

Third country equivalence in EU banking and financial regulation

Equivalence of third countries in financial services has been portrayed by the July 2019 Commission's [communication](#) as a key instrument to promote "open, fair and efficient financial markets that operate within rigorous prudential and conduct framework". While that communication is of general nature and does not specifically deal with Brexit, it nevertheless outlines a stronger regime (and "stronger assurances") in relation to "high-impact" countries along the lines of recently adopted legislation (i.e. "Investment firms review" and amendments to the "European Supervisory Authorities Regulation" and "EMIR" for central counterparties).

This briefing provides an insight into the latest developments on equivalence in EU banking and financial regulation both in terms of governance and decision making (Section 1) and in terms of regulatory and supervisory frameworks that governs the access of third countries firms to the internal market (Section 2). The briefing also gives an overview on the possible role of equivalence regimes in the context of Brexit (Section 3) together with Brexit-related supervisory and regulatory issues (Section 4). This briefing is an updated version of a briefing published in April 2018.

1. Today's 'equivalence' regimes

Rationale and objectives

A previous EGOV [briefing](#) on "Third-country equivalence in EU banking legislation" analysed in detail the key differences between:

- > 'passporting' rights for firms established in a Member State or in an EEA country (enshrined in secondary legislation), and
- > 'equivalence' regimes for third countries (provided for in secondary legislation dealing with financial services) that may be discretionarily activated or revoked by the Commission.

"Equivalence" refers to a process whereby the European Commission assesses and determines that a third country's regulatory, supervisory and enforcement regime is equivalent to the corresponding EU framework. That recognition makes it possible for the competent authorities in the EU to rely on third country entities' compliance with the third country framework which has been deemed 'equivalent' by the Commission. Equivalence decisions can include conditions or limitations, to better cater for the objectives of granting equivalence.



That equivalence assessment does not mean that the third country regulatory and supervisory framework is 'identical' to the EU framework. As emphasised by the Commission in its July 2019 [communication](#), the *"equivalence assessments look at the outcomes of third-country regulation and supervision, while taking into account the risks related to the third country financial system"*.

For the [Commission](#), the EU equivalence policy is intended to satisfy **three objectives**: (i) it reconciles the need for financial stability and investor protection in the EU, on the one hand, with the benefits of maintaining an open and globally integrated EU financial market on the other; (ii) it is pivotal in promoting regulatory convergence around international standards; (iii) it is a major trigger for establishing or upgrading supervisory cooperation with the relevant third-country partners.

Equivalence is primarily used to reduce overlaps in terms of regulatory and supervisory compliance in the interest of EU financial institution or market participants. By way of example, an equivalence decision could allow EU banks to treat a loan given to a company in a third country in the same way as a loan given to a company in the EU; absent such an equivalence decision, banks would from a supervisory point of view need to hold more capital for the transaction. Subject to conditions and processes laid down in the relevant sectoral legislation¹, equivalence may also provide third country firms with access to the internal market (see Table 1 overleaf and the overview of the different regulatory approaches below). This briefing focuses on this cross-border provision of services by third country firms further to an equivalence decision by the Commission.

Governance of equivalence decision

In terms of decision making, the European Parliament [resolution](#) of September 2018 (Rapporteur Brian Hayes) on relationships between the EU and third countries concerning financial services regulation and supervision calls on the Commission to *"provide a clear framework for a transparent, coherent and consistent application of equivalence procedures which introduces an improved process for the determination, review, suspension or withdrawal of equivalence"*². The July 2019 Commission's [communication](#) aims to clarify the way the Commission intends to carry out equivalence decisions and the ongoing monitoring of equivalence once granted.

Equivalence decisions are a **unilateral decision by the Commission**. The Commission ultimately exercises its discretion as conferred upon it by the "empowerment" given in EU sectoral legislation.

While financial legislation lays down, in many cases, assessment criteria, the Commission enjoys **discretion** in its equivalence decisions. As emphasised in the July 2019 Commission's communication, *"the technical assessment [...] may include further relevant criteria where necessary"*.

According to [Commission's](#) communication, *"While equivalence is assessed under the criteria established in EU law, the Commission also needs to consider whether equivalence decisions would be compatible with EU policy priorities in areas such as international sanctions, the fight against money laundering and terrorist financing, tax good governance on a global level or other relevant external policy priorities, in order to ensure the consistency of the EU's action on the international stage"*. In that respect, the European Parliament [resolution](#) of September 2018 pointed out to the "clear political dimension" attached to the equivalence decision for Swiss stock exchange (see Box 1).

The Commission also enjoys **discretion to withdraw equivalence decision**. The equivalence frameworks in force do not provide as such specific procedures for monitoring, reviewing or amending equivalence

¹ According to Commission July 2019 [communication](#), EU financial services law includes around 40 provisions allowing the Commission to adopt equivalence decisions. On this basis, until today, the Commission has taken over 280 equivalence decisions for more than 30 countries, across various parts of the financial industry.

² In particular, Parliament asked for (a) deeper transparency and accountability of the Commission towards the Parliament and the Council, (b) a more structured, granular, consistent and practical framework for assessing equivalence, (c) clear principles governing equivalence assessments, (d) involvement of the European Supervisory Authorities in continuously monitoring the third countries deemed equivalent.

decisions. It is up to the Commission to monitor any changes introduced by the third countries to regulatory, supervisory or enforcement regimes after an equivalence decision has been granted. The Commission has the power to launch procedures to amend, alter or even withdraw an equivalence decision, when it deems it necessary. In that respect, the Commission stressed in its July 2019 [communication](#) the ‘dynamic’ approach governing equivalence: *“the EU monitors and, where necessary, dynamically responds to external regulatory and supervisory developments (meaning improvement or deterioration of bilateral cooperation/mutual trust that may impact the broader regulatory environments for market participants active in the EU”*.

