may also formulate additional requirements for being imposed by ESMA., e.g collateral held in a CCP, segregation requirements, liquidity arrangements, Recital 21, Proposal.
[202] Article 25 b (2) Proposal
[203] See (ECB/2017/18) proposing an amendment to the ECB statute; COMMISSION OPINION of 3 October 2017 on the Recommendation of the European Central Bank for a Decision of the European Parliament and of the Council amending Article 22 of the Statute of the European System of Central Banks and of the European Central Bank (2017/C 340/01))al
[204] Changes to models and parameters e.g. have to be approved by ESMA. This will also apply to third-country CCPs.
[205] The ECJ shall have unlimited jurisdiction for reviewing ESMA fines
[206] See S. Butcher, Brexit's enhanced equivalence isn't dead. It was never alive, EFC, 27 February 2017.
http://news.efinancialcareers.com/uk-en/275400/enhanced-equivalence-brexit
See B. Reynolds, A Template for Enhanced Equivalence, Creating a lasting relationship in Financial Services between the EU and the UK, http://www.shearman.com/~/media/Files/NewsInsights/Publications/2017/07/LNDOCS011040030v16ConsolidatedAnEquivalenceRegulationFINAL02.pdf

this scheme will be sufficient to respond to systemic risks and events remain to be further investigated, e.g. on the background of the basis of the future regulation on recovery and resolution of CCPs[207]

K. Central securities depositories

Third country CSDs may establish themselves in the EU and offer the services as defined, setting up a branch or offer their services[208]. However, if this CSD offers services relating to securities issued under the law of one of the Member States, or is setting up a branch, the CSD is subject to recognition by ESMA including the provisions on the applicable EU prudential framework. The recognition is conditioned on the Commission having adopted an implementing act[209] providing for effective equivalence of the third country legal and supervisory regime – including the CPSS-IOSCO standards, where relevant -, and providing also for reciprocity[210]. Among the usual conditions for equivalence one can mention an effective supervisory regime, but also adoption of measures to allow holders of local securities to comply with their national law. The candidate CSD should further comply with the investor CSD requirements[211] . ESMA will establish cooperation arrangements with the third country authorities, providing for the exchange of information, information on infringements and coordination or supervisory action, including on-site inspection. Recognised CSDs may be active throughout the Union. Indirect access to EU CSDs could also be obtained by establishing links, subject to the applicable conditions and authorisations under the CSDR[212].

The consequences of Brexit on the activity of the UK settlement organisation will be minimal, as the latter is mainly active in the UK even dealing with EU securities. If it has established links with EU CSDs, these will have to meet certain conditions i.a. on credit lines, concentration and liquidity risks. Agreement of the supervisory authority of the linked CSD will have to be secured. Contractual arrangements will have to contain "unambiguous choice of law' clauses" for the operation of the link[213]. Moreover, ESMA will propose an RTS with a view of securing adequate protections of the linked CSDs and their participants.

As the British securities settlement organisation is also the CSD for the Irish exchange, the question arises whether the UK CSD could further act as a CSD for Ireland, provided the UK CSD is recognised in conformity with CSDR. In that case the settlement of transactions in Irish securities – denominated in euro – will have to take place directly with the ECB payment system. Several other schemes are being considered[214].

L. The Securities Financing Transactions.

[207] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, and (EU) 2015/2365

[208] The directive provides that a CSD offering services relating to securities other than EU securities should be recognised by ESMA. See Recital 34; comp article 25(2)

[209] Article 25 (9) CSDR: 'in effect equivalent". The CSD Regulation became effective on 17 September 2014, but third country CSDs will only be able to apply for recognition within six months from the later of: (i) the date of entry into force of certain regulatory technical standards (which remain outstanding); and (ii) the adoption by the Commission of its equivalence decision. (Article 69(3) of the CSD Regulation REGULATION (EU) No 909/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012)

[210] Article 25 (9) CSDR. The Commission has not adopted any implementing act on the basis of article 25(9), CSDR. It listed the information conditions in article 48 and Annex I, of the Commission delegated regulation (EU) 2017/392 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on authorisation, supervisory and operational requirements for central securities depositories.

[211] Article 49 (1) allowing the issuer to have its securities deposited at the CSD of its choice; refusals should be motivated.

[212] See Recital 8; article 48; ESMA RTS will govern the matter, after consultation with the ESCB members.

[213] See article 48, CSDR

[214] Ireland assessing CSD options as Brexit concerns grow,http://www.euromoneyseminars.com/articles/3659827/ireland-assessing-csd-options-as-brexit-concerns-grow.html; J. Brennan, Ireland may need new central securities depository post-Brexit, 3 April 2017 https://www.irishtimes.com/business/markets/ireland-may-need-new-central-securities-depository-post-brexit-1.303534

Pursuant to a recommendation from the FSB[215], the European Union has adopted a regulation dealing with specific aspects of "securities financing transactions"[216] being according to its definition: repurchase transactions[217], securities lending or borrowing[218], buy-sell transactions and margin lending transactions. These are essential tools in the financing of the financial markets and one of its main sources of liquidity, e.g. in support of the derivatives activity and the constitution of the required margin. Not only banks, but also central banks and many other market participants such as investment funds make a very intense use of these instruments, and this for a wide range of objectives. Several provisions of the SFTR deal with the third country regime.

Third country trade repositories may offer their services to EU entities after having been recognized by ESMA. The Commission may adopt an implementing act ensuring that the third-country legal and supervisory arrangements are equivalent to the ones provided in the SFTR. In addition, the Commission implementing act will have to ensure that equivalent conditions relating to supervision, access to information and secrecy obligations.

The information so filed with a trade repository will be defined by ESMA in an RTS, in close cooperation with the European Systemic Risk Board[219]

Reporting to third-country trade repository is considered equivalent to reporting to EU trade repositories under the conditions determined in an EU implementing act providing i.a. that the legal supervisory and enforcement mechanisms are equivalent. If this would not be case, the Council should open a negotiation with that third country with a view of ensuring mutual access. Under the condition of equivalence, reporting may validly take place to the third country trade repository if one of the counterparties is established in that third country[220].

Access to EU trade repositories will be granted to third country-authorities, while EU authorities will have access to third country trade repositories. Access would be granted whether directly to the entities listed in the regulation or indirectly to ESMA, according to agreements negotiated by ESMA.

The Commission will monitor the effective implementation of the equivalence requirement and may, if needed, withdraw the recognition.

Reuse of securities deposited in a third country and subject to that law may follow formats different from the European one, essentially by a transfer from the account. These will be held valid [221].

No equivalence decision on the basis of this regulation has been adopted to date.

M. Benchmarks

The regulation on benchmarks[222] or indices provides for a framework for the development and use of indices as financial benchmarks and was introduced after the investigations undertaken with respect to the manipulation of some benchmarks used for financial transactions (Libor being the best known one). The basic principle is that

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[215] FSB Strengthening Oversight and Regulation of Shadow Banking Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos 29 August 2013

[216] Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (SFT Regulation)

[217] Consists of a transfer of assets (including securities, commodities or guaranteed claims) with a guarantee of a stock exchange which holds title to the asset,) with a repurchase commitment

[218] These are the usual repos where securities are transferred in full property or as a security interest against liquidity. A haircut may apply: see FSB, Transforming Shadow Banking into Resilient Market-based Finance .Regulatory framework for haircuts on non-centrally cleared securities financing transactions, 12 November 2015, http://www.fsb.org/wp-content/uploads/SFT_haircuts_framework.pdf.