The July 2019 Commission Communication also underlines that the equivalence decision will have to consider the **treatment granted** in the third country to the EU market operators (often referred to as **reciprocity**). The Commission mentions, in this respect, that *“(…) some categories of equivalence decisions are taken after due consideration of the treatment that the third country affords to the EU regulatory framework, to the supervisory work performed by EU authorities and to the local presence of EU market participants. (…) Going forward, the Commission will continue to consider and, where appropriate, discuss with third countries what prudential treatment they grant to EU market participants when deciding on the equivalence decisions with that third country.”*

Box 1: Example of equivalence decision for Swiss stock exchanges

The Commission has linked equivalence to institutional and international developments in its decision to recognise the legal and supervisory framework for Swiss stock exchanges (see Commission [decision](#): *“This Decision also takes into account the Council conclusions of 28 February 2017 in accordance with which a precondition for further developing the sectoral approach with Switzerland is the establishment of a common institutional framework […] When deciding on whether to extend the applicability of this decision, the Commission should in particular consider progress made towards the signature of an Agreement establishing that common institutional framework”*. The same clause is kept in the [most recent Commission’s equivalence decision](#), which recognised equivalence until 30/06/2019 (see recitals 30 and 32).

That equivalence decision lapsed after 30 June 2019. According to [Commission](#), *“At this stage we have no indication about any intention of our Swiss partners to make further progress and hence there is no justification to extend the current equivalence decision beyond 30 June”*.

A recent [Bruegel](#) paper concludes that *“(…), for the time being, the loss of equivalence has left Swiss equities and the Swiss stock exchange not worse nor better off”*.

Ex-post and on-going monitoring

The review of the European Supervisory Authorities (ESAs) adopted by the [co-legislators](#) in April 2019 introduced an enhanced monitoring of equivalence decisions involving the relevant European Supervisory Authorities (ESMA – the European Securities and Markets Authority, EBA - the European Banking Authority, and EIOPA - the European Insurance and Occupational Pensions Authority).

According to the revised [Article 33 of the ESAs founding Regulations](#)³, ESAs are tasked with the monitoring of regulatory and supervisory developments and relevant market developments in third countries for which equivalence decisions have been adopted by the Commission. Importantly, this *ex post* monitoring is not limited to regulatory issues but also extends to supervision and enforcement. For this purpose, the ESAs are requested (i) to submit a confidential report on its findings to the Commission with a particular focus on financial stability, market integrity, investor protection or the functioning of the internal market; (ii) to cooperate with third countries national authorities on the basis of administrative arrangements that should allow the ESAs to obtain relevant information for the purposes of monitoring the equivalence decision. For the [Commission](#), *“monitoring results would feed into a potential review of an equivalence decision. Specifically, a review can be undertaken in response to a significant finding stemming from the monitoring exercise”*.

³ Provisionally agreed by the co-legislators, final adoption and publication pending.

2. Regulatory and supervisory approaches to equivalence

Scope of equivalence

EU equivalence provisions governing the access to the single market on a cross-border basis have been included in EU financial legislation over the years in order to cover certain specific financial services. The conditions to be fulfilled may vary depending on the nature of service provider, the service itself, and the potential customers of the service.

In accordance with the *acquis communautaire* of the EU, **most core banking and financial activities are not subject to an equivalence regime** providing access to the single market. This includes:

- Deposit-taking in accordance with the Capital Requirements Directive;
- Lending in accordance with the Capital Requirements Directive;
- Payment Services in accordance with the Payment Services Directive; and
- Investment services to retail clients.

Those core banking activities mostly involve retail clients, which are subject to depositor protection in the EU and stricter investor protection rules. Absent an equivalence regime, for most core banking activities third country firms need to establish a legal entity (i.e. a subsidiary in the EU) to provide those services across the Union. Nevertheless, individual Member States may still provide access to third country providers, but only to their home market (see model 3 and Table 3 below for further information).

In that respect, the February 2017 Commission's [staff working paper](#) stressed that *"equivalence decisions in a few areas may enhance the possibilities of doing business in the EU (e.g. investment firms under MiFID II), but the equivalence as such serves primarily prudential regulatory purposes and is a tool to reduce overlaps in compliance in the interest of EU markets"*.

Access to the internal market is possible today under equivalence regimes for the following key banking and financial activities related to firm's wholesale business, subject to conditions laid down in sector legislation (See Table 1):

- Alternative investment funds under [AIFMD](#)⁴ for professional investors;
- Clearing under [EMIR](#)⁵; this equivalence regime has been reviewed by EMIR 2.2 adopted by the [co-legislators](#) in April 2019 (see section below);
- Investment services for professional clients and eligible counterparts under [MiFIR](#)⁶; this equivalence regime has been reviewed as part of the Investment Firm Review (IFR) that has been adopted by the [co-legislators](#) in April 2019 (see section below). MiFIR equivalence regime applies to both credit institutions providing investment services and investment firms.

EU banking and financial legislation takes a "sectoral" approach (depending on whether the service is capital market driven or not) as opposed to an "activity-based" approach. The very same activity of providing a guarantee or a loan to a professional client could be subject to equivalence decision when falling within the scope of "investment services"⁷ under MiFID/MiFIR (capital market) for both credit institutions and investment firms, while a guarantee or a loan directly provided by a credit institution (banking intermediation) does not benefit from an equivalence regime under CRD.

⁴ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, OJ L 174, 1.7.2011, p. 1.

⁵ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ L 201, 27.7.2012, p. 1.

⁶ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, OJ L 173, 12.6.2014, p. 84.

⁷ Investment services under MiFID include "Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis" and "Granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction".

Table 1: Role of equivalence in key EU banking and financial services legislation

Sector	Direct access to the EU market under equivalence regimes	
	Professional	Retail
Banking (lending, deposit taking)	No	No
Payment services	No	No
Investment services	Yes ⁸	No
Regulated Markets (MiFID)	Yes ⁹	
Alternative Investment Fund	Yes ¹⁰	No
UCITS	No	No
Market infrastructure (EMIR)	Yes ¹¹	
Credit rating agencies	Yes ¹²	
Central Securities Depositories	Yes ¹³	
Trade Repositories (SFTR)	Yes ¹⁴	
Financial benchmarks	Yes ¹⁵	

Source: EGOV.

Financial services legislation also include other equivalence regimes for securities markets that are not dealt with in this briefing (see previous EGOV [briefing](#) “Third-country equivalence in EU banking legislation” for a comprehensive description of the different equivalence regimes and Commission’s [table](#) on equivalence decisions as published).