[219] Article 4(9) SFTR

[220] See for the same rule under the derivatives regime, article 33(3) Mifir.

[221] See article 15(2) SFTR

[222] REGULATION (EU) 2016/1011 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (BMR) ; See ESMA Policy rules on Benchmarks, https://www.esma.europa.eu/policy-rules/benchmarks; Clifford Chance, The New EU Benchmarks Regulation: What You Need to Know (9 May 2016) <www.clif fordchance.com/briefings/2016/09/the_new_eu_benchmarksregulationwhatyounee.html>

benchmarks may only be developed and used if produced by a firm, called “administrator”, subject to a registration and supervisory regime in the member state where it is located[223]. The “administrator” is the producer of the benchmark and has control over it. Elaborate rules provide for his integrity and reliability, ethical and governance standards, internal control and accountability, etc. An administrator may be “authorised” if it intends to provide benchmarks. It may also be a “registered” firm, being a credit institution, and investment firm, insurance undertaking, a UCITS, etc. if it is a supervised entity intending to provide indices to be used as a benchmark. ESMA will publish the list of administrators and may in exceptional circumstances remove them from the list[224]. It has also proposed draft regulatory standards on cooperation with third countries [225]

The regulation provides for several categories of benchmarks, called for different degrees of safeguards and supervision: critical benchmarks[226], significant benchmarks, regulated data benchmarks, etc. Supervised entities may only use benchmarks provided by administrator located in the EU and included in the ESMA register[227]. The use of benchmarks provided by third country administrators is limited to benchmarks and administrator that have been included in the ESMA register. In order to be included, administrators have to meet certain conditions, as laid down in the applicable Commission equivalence decision, and have been authorised or registered in the third country of origin, and are subject to effective supervision and enforcement. The third country regime will contain equivalent requirement to the EU regulation, especially with reference to the IOSCO principles for financial benchmarks. The equivalence decision may refer to whether the third country regime as a whole, or to individual administrators or benchmarks equivalent requirement binding requirements[228]. ESMA will not exercise oversight on the third country benchmark provider, but may in case of serious infringement withdraw the registration of a third country administrator. As the benchmark regulation is still quite recent, a specific regime applies to the recognition of administrators prior to the adoption of the equivalence decision, leading to a “prior recognition” regime[229]. The assessment of the equivalence will be based on the IOSCO principles and be determined by an independent external auditor or by the supervisory authority in the third country. A “Member state of reference” system will apply[230]. The benchmark developed by that administrator can then be used by supervised entities Europe wide.

Third country benchmarks may also be used by a Union administrator or by a Union supervised entity, on the basis of an endorsement of the benchmark in the host state. This administrator should be demonstrating to its competent authority that the benchmarks meets requirements which are “at least as stringent” as the EU ones and that it has the expertise to monitor the activity of the provider of the benchmark[231].

The regulation on benchmarks will apply from January 1, 2018. Some provisions on “critical benchmarks” apply from June 30, 2016. The probability that a benchmark decision will be adopted by the Commission is considered to be remote. Also, the “prior recognition” regime will be difficult to apply as full compliance with the regulation is the hypothesis. Endorsement may offer some opening, although the requirements should be “at least as stringent” as the one in the regulation. No equivalence regulation has been adopted up to now.

III. Analysis of the equivalence regime

The meaning of equivalence in EU financial regulation refers to the recognition that a third country’s legal and regulatory system is based on the same principles as those applicable in the EU, leading to the same level of protection of investors and of ensuring financial stability. In some provisions, there is the additional mention

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[223] See: ESMA, Draft technical standards under the Benchmarks Regulation 30 March 2017, ESMA70-145-48

[224] Article 31 especially if the home supervisor does not take the necessary action: article 31, (2). The list is maintained and published by ESMA: article 36 BMR

[225] Draft regulatory technical standards on cooperation arrangements with third countries under the Benchmarks Regulation, I June 2017, ESMA 70-145-81 https://www.esma.europa.eu/sites/default/files/library/esma70-145-81_final_report_draft_rts_on_cooperation_with_third_countries_bmr_0.pdf

[226] See article 20 BMR. Additional obligations apply. See also: COMMISSION IMPLEMENTING REGULATION (EU) 2016/1368 of 11 August 2016 establishing a list of critical benchmarks used in financial markets pursuant to Regulation (EU) 2016/1011 of the European Parliament and of the Council

[227] Article 29 BMR

[228] Article 30 BMR

[229] Article 32 BMR; this administrator will be subject to most requirements of the regulation, whereby the member state of reference may rely on the assessment by and “independent external auditor” art 31(2) BMR. The Member State of reference is defined in article 31(4).

[230] Article 32(4) BMR

that the regulation is adequately supervised and that the rules are effectively enforced. As the two regulatory systems are at a similar level of proficiency, the third country firms could obtain access to EU markets on the same terms as local firms.

A. Types of equivalence

In the older regulatory instruments, equivalence was often decided by individual decision of the member state's supervisory authority, on the basis of the – often very general - criteria mentioned in the EU instrument. In these cases, there is no formal equivalence decision as it derived from the general characteristics of the third country legal regime. Sometimes reference is made to the internationally accepted standards, such as the IOSCO principles. This approach allows for considerable flexibility, as the national supervisor, directly confronted with the subject matter, could make a finding about general equivalence of the foreign legal system, and verify the outcome in his own domestic system[232]. The regulation then requires the supervisor to make a finding on the possible consequences on e.g. investor protection or financial stability, often without explicitly mentioning these objectives. In these cases, the regulation may also provide for an exemption, which in fact can be read as an implicit equivalence finding[233].

In more recent regulations, a two-step reasoning is followed: equivalence will first be determined in a generally applicable decision, to be adopted by the Commission. The equivalence is then taken for granted by the national supervisory authority upon delivering its authorisation or registration.

The Commission's formal equivalence decision is based on a detailed analysis of the third country's legal and regulatory system, aimed at determining whether the objectives as expressed in the EU regulation are equivalent to the ones laid down in the third country's regulation[234]. In some regulations, there is the explicit requirement that the third country effectively exercises adequate supervision and enforces the regulatory regime which is analysed with a view of the equivalence assessment. The core objective is very often the protection of the EU investors which will be solicited by third country service providers. But only the regulatory aspects of investor protection are included: rules on liability are generally left to the applicable legal system, and except in one or two cases, conflicts of law matter or issues of judicial review remain unmentioned. This overall approach is also followed for determining equivalence in a broader context such as that of market structures, especially in the derivatives field, where financial stability objectives prevail.

Often, the equivalence decision applies to specific aspects of the EU regulation: so e.g. are there equivalence provisions and decisions relating to the confidentiality of supervisory information which is exchanged between supervisors. In other cases, the decision refers to the entire legal and regulatory system of a third country or at least to its relevant sections, or only with respect to the subject involved, e.g. the legal regime of a foreign CCP or CSD. In these cases, equivalence will touch upon a very wide range of issues which may affect the activity of a third country entity on the domestic EU market; or it may determine the position of the EU entity as relating to a third country party (e.g. in terms of risk assessment).

Over time, the approach to equivalence has evolved: in the early cases, the Commission approach was to require that the third country system should contain regulations which are similar if not identical to the EU ones. At one time, this was formulated in quite strict limits, almost requiring a "line by line" equivalence[235]. In practice, this was not tenable and gradually the correspondence between the two legal or regulatory systems has become more and more focused on "substantive" equivalence, "effective equivalence"[236], "equivalence of

[231] See article 33 Regulation BMR

[232] E,g, whether the financial information made in the third country is generally of the same quality as in his domestic system.

[233] See e,g., article 6(5), Regulation 596/2014 MAR and the equivalence decision*:* Commission Delegated Regulation (EU) 2016/522 of 17 December 2015 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council as regards an exemption for certain third countries public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers' transactions*;* compare: the elaborate system applicable to non-EU AIFMDs for the application of equivalent rules having the same regulatory purpose (article 37 (2)(b) AIFMD) and article 37(8) on the equivalence test.)

[234] see for a description: Commission Staff Working Document, n 2, and Commission and European Parliament, Third-country equivalence in EU banking legislation, n.9

[235] This was the initial approach for the CRAs

[236] Article 47, Mifir, or having an "equivalent effect" (article 4(3) Emir.) This notion may include comparable compliance enforcement and sanctioning of the third country rules, as required in some regulations.

outcomes" of similar ideas, sometimes described as offering the same guarantees in terms of investor protection, or financial stability[237]. The more recent documents also refer to "economically equivalent"[238] or equivalence with respect to addressing a specific issue. In other cases, "at least equivalent" is used[239]. These differences may become important in cases of judicial review of equivalence decisions[240].

Over time, the conditions for equivalence have become more demanding being based on explicit conditions laid down in the regulation. A standard formulation of equivalence of a third country regulatory system relates to the existence of legally binding comparable regulatory requirements, effectiveness of compliance and enforcement through local supervisors, and same or comparable results of the third country enforcement regime. In some regulation, specific reference is made to the money laundering regime- stating that the third country should not be included in the FATF list – or that the third country complies with the standards laid down in the OECD Model Tax Convention on Income and on Capital.

Generally, there are no requirements as to the legal status of the supervisory authority, although most of the time this is supposed to be a public authority with necessary enforcement powers[241].

Equivalence is far from a uniform criterion or process: each case has to be determined on the basis of its own requirements, and formulation. It is unfortunate to no uniform formulation or procedure has been developed: this would have facilitated the development a more coherent regulatory system[242] and allow for a better integration of the world financial markets in the EU financial system. The reasons for this diversity are numerous[243].

B. The process for establishing equivalence

As mentioned in some of regulations, equivalence is decided by the supervisory authority with respect to the specific matter that is submitted for authorisation of approval. In many of the more recent matters of equivalence, a preliminary decision is adopted by the Commission, which serves as the basis for the specific authorisation or approval.

This process for determining equivalence has been described in detail by the Commission and illustrates the complexity of the exercise[244]. In a large number of decisions – 212 according to the Commission[245] - formal

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[237] See Mifir, Recital 41 referring to "similar and adequate regulatory effects and meeting the same objectives as Union law". See further the analysis in the EU-US equivalence decision for derivatives: Commission Implementing Decision (EU) 2016/377 of 15 March 2016, n.3.

[238] Mifid II, article 57

[239] Mifid II, article 88, for the professional secrecy requirements for communications between supervisors. Also CRR, article 142 (2) with respect to third country prudential and supervisory requirements as applied by a third country, allowing for a certain degree of super-equivalence or "goldplating"

[240] Equivalence decisions, especially withdrawals and even refusals to authorise may be open to judicial review by the ECJ (article 263 TFEU), or indirectly by the jurisdictions of the member States involved, for cases of inaction by the Commission.

[241] A notable exception is the takeover directive 2004/25 of 21 April 2004: article 4(1) of that directive assimilates "private bodies recognised by national law or by public authorities expressed empowered for that purpose by national law"

[242] See for two examples to the contrary: article 47 Mifir and the definition of regulated market under the prospectus directive 2003 , see n.150.

[243] See for the causes of this diversity, E. Ferran, n.61, p. 16.

[244] See: Commission Staff Working Document, EU equivalence decisions in financial services policy: an assessment, esp. Pt 3.2 "how is equivalence determined?" 27 February 2017, SWD(2017) 102, final https://ec.europa.eu/info/sites/info/files/eu-equivalence-decisions-assessment-27022017_en.pdf. See also Commission : Recognition of non-EU financial frameworks (equivalence decisions): http://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions_en#recognition-of-non-eu-regulatory-frameworks ; European Parliament, Third-country equivalence in EU banking legislation. http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf, 12 July 2017; ISRG, The EU's third country regimes and alternatives to passporting, 23 January 2017, https://www.thecityuk.com/research/the-eus-third-country-regimes-and-alternatives-to-passporting-executive-summary/ ("ISRG"), n.121

[245] See Commission overview attached to Commission Staff Working Document, EU equivalence decisions in financial services policy: an assessment, Annex 1, 27 February 2017 SWD (2017) 102 final; Commission and European Parliament,

state by state equivalence findings have been made, based on a short description of the third country regulatory system or of its provisions with respect to the specific subject[246]. The decisions take the form of a Commission "implementing decision"[247] and conclude to the equivalence of the third country's legal and regulatory regime. In other cases, the decision is only delivered after additional conditions have been met[248], or applies for a limited period of time, opening to door to revisions on the basis of stricter conditions. The European Parliament is not involved in this process, although its observers attend the Regulatory Committee, composed of Member States representatives, where the proposed decision is discussed[249].

This process is very time consuming and often constitutes a delicate exercise, as it may amount to a critical analysis of a foreign country's legal and regulatory regime; in some cases, it is fraught with solid exchanges of views. Usually the ESAs, especially ESMA, play an active role by liaising with its foreign counterpart analysing the provisions of the foreign jurisdiction and comparing these with the EU requirements, resulting in an equivalence recommendation to the Commission. The final decision belongs to the Commission: it is a unilateral decision, in which the third country is legally not involved. When the third country regulatory system does not meet the EU equivalence test, there will be further analysis[250] or discussions, the third country will even be invited to adapt its regulation, or equivalence will be refused. In other cases, equivalence is granted on a provisional basis, or for a renewable period of time[251]. If equivalence is refused there will be no formal decision by the Commission and the grounds for refusal will remain unknown to the wider public.

The equivalence decision is a unilateral Commission decision, but – as appears from the Commission description of the equivalence process[252]- one can subsume that agreement with the third country has been obtained. The supervisory authorities in the EU will then be able to authorise the businesses or the operations which have been designated in the decision. The supervisory authorities should merely verify whether equivalence applies, i.e. whether the request for a certain authorisation is within the limits of the equivalence decision, and further apply the other conditions provided for in the regulation. These conditions usually refer to the existence of a cooperation arrangement with the third country authority, information sharing, etc. It is questionable whether national authorities could refuse equivalence and hence refuse access if a third country manifestly does not meet the safeguards which equivalence is supposed to establish.

A maximum degree of equivalence will be achieved if the third country firm is held to comply with the regulation in the EU host state, notwithstanding some additional requirements imposed due to the third-country origin of the firm or of its products. The regime applicable to third country banks applying for opening a banking operation illustrates this approach, while it is followed in the field of Alternative Investment Fund Management, for non-EU AIFMDs with respect to the offering or managing or marketing EU AIFs in the

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Third-country equivalence in EU banking legislation. http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf, 12 July 2017.

[246] See eg. the Commission Implementing Decision (EU) 2016/2270 of 15 December 2016 on the equivalence of approved exchanges in Singapore in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council, where each of the relevant aspects of the Singaporean regulation are briefly analyses, leading to the recognition of three Singaporean markets.