Until today equivalence regimes have not been activated for alternative investment funds nor for investment services for professional clients (MiFIR only applies from 3 January 2018). Should the Commission at some point activate equivalence regimes, firms established in a third country offering alternative investment funds or investment services to professional clients will have access to the internal market without establishing a legal entity or a branch in the Union. For alternative investment funds under AIFMD, third country firms will nevertheless be required to have a “legal representative” in the Union.

⁸ Article 47 of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

⁹ Article 25 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast).

¹⁰ Articles 35, 36, and 39 to 42 of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

¹¹ Articles 2a (definition of regulated market for the purposes of the definition of OTC derivatives), 25 (CCPs) and 75 (TRs) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

¹² Article 5 of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies.

¹³ Article 25 of 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.

¹⁴ Article 19 of 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.

¹⁵ Article 30 of 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.

Models for supervising third country firms under the equivalence regime

In terms of supervision of third country entities allowed to provide their services under a third country regime, financial services legislation provides for different models that are stylised below and ranked according to their degree of supervisory scrutiny.

Table 2: Supervision of third country firms under equivalence regimes

Model	Equivalence	Ex post monitoring	Additional authorisation	Application of third country rules/EU rules	Additional requirements
Model 1 - Investment services (MiFIR)	Yes Implementing act Granular assessment for systemic activities	Commission and ESA	Registration from ESMA does not come down to additional authorisation	Application of third country rules	Reporting to ESMA
Model 2 - AIFMD	Yes Delegated act	Commission and ESA	National authorities (Member States of reference)	Application of some EU rules (unless rules are equivalent)	Legal representative in the EU
Model 3 - Clearing (EMIR 2.2)	Yes Implementing act	Commission and ESA	European Supervisory Authority (ESMA)	Application of some EU requirements taking account third country rules	Dual supervision of Tier 2 CCP from ESMA)
Model 4 - Core banking activities	No	n.a.	n.a.	n.a.	n.a.

Source: EGOV based on EU legislation

Model 1: Registration by EU Supervisory Authority (but no authorisation) and equivalence decision by the Commission to access internal market. For investment services to professional clients, under MiFIR, third country firms need to be “registered” and shall provide the European Securities and Markets Authority (ESMA) with specific information, but this “registration” does not extend to an additional “authorisation”. ESMA has to keep the register up-to-date. Nevertheless, ESMA has the power to withdraw the registration of a third country firm on the ground of “*well-founded reasons*” spelled out in MiFIR and based on documented evidence. That supervisory framework has been tightened up by the Investment Firm Review adopted by the [co-legislators](#) in April 2019. This includes:

- Withdrawal of a registration or a temporally prohibition or restriction may be predicated on the absence of third country firms’ cooperation in investigation or information request;
- Access by ESMA to the relevant data;
- in terms of on-going monitoring of third country firms, reporting to ESMA is particularly demanding for investment firms carrying out bank-like services (i.e. dealing on own account and underwriting) that need to report their exposures to EU counterparties (Article 46(6a) of MiFIR as amended by the IFR).

Model 2: Authorisation by national authorities and equivalence decision by the Commission to access the single market. For asset management, under AIFMD, access to the single market is contingent upon two regulatory checks, providing a “double-lock” system: i) equivalence assessment and decision by Commission and ii) authorisation by the national competent

authority of the “Member State of reference”, which is designated according to criteria laid down in AIMD. In addition, the AIFMD provides further supervisory requirements:

- Under the AIFMD third country passport regime, a non-EU AIFM shall comply with most substantive rules of the Directive unless it can demonstrate that this is impossible or the third country law provides for an equivalent rule;
- The AIFM needs to appoint a legal representative established in the Member State of reference that performs the compliance function pursuant to AIFMD

Model 3: Authorisation and ongoing supervision by European Supervisory Authority and equivalence decision by the Commission to access internal market. This model has been introduced by EMIR 2.2 as adopted by the [co-legislators](#) in April 2019. EMIR 2.2. entrusts ESMA with the supervision of third country CCPs which are subject to proportionate requirements depending on whether ESMA determines a CCP to be systemically important or likely to become that (Tier 2 CCP). Tier 2 CCPs are subject to the following requirements that come down to a “dual supervision” from both ESMA and the third country competent authorities. Requirements include:

- Tier 2 CCPs willing to service clearing members or trading venues established in the EU would be authorised by, and registered with, ESMA following an authorisation process comparable to that of CCPs established in the EU;
- Compliance with material rules of EMIR (Article 16 and Titles IV and V of EMIR). ESMA has to take into account the extent to which an CCP's compliance with those requirements is satisfied by the CCP's compliance with the comparable requirements (if compatible with those of the FSB) applicable in the third country (*'comparable compliance'*);
- The CCP shall provide ESMA with its unconditional written consent, signed by the legal representative of the CCP, to provide within three working days after service of a request by ESMA any documents, records, information and data held by such CCP at any time, and that ESMA may access any of the CCP's business premises, as well as a reasoned legal opinion by an independent legal expert confirming that the consent expressed is valid and enforceable under the relevant applicable laws.

EMIR 2.2 also features a “location policy”, allowing the Commission to require a third country CCP considered of systemic importance to locate within the EU in order to provide services in the EU (new paragraph (2c) of Article 25). A relocation decision amounts to a withdrawal of equivalence that EMIR frames.

Model 4: No equivalence regime: access only to national market. For other core banking activities (deposit-taking, payment and lending), the Capital Requirements Directive (CRD) and the Payment Services Directive (PSD) do not provide for equivalence mechanisms for accessing the single market. Absent an equivalence mechanism, conditions to access national market are left to national law and national implementation. Banks may be required to set up a third country branch that will only be authorised to provide service in the Member State in which it is established. Model 4 is also applicable in other financial services legislation in lieu of equivalence¹⁶ or available in the absence of an equivalence decision. Access to national market as opposed to equivalence is summarised in Table 3 for different financial services.

The EU acquis provides alternatives to equivalence for firms to access the EU or Member States' market. While the establishment of a legal entity (i.e. subsidiary) provides access to the internal market in the

¹⁶ Under AIFMD, Member States may allow alternative investment funds managers who are not established and authorised in the EU to market AIFs (EU AIFs and non-EU AIFs) only in their territory under the so-called National Private Placement regimes (“NPPR”). The third country regime under MiFID II/MiFIR offers Member States the possibility to allow third country firms to provide investment services in their territories in accordance with national regimes (both for retail and professional clients). Those investment services cannot be ‘passported’ inside the EU.

absence of equivalence regimes, firms may also opt for accessing national market either by establishing a third country branch or under “National Private Placement Regime”, where available (see Table 3).

Table 3: “Routes” to access EU/Member States market

Sector	Access to the whole EU market		Access to a national market in the EU	
	Equivalence	Legal entity (i.e. subsidiary)	Third country branch	National Regime
Banking (lending, deposit taking)	No	Needed to access the EU market	Possible Authorisation required	Not specified in EU legislation
Investment services	Yes	Needed in the absence of equivalence to access the EU market	Possible Authorisation required	Not specified in EU legislation (although Member States may not treat third country branches more favourably)
Alternative Investment Fund	Yes	Needed in the absence of equivalence to access the EU market	Possible Authorisation required	Marketing possible under national and EU laws ¹⁷
Market Infrastructure (EMIR)	Yes Recognition by ESMA (for CCPs and TRs) required	Needed in the absence of equivalence to access the EU market	Not specified in EU legislation	Not specified in EU legislation
Credit Rating Agencies	Yes Certification by ESMA required	Needed in the absence of equivalence to access the EU market	Not specified in EU legislation	Not specified in EU legislation
Central Securities Depositories	Yes Recognition by ESMA required	Needed in the absence of equivalence to access the EU market	Possible, but need to comply with the requirements set out in the regulation	Possible
Trade Repositories (securities financing transactions regulation)	Yes Recognition by ESMA required	Needed in the absence of equivalence to access the EU market	Not specified in EU legislation	Not specified in EU legislation
Financial benchmarks	Yes Inclusion on ESMA register required or recognition by the MS of reference	Needed in the absence of equivalence to access the EU market	Not specified in EU legislation	Not specified in EU legislation

Source: EGOV

Against the background of the different regulatory approaches outlined above, the Commission has stressed in its [staff working paper](#) that “*equivalence provisions are tailored to the need of each specific act*”. The Commission’s July 2019 [Communication](#) further notes that “*it is now generally accepted that it would be extremely difficult to implement a uniform assessment and decision-making process encompassing various areas of equivalence. Policy-makers, regulators and other stakeholders now accept the need for heterogeneity in the EU approach to equivalence as long as under each specific equivalence type some common principles are respected: proportionality in the assessments, a risk-sensitive approach to determining equivalent outcomes, as well as enhanced transparency both towards the interested third country and the public at large. In addition, there is a general consensus on the need to put in place arrangements to monitor the ongoing fulfilment by the third countries of the conditions underlying any positive equivalence decision*”.

¹⁷ Member States may allow AIF managers who are not established and authorised in the EU to market AIFs (EU AIFs and non-EU AIFs) only in their territory under the so-called National Private Placement regimes (“NPPR”), in accordance with the provisions set out in article 43 of the AIFM Directive. That Directive provides Member States with discretion as to whether to activate NPPR and allow for stricter rules in addition to the minimum requirements in that Directive.

The question has been raised as to whether European Supervisory Authority should be empowered with further supervisory responsibilities along the lines of model 3 or 4. In a [letter](#) to the European Commission in July 2017, ESMA welcomed the EMIR 2.2 proposal, and stressed that “*depending on the risks posed by third country entities, it is important to have the possibility of supervision at EU level, to ensure efficient and effective supervision and meeting the objectives of investor protection and stable EU financial markets*”. In that context, considering the impact of the UK’s withdrawal from the EU and the “associated emergence of certain third country entities with a potential impact on EU financial stability and investor protection”, ESMA invited the Commission to consider whether similar proposals should be considered for other market infrastructures and key market players, including third country regimes for credit rating agencies, trade repositories, benchmarks, and possibly trading venues, and data providers.

Proportionality and risk-sensitivity of assessment

The Investment Firms Review (IFR) adopted in April 2019 by the [co-legislators](#) provides for a proportionate and risk-sensitive equivalence assessment for third countries investment firms under MiFIR. In particular, the IFR requires a “detailed and granular assessment” of the “prudential, organisational and business conduct requirements” when it comes to services and activities performed by third country firms that are “likely to be of systemic importance for the Union”. In that case, the Commission is specifically invited to “*attach [to the equivalence decision] operational conditions [...] that would ensure that ESMA and national competent authorities have the necessary tools to prevent regulatory arbitrage and monitor the activities of third country investment firms*”. That legislative change initially proposed by Commission echoes concerns voiced by EBA in its [Brexit opinion](#): “*The Commission should consider ensuring that, when investment firms are established in third countries, they be subject to appropriate conditions for access to the single market including a robust assessment of the equivalence of the prudential standards applicable to them*”.

The Commission intends to apply that approach across the board to all equivalence decisions: “*the determination of equivalence [...] is driven by two main aspects: the principle of proportionality and the need to assess risks derived from an equivalence decision*” [...] “*The focus on risk in this process implies that, as a rule, “high impact” third countries, for which an equivalence decision is likely to be used intensively by market participants, will represent a more significant set of risks which the Commission will need to address in its assessment*” (July 2019 Commission [communication](#)).

Supervisory cooperation and enforcement mechanisms

Financial services legislation features cooperation arrangements with third countries’ authorities as a condition for determining equivalence. The July 2019 Commission’s [communication](#) on equivalence in the area of financial services puts a particular emphasis on cooperation arrangements with third countries: “*Lack of timely cooperation by third-country authorities in sharing information on legislative developments, or supervisory practice or implementation policies could be a ground for starting an ad-hoc review of an equivalence decision*”.

By way of example, under MiFIR cooperation arrangements for the supervision of third country investment firms includes mechanism and procedures governing the coordination of supervisory activities and exchange of information (see Box 2). For the purpose of supervising central counterparties under EMIR, ESMA and the US Commodity Futures Trading Commission (CFTC) have established a [Memorandum of Understanding \(MoU\)](#) under EMIR.