[247] Based on Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers; see e.g. Regulation 1569/2007 on the equivalence of third country general accepted accounting standards as amended by Commission delegated regulation 2015/1605

[248] These conditions would have been included in the vetting process and before the equivalence finding is finalised.

[249] Third-country equivalence in EU banking legislation, n.9

[250] See the EU-US equivalence decision, pt 3 where it was considered that differences between the two systems could be overcome on the basis of "an assessment of the outcome of those requirements, and their adequacy to mitigate the risks that clearing members and trading venues established in the Union may be exposed to in a manner considered equivalent to the outcome of the requirements" of EMIR. See: Commission Implementing Decision 2016/1073 of 1 July 2016 on the equivalence of designated contract markets in the United States of America in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council.

[251] There are also different degrees of equivalence as to their validity: while in the financial markets, equivalence is granted without time limit, subject to revocation, adjustment, or even termination. In insurance, equivalence is granted for a limited period of time or on a provisional basis. For details see G. Bernardino, Third-Country equivalence: exchange of views with the European Commission and the European Supervisory Authorities (ESAs), speech European Parliament, 9 March 2017; for an overview of EIOPA equivalence decisions based on Solvency, II. See: n.

[252] See Commission Staff Document n. 2

Union (article 37). The latter regime is particularly demanding as additional conditions relating to the non-EU origin of the product may have to be taken into account[253].

Commission equivalence decisions are in some cases subject-specific and not country specific: this is the case with the equivalence of accounting requirements referring to accounting standards considered equivalent[254] especially on provisions on consolidated accounts for which reference is made to the IFRS as endorsed on the basis of regulation 1606/2002. This provision is applicable to all jurisdictions, and based on the accounting directive and on the transparency – financial disclosures – matters (prospectus and annual disclosures). Some countries may have kept their national GAAPs, as these were largely equivalent.

Equivalence sometimes refers to specific aspects of another, not clearly related EU regulation: where the provision of article 25 of Mifid II refers to shares being traded on a "regulated market" or on the "equivalent third country market"[255], it refers to the general equivalence criteria which have been mentioned in the prospectus directive [256]. These criteria might be included in a Commission delegated act establishing the "organisational requirements" for investment firms in general[257]. In each case, one will have to verify which items have to be compared to conclude to equivalence.

From a legistic point of view, is not always very clear how the Commission equivalence decision relates to the individual supervisory decision: normally the Commission decision should be a precondition to the supervisory decision, but this relationship is not always formulated as an explicit condition. One should presume that once an equivalence decision has been adopted, this should be binding on the authorising supervisory body even if the Commission decision has not explicitly been formulated as a pre-condition for granting access[258]. The supervisory body cannot refuse equivalence which has been adopted in a Commission decision, nor grant it if the conditions have not been met, nor impose additional conditions. In other cases, the existence of an equivalence decision is expressly formulated as a precondition for a supervisory decision[259]. This difference may be more a drafting matter, than a point of substance, but the difference may be a subject of further analysis and possibly litigation.

But what applies in case the Commission has not adopted any decision on equivalence? It is striking that in certain fields, no equivalence decisions have been adopted. According to a recent staff document from the Commission, this is the case for subjects such as: the use of a third country prospectus, transparency of

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[253] See e.g. article 35 AIFMD, according to which the home country should not be listed under the FATF requirements, and has agreed and complies with the OECD Model Tax Convention. Cooperation agreements possibly along the guidelines contained in a "common framework" will be developed in a Commission delegated act, while ESMA shall specify the procedures for the exchange of information. (article 37 AIFMD).

[254] See e.g. article 23(4) and (5) of the Transparency directive

[255] The "execution only" rule, laid down in Article 25(4) Mifid II 2014/65, relates to equivalence of certain third country markets, referring to the prospectus directive 2003/71, as amended by directive 2010/73. A Commission delegated act will further detail the conditions of application of article 25 (2 to 6), but the conditions for equivalence are not part of this delegation of power (article 25(8)Mifid II). The same approach is found in article 25(8) for the definition of third country "eligible counterparties" thereby referring to Member States decisions applying the same conditions as EU "eligible counterparties". There is no regulatory delegation to the Commission on this point.

[256]See article 25(4) of Mifid II, referring to the criteria laid down in article 4(1) of the prospectus directive 2003/71 as amended by directive 2010/73, see n.150. These criteria mention that the markets have to be subject to: authorisation, effective supervision and enforcement; have clear and transparent rules for admission and trading, require periodic and ongoing disclosures by issuers, while the market abuse provisions should ensure transparency and integrity. Several other equivalence provisions refer to this article 4(1) of the prospectus directive, the latter to be amended in the near future.
These criteria have e,g, been applied in the equivalence decision relating to the Japanese regulated markets. See Commission implementing decision 2016/2271 of 15 December 2016 on the equivalence of financial instrument exchanges and commodity exchanges in Japan in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council. For Canada e.g: Commission implementing decision2016/2273 of 15 December 2016.

[257] Branches of third country investment firms may have qualified for a national exemption under article 3 (1) Mifid 1, 2004/39. As to organisational requirements for investment firms, see: Commission directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

[258] This seems rather an ambiguity in the drafting of the regulation making the authorisation not expressly conditional upon the application of the equivalence decision.

[259] See e.g. AIFMD, article 37 (2)(c).

company information, financial benchmarks, transaction requirements, trade repositories, CSDR, SFTR, short selling, AIFMD, Mifid/Mifir, derivatives and CCPs, Investment firms, regulated markets, MAR[260]. This finding does not necessarily mean that instruments – e.g. prospectuses[261] – originating from these jurisdictions will automatically be refused in the EU: the EU authorities may approve the document on the basis of the EU regulation referring to the "legal and regulatory regime of the third country".

In several of these cases, this gap may be due to the recent nature of the respective regulations and the long preparation time for preparing and adopting equivalence decision. In the meantime, some decisions may have been prepared by ESMA, or are awaiting adoption by the Commission[262]. But the absence of equivalence decisions in a number of regulations will raise question marks about the Commission's action in implementing the regulations: it amounts to fencing off the EU markets for certain activities, which constitutes an implicit policy choice. This would be "Fortress Europe", in an indirect way.

Should one presume that in the absence of a Commission decision on equivalence, the authorisation by the national supervisor should be refused, or that the supervisor may be entitled to establish itself the conditions of equivalence? If, as is the case in several provisions, there is no explicit *formal* linkage between the requirement relating to a possible equivalence decision and the authorisation, should the national supervisor nevertheless refuse access to a third country entity? This question may arise for several subject matters, e.g. the recognition of a third country CSD[263], which should be refused as long as the Commission has not adopted an equivalence decision. But the formulation of the provisions in the regulation may give an indication, as will be analysed below.

C. Generally applicable equivalence regimes

Most equivalence decisions relate to specific aspects of the regulation, as applicable to a third country situation, leading to considerable fragmentation. The Commission has not developed a general equivalence regime which could be applied to an entire third country regulatory regime and further implemented in numerous individual cases. Although the procedures for establishing equivalence have been described in Commission documents, the process has been largely a state by state, or – and cumulatively – a regulatory point by point approach, leading to a considerable number of state by state decisions. The absence of an overarching approach has not been conducive to establishing a coherent equivalence regime as may have been envisaged in the directives or regulations. The different ways equivalence has been treated in the different EU instrument is striking. The resulting complexity is considerable and has been widely regretted[264].