Box 2: Cooperation arrangements under MiFIR Article 47(2)

“ESMA shall establish cooperation arrangements with the relevant competent authorities of third countries whose legal and supervisory frameworks have been recognised as effectively equivalent in accordance with paragraph 1. Such arrangements shall specify at least:

- (a) The mechanism for the exchange of information between ESMA and the competent authorities of third countries concerned, including access to all information regarding the non-Union firms authorised in third countries that is requested by ESMA;*
- (b) The mechanism for prompt notification to ESMA where a third-country competent authority deems that a third-country firm that it is supervising and ESMA has registered in the register provided for in Article 48 infringes the conditions of its authorisation or other law to which it is obliged to adhere;*
- (c) The procedures concerning the coordination of supervisory activities including, where appropriate, on-site inspections which ESMA may carry out, in cooperation with the competent authorities of the Member States where the third-country firm provides services or performs activities in accordance with Article 46, where it is necessary for the accomplishment of the tasks of ESMA or the competent authorities in accordance with this Regulation, having duly informed the competent authority of the third-country thereof;*
- (d) The procedures concerning a request for information pursuant to paragraphs 6a and 6b of Article 46 that ESMA may submit to a third country firm registered in accordance with Article 46(2).*

In addition to the MoU between ESMA and third country authorities, EMIR 2.2 includes a comprehensive framework to ensure the enforcement of ESMA supervisory decisions and other EU requirements. In particular, ESMA has the power to impose fines and take other administrative measures in case of established infringements by third-country CCPs (Article 25g and 25n), including the possibility to withdraw the recognition (Article 25m).

3. The EU equivalence regime and Brexit

Loss of ‘passporting’ rights

When the UK will become a third country - and without prejudice to any transition that may be agreed upon as part of the withdrawal agreement - EU legislation providing ‘passporting’ rights within the EU will no longer apply to financial services providers established in UK. This is recognised in the UK White Paper of July 2018: “*The UK can no longer operate under the EU’s passporting regime as this is intrinsic to the Single Market of which it will no longer be a member*”.

In the context of firms’ preparedness for the Brexit scenario, the Commission has published a number of [notices](#) outlining the legal consequences attached to the loss of ‘passporting’ rights in different financial services legislation, including banking, investment services, derivatives and asset management. As emphasised by the Commission, firms will need to get an authorisation (i.e. a new legal entity established in the EU or extension of an existing licence) from EU competent authorities to fully keep the benefit of the internal market (i.e. ‘passporting’ rights)¹⁸. This is without prejudice to equivalence decisions that may be adopted by the EU in accordance with specific sector legislation.

European Council position on equivalence

The [guidelines](#) of the European Council (Art. 50) adopted on 23 March 2018 on the framework for post-Brexit relations with the UK are not financial services specific. For services, the EU Council guidelines specify that provision of services would take place under “host rules”, i.e. EU law. This means that EU law (rules of establishment and equivalence, where appropriate) will govern the provision of services from third countries in the EU¹⁹.

Equivalence regimes would be available to the UK after the transition period. During the transition period the *acquis communautaire* with full rights and obligations related to the access to the single market will be applicable. This means that the UK authorised entities will keep their ‘passporting’ rights during the transition period (see [presentation of Task Force 50 on financial services](#)). In the absence of a transition period (i.e. “no deal scenario”), equivalence may, where appropriate and available under sectoral legislation, be used to provide partial access to the internal market (see below - Possible use of equivalence in a no deal scenario).

UK position on equivalence

The UK published on 12 July 2018 a [White Paper](#) on “The Future Relationship between the United Kingdom and the European Union” that include considerations on how market access should be governed in the future under an “enhanced” equivalence regime. This proposal has been further worked out in a [presentation](#) published in August 2018 (see Table 4 overleaf).

¹⁸ “[At the time of withdrawal,] UK entities providing banking and payment services will no longer be allowed to provide services in the EU on the basis of their current authorisations. [A continuation of those services may hence require the] authorisation as a branch or subsidiary, and potentially result into changes for depositors, for instance where deposit guarantee arrangements would need to change”.

¹⁹ The draft European Council guidelines unveiled by [Politico](#) featured a statement in its Annex IV on financial services which called for “*reviewed and improved equivalence mechanisms*” to allow “*appropriate access to financial services markets, while preserving financial stability, the integrity of the single market and the autonomy of decision making in the European Union*”. That annex, however, was not part of the [final guidelines](#) adopted by the European Council on 23 March 2018. Nevertheless, it must be noted that EMIR 2.2, the ESA review and the Investment Firm Review outlined above have been presented as “adaptation measures” for Brexit purposes (see [presentation of Task Force 50 on financial services](#)).

The UK position on equivalence has evolved over time. While equivalence was deemed “wholly inadequate” in March 2018²⁰, the July 2018 UK White Paper suggests expanding the “existing autonomous frameworks for equivalence”. Decisions on whether UK firms should have access to the EU’s markets would be a matter for the EU and vice versa, in keeping with the regulatory autonomy principle. However, the White Paper suggests bilateral Treaty-based commitments to provide certainty and stability that is not provided for under existing EU equivalence regimes. As the UK government puts it, “*autonomy does not prevent either of us entering into commitments today about how we will approach our respective judgments, or agreeing clear processes around mediation, problem solving and sensible timetables for winding down activity and avoiding retaliation*”.

The White Paper leaves open for discussion which processes would be treaty-based or achieved through the autonomous measures of the UK and EU.

Table 4: The UK White Paper approach to equivalence

	Item	UK approach to equivalence	Current EU law and practices
Decision making process	Reciprocal recognition from the onset	As the UK and the EU start from a position of identical rules and supervisory framework, UK suggests reciprocal recognition of equivalence under all existing third country regimes, taking effect at the end of the transition period.	Unilateral decision
	Market access	Both the UK and the EU will wish to maintain autonomy of decision making in terms of market access	Unilateral decision Commission’s discretion to lay down conditions
	Consultation of stakeholders	Consultation with industry and other stakeholders Possibility of using expert panels	Commission to assess ESA review suggests assistance of ESA
	Assessment methodology	Evidence-based judgment of the equivalence of outcomes achieved by the respective regulatory and supervisory regimes	Detailed and granular assessment proposed by Commission as part of the Investment firms review
	Withdrawal of equivalence	If equivalence were to be withdrawn, there would need to be an initial period of consultation on possible solutions to maintain equivalence, followed by clear timelines and notice periods	Not specified Commission can withdraw
Governance structure	Regulatory dialogue	Structured consultative process of dialogue at political and technical level while respecting the autonomy of each side’s legislative process and decision-making	Regulatory cooperation with US and Japan
	Supervisory cooperation	Information exchange, mechanisms for consultation over decisions, and arrangements for the supervision of market infrastructure	MoUs with third countries (condition for granting equivalence). In some cases, EU <i>acquis</i> offers the possibility to conclude international agreement (e.g. for the purposes of supervision on a consolidated basis in banking)
	Scope of market access	Broader range of cross-border activities than existing equivalence regimes, e.g. for the marketing of funds to retail clients	Limited, in particular retail activities, lending and insurance are excluded

Source: EGOV

Reacting to the UK proposal, in a speech in August 2018 reported by the [financial press](#), Vice President Dombrovskis welcomed UK proposals to build market access for the City of London around EU rules (i.e.

²⁰ In a [speech](#) delivered in March 2018, the Chancellor of the Exchequer, Philip Hammond discarded the equivalence system as a promising way forward and explained that the equivalence regime “*would be wholly inadequate for the scale and complexity of UK-EU financial services trade*”. The following arguments were put forward: “[the equivalence regime] was never meant to carry such a load. The EU regime is unilateral and access can be withdrawn with little to no notice: clearly not a platform on which to base a multi-trillion pound trade relationship”.

equivalence) but stressed that market access could never be taken for granted. The Commission seemed open to discussion about adding more equivalence possibilities into EU law but seemed to dismiss reciprocal recognition or broader commitments). The financial press reported that Vice President Dombrovskis objected to a “super equivalence to UK” as the assessment of equivalence would require individual assessment sector by sector and legislation by legislation. The EU Chief Negotiator, Michel Barnier, has also made clear (see Box 3) that the EU will be making autonomous equivalence decisions.

In support of its proposal for a treaty-based economic and regulatory arrangement, the UK has put forward the precedent of the Free Trade Area (FTA) between Japan and the EU which follows a two-pronged approach. While the criteria and decision making for equivalence is outside the agreement, the FTA establishes regulatory cooperation, including consultation and technical mediation. In addition, it must be noted that when discussing the EU-US trade agreement (TTIP), the Commission suggested in 2014²¹ a “commitment to outcome-based assessments of whether the other party’s regulatory and supervisory framework is equivalent” (see [EU negotiating position on financial services](#) for TTIP) that “could potentially lead to mutual reliance on the rules of the other party”. Nevertheless, the EU did not envisage “each party making binding declarations of the equivalence of the other’s entire regulatory and supervisory framework, but rather carrying out a detailed assessment of the consistency of the implementation of each standard”.

Box 3: Michel Barnier’s [speech](#) of July 2018

“A clear example of what this means concerns our future relationship in financial services.

- *We discussed financial services this week and agreed that future market access will be governed by autonomous decisions on both sides.*
- *We recognised the need for this autonomy, not only at the time of granting equivalence decisions, but also at the time of withdrawing such decisions.*

And we agreed to have close regulatory cooperation, which will also have to respect the autonomy of both parties.”

Equivalence as part of the future relationship

According to the political [declaration](#) of 22 November 2018 setting out the framework for the future relationship between the European Union and the United Kingdom, equivalence will govern the provision of financial services post Brexit (see Box 4). Importantly, in keeping with the principle of autonomy outlined above, “each party [keep] its ability to take equivalence decisions in their own interest”.

²¹ Before the financial crisis, the EU Commission and the US Securities Exchange Commission discussed in 2008 an EU-US “mutual recognition arrangement” that “would have the potential to facilitate access of EU and US investors to a broader and deeper transatlantic market [...] and increase oversight coordination among regulators”.

Box 4: Equivalence of financial services as part of the future relationship

“IV. FINANCIAL SERVICES

37. The Parties are committed to preserving financial stability, market integrity, investor and consumer protection and fair competition, while respecting the Parties’ regulatory and decision-making autonomy, and their ability to take equivalence decisions in their own interest. This is without prejudice to the Parties’ ability to adopt or maintain any measure where necessary for prudential reasons. The Parties agree to engage in close cooperation on regulatory and supervisory matters in international bodies.

38. Noting that both Parties will have equivalence frameworks in place that allow them to declare a third country’s regulatory and supervisory regimes equivalent for relevant purposes, the Parties should start assessing equivalence with respect to each other under these frameworks as soon as possible after the United Kingdom’s withdrawal from the Union, endeavouring to conclude these assessments before the end of June 2020. The Parties will keep their respective equivalence frameworks under review.

39. The Parties agree that close and structured cooperation on regulatory and supervisory matters is in their mutual interest. This cooperation should be grounded in the economic partnership and based on the principles of regulatory autonomy, transparency and stability. It should include transparency and appropriate consultation in the process of adoption, suspension and withdrawal of equivalence decisions, information exchange and consultation on regulatory initiatives and other issues of mutual interest, at both political and technical levels”.

Source: Political [declaration](#) of 22 November 2018 setting out the framework for the future relationship between the European Union and the United Kingdom.

Possible role of equivalence in a no deal scenario

The UK [adopted](#) in November 2018 a temporary permission regime for firms operating in the UK (the “[EEA Passport Rights \(Amendment, etc., and Transitional Provisions\) \(EU Exit\) Regulations 2018](#)”). According to the [Bank of England](#), the aim of the temporary permissions and recognition schemes will be to allow firms, including CCPs, who wish to continue carrying out business in the UK in the longer term to operate in the UK for a limited period after withdrawal while they seek authorisation or recognition from UK regulators. This temporary permission regime comes down to granting market access to EU firms under “equivalence” for a limited period of time (maximum of three years). In the event that the Withdrawal Agreement is not ratified, the temporary permission has been portrayed as a “back-stop” to mitigate disruption risks. An EU27 temporary permission regime has been advocated for by the [Bank of England](#) with respect to the provision of services by UK firms in the EU.

The Commission has not provided a similar mechanism in case of a no deal scenario. While temporary equivalence decisions are available under the EU *acquis* (for services subject to equivalence regimes - see Part 1), it must be noted that such decisions are subject to a process (i.e. comitology involving Member States before adopting implementing acts) that may not necessarily be fit-for-purpose for timely (interim or temporary) equivalence decisions. As part of its contingency measure in a no-deal scenario, the [Commission](#) has deemed it necessary to implement contingency measures to safeguard financial stability in the EU27 only in relation to derivatives²² for which temporary and conditional equivalence decision has been taken. The Bank of England already announced in December 2012 that it would recognise the equivalence of non-UK CCP.