In one or two cases, however, the regulations open the possibility to adopt a "general equivalence approach" relating to the regulatory and supervisory regime of a third country, or at least to a large part of its regulatory system. Equivalence decisions on that basis would entitle firms from that country to be considered subject to an equivalent regulatory regime for the application of several EU regulations and this from the angle of investor protection and financial stability. According to Mifir, the Commission is entitled to qualify the legal and supervisory regime of a third country as equivalent for the application of Mifir, CRD IV and Mifid II and therefore allowing investment firms to rely on this regime for the benefit of the recognition as "investment firm"[265]. The conditions for this type of general equivalence are mentioned in general terms, such as authorisation and supervision, capital requirements, conduct of business rules, transparency. This more widely defined equivalence regime seems to be applicable to all items mentioned in these directives and regulations

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[260] Equivalence decisions taken by the European Commission as at 21 December 2016, Table, https://ec.europa.eu/info/sites/info/files/file_import/equivalence-table_en_0.pdf. See also: Commission Staff Working Document, EU equivalence decisions in financial services policy: an assessment, 27 February 2017, n.17.

[261] see Article 20(3), prospectus directive, 2003/71; compare article 29, Regulation 2017/1129.

[262] See the ESMA decision on equivalence under AIFMD: ESMA advises on extension of Funds passport to 12 non-EU countries, 19 July 2016.

[263] See article 25, CSD regulation. Firms could also limit their activity in the field of investment services to the sole state in which they have established a branch, see articles 39 Mifid II and 46 e.s. Mifir.

[264] See for an analysis of the causes: Ferran,.65, p, 56, referring to the Sharon Bowles qualifying the solutions adopted as "rubbish compromises"; N. Moloney ,n.56, p 55 e.s.

[265] See article 47 (1) Mifir; It also contains a reciprocity requirement. See article 23 (1) and 28(1)(d) Mifir for equity c.q. derivatives. Mifir on the equivalence of third country equity or derivatives regulated markets; see also article 25(4)(a) of Mifid II referring to article 4 (1) of the Prospectus directive, now replaced by the prospectus regulation 2017. Article 44(3) of the Prospectus Regulation 2017 states "Reference to the third and the fourth subparagraphs of Article 4(1) of Directive 2003/71/EC in the second subparagraph of point (a) of Article 25(4) of Directive 2014/65/EU shall continue to apply for the purpose of defining the notion of equivalent third-country market under Directive 2014/65/EU

and each time equivalence is required. An additional flexibility is derived from the provision allowing these firms qualifying according to the general equivalence regime, to offer their investment services to professional clients and eligible counterparties throughout the Union without being required to establish a branch in each of the Member States of activity, as would be the case for firms from non-equivalent regimes [266]. The original branch could service the entire Union, remaining under the supervision of its original location in the EU as a branch[267]. This flexibility illustrates that firms from equivalent regimes enjoy a higher degree of confidence as they can offer their services without any presence in the state where the services are being offered. One can wonder whether this "general equivalence regime" should not be followed more widely, being on the one hand simpler, while contributing to a more harmonised regime throughout different EU instruments and in several jurisdictions. Legal safeguards would derive from the conditions that these firms are subject to authorisation, supervision and enforcement in their home state along with arrangements on the exchange of information and the existence of an enforcement regime in case of infringement. The absence of a detailed framework for assessing equivalence is likely to burden any progress to the future application of this important key to the financial markets in the EU and beyond.

This general Mifir regime will only enter into force in January 2018, and therefore no general equivalence regime has yet been developed. Also, this regime applies to investment firms, it does not grant equivalence for specific fields of activity – e.g. derivatives clearing - for which other more specific equivalence requirements apply.

A comparable example of a wider equivalence regime can be found in directive 2010/73, modifying the prospectus directive 2003/71 where the conditions were spelled out for a third country legal and supervisory framework to be considered equivalent in order to define "markets and issuers" and hence regulate access to them. These conditions require these markets to be authorised, supervised and their rules enforced; they should have clear and transparent rules on admission of securities, periodic and ongoing information has to be published and market abuse prohibited[268]. By making a reference to this regime, Mifid II incorporated this definition in its scope for defining its execution-only regime[269]. A similar reference is found in Mifir, for defining third country markets as equivalent[270]. This definition of an "equivalent" market obviously has a structural function, applicable in other regulations as well[271]. The definition is part of the 2003 prospectus directive - which has been abolished by the 2017 prospectus regulation – but the reference has been maintained in the later regulation[272], underlining once more the structural function as a definition. In practice, this would mean that a market that has been recognised on the basis of these criteria would be equivalent for all other instruments that refer to it[273]. One may even argue that this definition could validly guide national authorities in the absence of any other regulatory requirement.

A recital to Mifir makes it clear that its draftsmen had the intention to develop to develop a common regulatory framework for third-country firms and for the applicable equivalence conditions, conscious about the fragmentation of the present framework[274]. The regulation not yet being applicable, it is too early to verify how this intention will be implemented.

D. Optional character of the equivalence decision

[266] Article 46-47 of Mifir. The branch requirement would apply on the basis of article 39 of Mifid II.

[267] Article 46-47 Mifir, and article 39 Midif II. It should be registered with ESMA as a third country firm, and subject to the general equivalence test of article 47.

[268] The present situation is relatively confused: the 2010 prospectus directive empowers the Commission to adopt a delegated act to "specify these criteria or add further ones to be applied in the assessment of the equivalence". However, this delegation of power only refers to the offer of securities to directors or employees, mentioned in article 4(1)(e) of the 2003 directive. In other regulations, there is a mere reference to the criteria.

[269] See article 25 (4) (a) of Mifid II. Also article 11(22) Solvency II. See n.150 on the present status of article 25.

[270] Article 23, Mifir, referring to article 25(4)(a) Mifid II. See n.150 on the present status of article 25.

[271] Comp article 38(3) Mifir referring to the Commission decisions on the equivalence criteria for deciding on access of third country CCPs

[272] See article 44(3) of the Prospectus Regulation 2017. .See n.150 on the present status of article 25.

[273] Comp article 38(3) Mifir referring to the Commission decisions on the equivalence criteria for deciding on access of third country trading venues and CCPs

[274] See recital 41 Mifir

It is striking that in many fields the Commission has not adopted equivalence decisions although this is provided in the respective regulations.[275] As a consequence, the absence of a Commission decision would effectively block access to the EU, or not allow transactions or actions to third-country firms.

This may be due to the difficult process of establishing equivalence and the complexity of the process which has to be followed before a decision on equivalence can be reached. It may also be based on a cost-benefit analysis, as the process to reach a decision on equivalence may bear no relationship to the interests of the potential beneficiaries. For the more recent regulations, time constraints are likely to be the explanation.

But it may also correspond to policy objectives, allowing to close off certain markets from external influence, whether blocking foreign access to EU markets, or protecting EU investors by limiting their access to foreign products or markets. Other policy considerations should not be disregarded such as privileging transactions to take place in the Union, or as an instrument for requiring reciprocity. Therefore, the question should be raised to what extent the Commission is free to decide to start the assessment process[276] and whether or not to grant equivalence, or to refuse it even when the objective conditions for equivalence would be met. In other words, is an equivalence decision a technical one, possibly subject to judicial control, or does it contain political elements such as aiming at reciprocity, or at obtaining advantages that may not be directly linked to the subject matter to be assessed from the point of view of equivalence? Another aspect of this question concerns the Commission's right to refuse equivalence on the basis of wider political motives, although technically no grounds for refusal have been identified. These objectives may relate to the ability to better control capital flows, to avoid negative developments being imported from other markets, to reduce the risk of considerable financial imbalances with the said third country, but more bluntly: the decision to refuse to a certain third country access to the EU markets. Here" Fortress Europe" looms on the horizon.