Failing other contingency measures, *“UK operators and their counterparts in the EU27 must therefore take action to comply with Union law in all scenarios and in time for the United Kingdom’s withdrawal, as the*

²² The Commission adopted in December 2018 (i) a temporary and conditional equivalence decision for a fixed, limited period of 12 months to ensure that there will be no immediate disruption in the central clearing of derivatives ; (ii) A temporary and conditional equivalence decision for a fixed, limited period of 24 months to ensure that there will be no disruption in central depositories services for EU operators currently using UK operators ; (iii) Two Delegated Regulations facilitating novation, for a fixed period of 12 months, of certain over-the-counter derivatives contracts, where a contract is transferred from a UK to an EU27 counterparty.

Commission has indicated in the stakeholder notices" (see above). This means that UK-based institution and market participant need to be authorised in the EU to continue their operations.

Temporary permission regimes have nevertheless been established at national level to provide services in the concerned Member State. By way of example, in [Germany](#), Bafin has been authorised to declare – for the purpose of avoiding disadvantages for the operability and stability of the financial market – that UK banks and financial services providers which currently provide services on a cross-border pass-ported basis either through a branch or through mere services without a branch shall be deemed to be allowed to do so on the basis of the currently existing rules for a period of up to 21 months post Brexit if the services are closely connected to contracts that existed at the time of withdrawal. Other Member States have implemented or plan to implement regimes aiming at avoiding cliff effects of Brexit (for an overview of such regimes in Member States, see an [analysis](#) provided by Norton Rose).

The question as to whether Commission will be willing to grant equivalence in case of a no deal scenario remains. While Commission's July 2019 communication is not UK-specific and provides for a horizontal approach, the following statements are worth mentioning in a no-deal context:

- *"The EU monitors and, where necessary, dynamically responds to external regulatory and supervisory developments (meaning improvement or deterioration of bilateral cooperation/mutual trust) that may impact the broader regulatory environment for market participants active in the EU";*
- *Consideration of the "equity and fairness in the treatment of EU players active in third countries";*
- *"Equivalence empowerments do not confer a right on third countries for their framework to be assessed or to receive an equivalence determination, even if those third countries are able to demonstrate that their frameworks fulfils the relevant criteria";*
- *"While equivalence is assessed under the criteria established in EU law, the Commission also needs to consider whether equivalence decisions would be compatible with EU policy priorities in areas such as international sanctions, the fight against money laundering and terrorist financing, tax good governance on a global level or **other relevant external policy priorities**, in order to ensure the consistency of the EU's action on the international stage" [our emphasis];*
- *"The Commission is committed to stable and open financial markets. However, if the United Kingdom leaves the European Union without an agreement on 31 October 2019, this will necessarily result in some market fragmentation in financial services"²³.*

²³ State of play of preparations of contingency measures for the withdrawal of the United Kingdom from the European Union, [Commission](#), June 2019

4. Brexit-related supervisory and regulatory issues

Planning for the worst (no deal and no equivalence)

In its July 2018 [opinion](#) on firms' preparedness to Brexit, EBA emphasised that *"progress in the preparations of financial institutions for the potential departure of the UK from the EU without a ratified withdrawal agreement in March 2019 is inadequate"*. The ECB and EBA have urged firms to step up their efforts in implementing contingency plans, while further outlining supervisory and regulatory expectations. Public authorities continued to discuss and update market participants of what to expect in case of a no deal scenario. In addition, the issue is being raised as to whether contract continuity for derivatives may need a "public solution" absent satisfactory preparation (see further below).

Absent applicable equivalence decisions service providers established in the UK would need to relocate into the EU in order to continue providing financial services across the internal market. In 2017, the [ECB](#) warned banks to plan for a worst case scenario (i.e. no withdrawal agreement, no transition and no equivalence decisions) and has since been preparing for all operational aspects related to a possible relocation of UK-based banks to the EU post-Brexit. The ECB has laid down procedures for the relocation of banks to the euro area in the context of Brexit that are kept updated²⁴ on its [web site](#). The ECB [has also clarified](#) in November 2018 that all banks which are expected to come under direct supervision by the ECB will be subject to a comprehensive assessment. The exercise usually takes place before a bank comes under ECB supervision, but may also be conducted at a later stage. In [February 2019](#) the ECB outlined its work on Brexit related issues and risks, referring, in particular, to the orientations contained in its *"supervisory expectations"* released in August 2018. These aim at ensuring compliance with EU rules and a sufficient presence in the EU.

Banks have been reminded in May 2019 that a *"hard Brexit is still possible on 1 November 2019"*. Against that background, *"banks should [...] not lessen the pace of implementation of their Brexit plans, as the overall situation remains broadly unchanged. Rather, they should use the coming months to ensure that they are full prepared"* ([ECB](#), Brexit: latest state of play).

Over the past years, European Supervisory Authorities have also monitored firms' preparedness to a non-deal Brexit:

- [EBA](#) published in June 2018 an opinion to hasten the preparations of financial institutions for Brexit. EBA is asking competent Authorities to ensure that financial institutions take practical steps now to prepare for a no deal scenario. In addition, in March 2019, EBA issued an [opinion](#) addressed to the competent authorities under the Deposit Guarantee Schemes Directive calling for enhanced action to ensure deposits of UK credit institutions branches operating in the EU continue to be adequately protected after the UK's withdrawal from the EU²⁵. EBA also stepped up its [requests](#) that financial institutions provide their clients sufficient information on the possible impacts of Brexit.
- ESMA issued several notes regarding a possible no-deal scenario. These address issues such as [data](#) required for MiFIR and MiFID transparency calculations, clearing and settlement (ESMA already

²⁴ Last update at the time of writing: 2 August 2018.