If equivalence is exclusively based on objective elements as mentioned in the Regulation, it could be proved by other means than on the basis of the Commission investigation and resulting decisions, e.g. by investigating the third country regulatory system and supervisory practice. Related is the issue whether equivalence could be proved in court, by comparing the two legal and supervisory regimes, what might lead to action against the Commission for not adopting the appropriate decisions.

A first element of analysis is the formulation in the delegating regulation itself. Many EU instruments declare that the Commission "may" adopt an equivalence decision, hence that is not required to do so[277]. Depending on the formulation of the regulation, the decision may have been left in the hands of the national supervisor concerned, who can decide on the general criteria mentioned in the regulation which the Commission was supposed to take a position on. In these cases, the recognition or authorisation by the national authority will not directly be linked to the existence of a formal equivalence decision[278]. Whether that is the case or not should depend on the formulation of the regulatory basis. In most regulations, this 'may' formulation should be read as that the equivalence test is an optional or alternative element to be taken into account by the national authority, but it is not a strict requirement without which that authority cannot adopt a decision which recognises even implicitly equivalence. This clearly contrasts with the other regulations which mention that the Commission "shall" adopt an implementing decision and this before a certain date, what seems to indicate that it has no choice as to implementation. But even in these cases it happens than no equivalence decision has been adopted, with the consequence that equivalence will not flow from the regulation itself, being the outcome of the process of assessment and evaluation.

This opinion was not shared by the Commission. In its statement on equivalence[279], the Commission's staff stated that equivalence decisions are discretionary in accordance with the relevant empowerment, referring to e.g. the promotion of the internal market, market integrity or financial stability[280]. But beyond these criteria the Commission stated that it should also consider "external policy priorities and concerns, including the promotion of "common values and shared regulatory objectives"[281].

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[275] See the list of the fields where no equivalence decisions have been adopted, supra Part ii, initial overview
[276] Several regulations state a date before which the regulation has to be adopted.
[277] See e.g.in the prospectus directive 2003/71, article 20(3) where equivalence of the prospectus was described by reference to international standards, esp. IOSCO standards. This provision will be deleted under the 2017 Prospectus regulation.
[278] See e.g.in the prospectus directive 2003/71, article 20(3) where equivalence is decided by the supervisory authority.
[279] Commission Staff working Document, n.17
[280]Commission Equivalence Report, n. 2, 9. [281]
Commission Staff working Document, n.17

This seems to indicate that according to the Commission's staff, equivalence decisions may be based on political arguments. The Commission's statement relates these factors to the amount of risk to financial stability or to the protection of market participants. In other words, the technical restrictions to equivalence can only be superseded by more general, possibly political imperatives if these are likely to affect the financial objectives as stated in the regulation which empowers the Commission to adopt the equivalence test. These criteria still belong to the broader field of action that could be pursued in financial regulation. On the other hand, it is doubtful whether the Commission would be allowed to refuse equivalence on merely political motives, such e.g. as its overall strategy to the functioning of financial markets in Europe.

This point would be important in the Brexit context as a refusal of equivalence could only be based on arguments derived from the regulation itself, and not from the wider political negotiation taking place between the EU and the UK[282]. If the EU wants to restrict the opening certain EU markets to UK market participants, it should adopt the necessary instruments for doing so, but the equivalence standards are not the right instruments.

A related question concerns the right of EU market participants to "enforce the benefits of an equivalence decision", more precisely whether they can obtain a legal protection comparable to the one intended by the equivalence decision: this question may be of importance both for the validity of the equivalence decision itself, but also for the validity of the recognition or authorisation granted by the national EU authority[283]. Could a national supervisor be held responsible for having allowed a third country operator, while notwithstanding the equivalence decision, the guarantees offered to investors were of a lower standard? If the equivalence decision has been adopted on the basis of that authority's own assessment, the answer could be positive. If equivalence has been based on a Commission decision, the answer is likely to be different: should the presumption of equivalence based on the Commission decision not be irrebutable? Only the ECJ could give an authoritative interpretation to the content of equivalence decisions.

This argument should be further analysed on the background of the paradox in case of the Brexit transition: the regulation in the UK will be fully equivalent the day before Brexit takes effect. There should be an irrebuttable presumption of compliance with EU law and regulations: otherwise the Commission as guarantor of the Treaty should have taken action in compliance with the Treaty principles. The day after Brexit, and without any change in the UK regulation, none of its regulations would be equivalent. The Commission will not have adopted formal equivalence investigations as the regulations will continue to meet the EU requirements. Therefore, one could argue that upon Brexit, the UK has remained in compliance with EU law, and hence its regulatory system remained equivalent.

There are some legal arguments against this logic: firstly, the legal basis of the regulation will not further be EU law, but UK law. This implies that legal recourse against decisions based on the UK regulation will have to be submitted to UK jurisdictions and not to the European ones, especially the ECJ[284]. Administrative enforcement of the regulations will be entirely in the hands of the UK authorities, and in case of disagreement with EU supervisory authorities, no recourse to the ESMA competences in case of "disagreements between competent authorities" will be possible[285] . Other mechanisms of coordination e.g. in case of emergency would also cease

[282] See N. Moloney,, n.56, at 14 stating that "the Commission's power .. is almost always discretionary. COMMISSION STAFF WORKING DOCUMENT EU equivalence decisions in financial services policy: an assessment, is more ambivalent: "In this context, it should be noted that while equivalence provisions set the *criteria* on the basis of which the underlying assessments should be performed, the same provisions also confer to the Commission discretion whether to grant equivalence or not". p. 7 Also: "equivalence decisions can be withdrawn at any moment.." p.9 COMMISSION STAFF WORKING DOCUMENT EU equivalence decisions in financial services policy: an assessment n. 2 . Both statements are not supported by the applicable regulations. N.Moloney ,n.56, at 48 She rightly refers to the benefit of ESMA's involvement for reducing the "potential for politicization". Norton Rose Fulbright, 121, p 24 also expresses concerns in this respect.

[283] Indirect aspects of a recognition of equivalence of the legal and regulatory regime would be the application of the liability regime, involved, the applicable depositor or investor compensation system, the application of insolvency laws, or the application of data protection rules.

[284] The extent to which the competence of the ECJ to deal with UK related issues will continue to apply is the subject to different opinions in the UK: G. parker and A. Barker UK paves way for compromise over ECJ jurisdiction post-Brexit, FT., August 23, 2017.

[285] On the basis of article 19 of the ESMA regulation.

to be applicable. Hence the reasoning that "equivalence in substance" supersedes "formal equivalence" would not constitute a sufficiently solid basis for post-Brexit financial markets.

This strict reasoning would not apply in all fields: in fields in which equivalence is granted without a Commission decision, the national supervisor could determine that the third-country legal and supervisory arrangements are equivalent. Hence the national supervisor could apply the same approach to the UK as to any other third country, e.g. with respect to the approval of prospectuses. This type of appreciation would also be allowed when the Commission decision was not a prerequisite to the national authority's evaluation – the regulation stating that the Commission "may" -, but not when the Commission's equivalence decision was a prerequisite to granting access to the EU markets – the "shall" cases.

E. Withdrawal of equivalence

Can equivalence be withdrawn? Certainly, if the relevant conditions in one of the jurisdictions under consideration have changed: equivalence is based on comparable conditions in the EU and the third country at a certain moment in time. In some cases, the repeal of the authorisation is expressly mentioned in the EU regulation[286], but in many it is assumed: the concept of equivalence implies the possibility to formally withdraw the equivalence status, if one of the two regulatory regime or not further equivalent. Changes in equivalence may be due not only to changes in the EU, but also in the third country. To be mentioned are the cases in which equivalence has been granted as a temporary measure, or provisionally until the third country has adapted its regulation.

Withdrawal would imply an orderly procedure, respecting due process, as it will affect the position of the beneficiary of equivalence, this is the third country firms that have been authorised on that basis. As the authorisation to be active in the EU has been granted by the national supervisory authorities, or ESMA as the case may be, it will be up to them to start the necessary procedures leading to the withdrawal of their authorisation by the Commission.

Conclusion

This paper deals with the consequences of Brexit but only from the angle of equivalence of financial regulation. The numerous other aspects of Brexit, whether or not dealing with financial services remain unmentioned. Also, the strategies and challenges for dealing with the post-Brexit period other than on the basis of the equivalence of regulations are beyond the scope of the present paper[287]. While the discussion between the UK and the EU are still going one, the working hypothesis has been that no transitional agreement has been found, and that arrangements will have to be worked out on the basis of the existing regulations.

The technique of equivalence of third country regulatory regimes expresses the philosophy on which it is based: it stands for a limited opening of the EU markets to third country operators on the basis that the third country regime offers the same or comparable guarantees as enjoyed by EU investors and institutions.
Equivalence is almost invariably applicable unilaterally: reciprocity is rarely mentioned[288]. Therefore, equivalence is a technique to protect the European interests, not the interest of the third country. In some more recent decisions mainly relating to the functioning of the markets, the interdependence of European and third country interest is also recognised as an objective which can deliver a useful, or necessary contribution to the European markets. In these cases, financial stability and risk transfer will enter into the analysis: the protection of EU interests remaining however the leading policy objective.

The comparison between equivalence and passporting has often been made, especially in the UK, calling for a reintroduction of passporting after Brexit. Equivalence is not a weaker form of passporting, but a considerably different technique. Equivalence is confined to well-defined aspects of the third country regulatory regime, and the finding that the same safeguards as the EU regime are being offered, without triggering negative effects on the EU markets or investors. There have been no cases where the third country legal system as a

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[286] See e.g. Mifir Recital 42, and article 49, Mifid II, article 43.
[287] See for these, AFME, Implementing Brexit, Practical challengers for wholesale banking in adapting to the new environment, April 2017.
[288] See under the regulation on auditors, or in the CSD regulation

whole has been declared equivalent, which is considerably different from the effects of passporting. Some attempts have been made to develop a comprehensive third country equivalence assessment and resulting recognition, but these have not been implemented up to now, and have remained exceptional. This is a sharp contrast with the internal EU position where mutual recognition has been the basis for the internal market.

In terms of decision making, equivalence is also much more complicated than passporting: while the latter flows directly from the Treaty freedoms, as applied in specific directives or regulation, equivalence applies on a case by case basis as stated in the regulation, is limited to a specific subject, is determined by a Commission decision, adopted after a thorough and lengthy investigation and is finally applied in a decision of a supervisory body in the EU state where the activity will be developed. Its effects are often limited to that specific subject matter, being restricted to the activities as defined in the equivalence decision. In some cases, the equivalence decision lists the entities – the regulated markets, the CCPs e.g. - for which equivalence has been granted.
Equivalence can be seen as the key that opens the door to specific parts of the EU market.

There are significant differences in the supervisory practice depending on who decides about equivalence. As mentioned in the overview, in some fields equivalence is part of the decision of the host state supervisory authority to whom a specific matter is submitted: it will estimate that the legal and regulatory regime to which the third country operator is subject is largely or effectively equivalent, so that it can give its approval. In these cases, there is no preliminary decision of equivalence by the EU Commission and the supervisory decision will be based on general information and an assessment of outcomes (e.g. on the quality of information made available). This approach would allow national supervisory authorities to assess the substantive equivalence of the regulation of the UK, and would, certainly in the early times after Brexit conclude to its equivalence. The UK would be treated as any other third country.

In other cases, the regulation provides that the Commission decision may define the equivalence *criteria* which the supervisory authority should take into account, leaving a wider appreciation right to that authority. If no such equivalence decision has been adopted by the Commission, the same regime as in the previous case would be applicable.

In a third number of cases, the Commission decision should first declare the regulatory and supervisory system of a specific third-country equivalent, as a precondition for a decision by the supervisory authority. In these cases, one can assume that the equivalence of the third country regime will not further be open for appreciation, nor challenge.

The number of cases subordinating the decision of an EU national supervisory authority to an equivalence decision as adopted by the Commission is quite limited. This aspect is important in the UK-EU context, as for many subjects where no such formal requirement applies, it would allow national supervisory authorities to further consider third country equivalence on the basis of elements of the application. In the field of financial information e.g., the criterion is whether adequate information is being made available to investors in the host state, irrespective of the differences in the applicable national regulations. This regime has been functioning for many years without major deficiencies being reported. It has been applied with third countries from different parts of the world.

The question arises whether this flexible regime can also be applied in fields in which the Commission has not adopted equivalence decisions, although it was authorised to do so. The absence of Commission equivalence decision can be analysed as an indication that no further formal measures were needed, and that the matter could as well be left to the appreciation of the national authorities. In the formulation of quite a few regulations, one can doubt whether this preliminary decision is needed, allowing the supervisory authority to proceed on the basis of its own analysis, applying the criteria mentioned in the regulation. This analysis is reinforced by the finding that in many cases, the Commission has obviously not considered it necessary to proceed to a formal equivalence decision. The conclusion would be that in these cases, these national authorities could authorise transactions or register parties without putting the interest of the EU investors or markets in danger. But on the contrary, if such a decision has been adopted, it should be fully respected by the national supervisors.

In the third series of cases, formal equivalence decisions have been clearly adopted by the Commission following a complex assessment procedure, and as a precondition to acceding to the EU investors or markets. The fields in which an equivalence decision has been adopted in the past indicate that these are matters with a very considerable number of addressees (e.g. auditors, listed companies) or in cases where the interests involved touched on a broader range of market related risks including market surveillance and financial stability.

Post Brexit

As per hypothesis, the Commission will not have adopted equivalence decisions with respect to the UK - a Member State until the Brexit date – and in some cases, access to the EU markets would be blocked, while EU firms may not further be able to deal with UK intermediaries, or offer their products. In the absence of mitigating action, this state of affairs is likely to create a major disruption in the financial markets affecting both the UK and the EU. It is in the interest of both parties that this disruption be avoided, at least its damaging effects kept to a minimum. A careful and gradual approach is to be preferred, especially as it is not predictable how the present negotiations will evolve, or how the respective economies will react. Moreover, over time it is likely that the two regulatory regimes will increasingly diverge.

In the meantime, the factual situation will have evolved, limiting the impact of the Brexit disruption[289]. But it is far from clear that after Brexit, it will all be more of the same.

Many of the larger institutions will have adopted actions that are likely to reduce the impact of Brexit: one can refer to the ongoing trend to relocate in the EU, by establishing a subsidiary which will enjoy full passport rights. In these cases, these relocated firms will face restrictions for offering products from third countries; on the other hand, the EU authorities have repeatedly warned for letter-box companies and other evasion mechanisms. Also, this solution does not extend to branches, and therefore this form of doing business through subsidiaries would be significantly more burdensome. Other considerations will have to be taken into account: in the debate about derivatives clearing, the monetary concerns have been most clearly exposed, but in other fields similar concerns exist, e.g. with respect to resolution of large systemic institutions. In the absence of a transitory regime, the shorter-term consequences are difficult to predict, and considerable instability in each or both of the markets may be feared.

Different approaches for avoiding this type of disruption have been mentioned: a full passporting regime seems unrealistic, both politically and for reasons of lack of equivalence on the longer term[290]. Some have proposed more broadly to extend the internal market, by way of an "interim trade agreement" which would be a limited term continuation of the pre-Brexit regime. This also raises questions on what the ongoing changes in the legal and regulatory regimes will be, and whether the interim regime would allow each party to oppose changes in the other jurisdiction. One should not forget that after Brexit the EU and the UK will not further be partners, but competitors. But their respective fundamental positions are different: the UK is mainly interested in attracting business activity from the EU and worldwide, while the EU wants to keep the activity within its borders, and avoid it to be handled in the UK.

"Enhanced equivalence" was also mentioned as an approach: it seems to refer to broader regulatory cooperation across Europe[291]. The ISRG, a study group of the CityUK and City of London analysed different possibilities[292] and concluded that bespoke arrangements reflecting the integrated and interdependent markets would be preferable to building on the equivalence regime. This means that only a negotiated solution will offer some comfort. In academic writing, several paths have been described such as superequivalence, allowing to reduce the risk of refusal by EU countries. Interesting is the proposal to create parallel regulatory regimes, introducing one regime for relations with EU countries and which would be strictly EU compatible, while another would be developed independently and would be open to third country operators worldwide[293]. These different proposals are all based on a considerable renegotiation of the UK position, for which there will be little time, and perhaps even less appetite. In sensitive fields, solutions should be available on day one, even if they have to be revised later on.

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[289] See the opinion of W.G. Ringe The Irrelevance of Brexit for the European Financial Market *Oxford Legal Studies Research Paper No 10/2017*, Ringe, SSRN: https://ssrn.com/abstract=2902715 or http://dx.doi.org/10.2139/ssrn.2902715

[290] The UK government seems to have excluded this option.

[291] See S. Butcher, Brexit's enhanced equivalence isn't dead. It was never alive, EFC: The CCPs proposal of the Commission was labelled "enhanced equivalence"

[292] ISRG, The EU's third country regimes and alternatives to passporting, 23 January 2017, n.121; *in the same sense: Norton Rose Fulbright, n 121, , 15 and 31, proposing a building blocks model*

[293] See E. Ferran, n. 65 , p.23 referring to the Jersey regulation in the field of AIFMD creating "parallel regulatory requirements". This may be considered as overtly organised regulatory competition.

A more granular approach may consist of building on the existing equivalence regime for dealing with third countries, ensuring a limited and controlled opening of the respective borders. This is the regime already practised with third countries today, as analysed above. The differentiation in three groups, as outlined above, would only call for urgent action for the third group. One could assume that the national authorities would in many cases, and certainly for some time after Brexit, accept that they can themselves assess the value of the UK regime, and decide about its equivalence. After all, this is what they do for all other third countries.
Information could be made available indicating how much the two legal and regulatory system are equivalent.

An analysis of the fields where the Commission has already adopted equivalence decisions illustrates that in many instances, equivalence with respect to the UK could readily be accepted: this would be the case with respect to the equivalence of financial information (accounting standards; prospectus and transparency), the position of the auditors, the regime of the credit rating agencies, the recognition of third country positions in the bank's financial position, or that of the insurance companies. In all these fields, the UK regulatory regime would remain largely equivalent – in some cases even superequivalent – with the EU regime. It could be advised that the Commission published its opinion on the general equivalence with respect to the UK in these fields. This decision would, like all equivalence decisions, be subject to revision in case of change in the regulation of the EU or of the EU, in which case a negotiation should take place, which if unsuccessful, would end equivalence.

Remains to identify in which cases an express equivalence regime would be necessary: this list is twofold. On the one hand the existing cases based on EMIR and dealing with CCPs, and regulated markets, where a substantial number of third countries have been recognised as equivalent. On the other hand, there are the recently adopted regulations for which no equivalence decisions have yet been adopted: CSDR, SFTR, Mifir and Mifid II, Mar.

The most obvious one if the regime of derivatives clearing and of the CCPs[294], about which equivalence decisions have been adopted by the Commission. In the absence of significant changes in the regulation, the equivalence could be further assumed. With respect to the CCPs, as mentioned above, the Commission has proposed a new scheme[295]

Another case is the recognition of UK trading markets for equity and derivatives[296], subjects for which little discussion seems possible as these are well functioning and established organisations. With respect to these two subjects, it would be sensible to further recognise their equivalence, without applied the elaborate procedures for its recognition. The Commission should be invited to adopt a temporary decision in these fields.

As for the many new regulations awaiting later equivalence decision, these will be the subject of separate negotiations by the Commission with third countries, including the UK. Whether the Commission will open negotiations is unknown and in which direction they will run, is unknown, and therefore it is not possible to make much progress here. Account should be taken of the changing regulation and environment in the UK and this may require a more in-depth analysis.
From a practical point of view, one should consider in which fields equivalence decisions will be essential: the new private placement regime of MIFIR[297] will not be accessible starting 1 January 2018, but the old one may suffice. For reporting Securities Financing Transactions, the regulation provides that these can also be reported to the existing trade repositories under EMIR. On CSDR, clearing of euro denominated transactions could also take place in other CSDs, while for benchmarks an equivalent criterion has been mentioned[298] . All this is far from perfect, but would allow most of the difficulties to be solved in a pragmatic way, immediately after Brexit has occurred, and this until a better solution can be negotiated.

The proposal would essentially consist of a declaration by the Commission that for the application of certain rules, the UK legal and regulatory system will be considered equivalent. The accompanying measures dealing with the supervisory arrangements, or the rules on the exchange of information, including secrecy[299], are in

[294] Article 25(6) EMIR
[295] See under CCP-UK
[296] Article 2 EMIR referring to Article 4(1)(14) and 19(6) of Directive of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (Mifid 1) now article 23 Mifir
[297] Article 46 Mifir
[298] See article 32 (2) BMR, where reference to the IOSCO principle can may be considered sufficient to be considered equivalent with the requirements of the regulation.
[299] See e.g. UCITS directive 2009/65, art 102 (3)

the remit of the supervisory authorities and are not likely to raise fundamental questions, and could be dealt with accordingly[300].

This system could be introduced almost immediately. In the case of the UK, decisions will not require an in-depth assessment of the third country legal system. The equivalence approach allows both parties to keep the changes in the overall regulatory system under control, avoiding some of the pitfalls of passporting[301]. There is no need to fix a time limit, as equivalence can be terminated as soon as the two systems diverge, but a minimum stability period would contribute to avoid markets to be upset.

It would useful, for stability reasons that the Commission confirms in an interim statement that this approach will be adopted, indicating that further work will be undertaken at a later stage.

[300] In many cases these would require a RTS, calling for approval by the Commission and scrutiny by Parliament
[301] A. Belchambers developed some of these points in: Equivalence offers the best hope for a UK-EU markets deal, Financial Times January 18, 2017.

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