²⁵ EBA points out that the expected impact of Brexit to depositors should be low but cautions that "(...) the UK's Bank of England published a consultation paper, which proposes that EEA branches of UK credit institutions will no longer be protected by the UK DGS. This would be in line with the UK's current policy of not covering branches of UK credit institutions in third countries. (...) on 28 February 2019 the Bank of England confirmed their intentions in the 'near-final' post-exit rules and standards. The UK's intended approach (...) means that, in the absence of any action taken by the competent authorities, depositors at branches set up by UK credit institutions in the EU will lose coverage, unless these branches join a local DGS in the EU. Therefore, (...) such branches should be required to join a local (EU) DGS subject to the requirements of the national law (...). This is based upon the assumption that, if no protection is provided to these branches by the UK DGS, that would clearly mean that their protection is not equivalent to the protection offered by the DGSD, and so no further checks of equivalence would be needed."

recognised UK [CCPs](#) and [CSDs](#)²⁶), [EMIR reporting](#), on [supervision](#) of non-EU branches of EU firms providing investment services and activities and on the [Transparency and Prospectus frameworks](#). ESMA also established *memoranda of understanding* with the UK authorities (with the [Bank of England](#) and the [Financial Conduct Authority](#)) that are necessary for ensuring smooth cooperation. As part of their work on investor protection, [ESMA](#) has also urged firms to provide their clients sufficient information ahead of Brexit²⁷.

- EIOPA issued in February 2019 its [recommendations](#) for the insurance sector addressing in particular continuity and regularity of services.

The “State of play of preparations of contingency measures for the withdrawal of the United Kingdom from the European Union, [Commission](#), June 2019” takes note of the “significant progress” firm have made, “including establishment in the EU27 Member States” (see Box 5).

Possible supervisory challenges in relation to authorisation

As part of banks’ preparation to Brexit, banks have been requested by the [ECB](#) to submit complete and high-quality applications by the end of Q2 2018 for the ECB to complete the authorisation process. In view of the challenges that banks face in adapting to Brexit, the [SSM](#) emphasised in July 2019 the large “flexibility” it has used “*as regards the time banks take to meet certain supervisory expectations and build up their capabilities in the euro area*”. Against this background, “*despite the extension of the Article 50 Treaty on European Union period, banks are still expected to implement their plans as soon as possible and in accordance with the timelines agreed with their supervisors*”.

The three ESAs, and in particular the [EBA in banking](#) and [ESMA for investment firms](#), have adopted Brexit opinions outlining supervisory expectations regarding authorisation and outsourcing arrangements. Those opinions aim at preventing the establishment in the Union of “empty shells” relying on “outsourcing arrangements”.

The issue has been raised as to whether a legal entity established in the EU could serve its EU clients via its branch located in the UK. Both the ECB and ESMA have put limits to “back-branching”:

- The ECB has clarified in its [frequently asked questions on relocation](#) that the “*ECB and the national supervisors believe that the purpose of branches in third countries is to meet local needs. The ECB and national supervisors do not expect that branches in third countries perform critical functions for the credit institution itself or provide services back to customers based in the EU*”;

²⁶ ESMA has also registered DTCC Ireland which will be providing services of trade repository from Ireland as part of the DTCC Group strategy for dealing with Brexit.

²⁷ ESMA requires, in particular, that firms inform their clients in relation to (a) impact of UK departure for the given firm and its business, and the implications this has for the relationship between the client and the firm; (b) actions the firm is taking such as organisational arrangements to deal with client inquiries; (c) implications for clients of any corporate restructuring and, in particular, any relevant changes to contractual terms; and (d) contractual and statutory rights of clients, including the right to cancel the contract and any right of recourse, where applicable.

- Likewise, ESMA in its Brexit opinion has made clear that the use of non-EU branches needs to be based on objective reasons linked to the services provided in the non-EU jurisdiction and does not result in a situation where such non-EU branches perform material functions or provide services back into the EU.

Box 5: Brexit preparedness in the area of financial services (June 2019)

"In the area of financial services, in the run-up to the previous withdrawal date of 12 April 2019, firms had made significant progress with their contingency planning, including establishment in the EU27 Member States, modification ('repapering') or termination of cross-border contracts, and adaptation of business models. However, some residual issues remain. Insurance firms, payment services providers and other financial service operators which remain unprepared regarding certain aspects of their business (for example contract management and access to infrastructures) are strongly encouraged to finalise their preparatory measures by 31 October 2019. The Commission is working with EU-level and national supervisors to ensure that firms' contingency plans are fully implemented, and it expects that UK supervisors will not prevent firms from implementing such plans. The Commission is also working together with Member States to ensure a consistent approach to contingency preparations in the area of financial services at national level, to preserve financial stability and avoid harming the level playing field in the single market for financial services. The Commission is committed to stable and open financial markets. However, if the United Kingdom leaves the European Union without an agreement on 31 October 2019, this will necessarily result in some market fragmentation in financial services"

Source: State of play of preparations of contingency measures for the withdrawal of the United Kingdom from the European Union, [Commission](#), June 2019

Supervision of third countries branches

With Brexit, third countries branches are expected to expand their business, which may raise concerns in terms of how national authority would coordinate their supervisory actions. In that respect, the FSAP conducted by the [IMF](#) on the euro area recommended not only that the SSM be responsible for the supervision of systemic investment firm (as proposed by Commission in the Investment Firm Review), but also that "EU branches of non-EU banks, especially the large ones forming or growing in advance of Brexit be brought under the SSM". For smaller investment firms, the IMF suggests that more harmonisation of practices among the national authorities, under the aegis of ESMA. In that respect, the Investment Firm Review as agreed by the [co-legislators](#) in April 2019 features a coordination role for ESMA that may request national authorities to communicate to ESMA the scale, the turnover and the total assets as well as the scope of the services and activities carried by an authorised branch in a Member State.

Supervisory cooperation would be of particular importance. In relation to branches, the UK has already placed a great emphasis on the degree of cooperation it would expect from the EU competent authorities (see Box 6).

Box 6: UK authorities' expectations in terms of supervisory cooperation

In its December 2017 [consultation paper](#) on branch authorisation and supervision post Brexit, the Bank of England Prudential Regulation Authority (PRA) emphasised that it would place a particular focus on the quality of supervisory cooperation, in particular with respect to EU Member States: *"on the basis of their existing business structures and current degree of supervisability, including the level of supervisory cooperation already in place, the PRA does not expect the new approach to affect any of the non-EEA international banks currently authorised to operate in the UK through branches"*. Further to that [consultation](#), no material changes have been made to this policy.

This consultation document does not contemplate direct access to the UK market from the EU, but outlines conditions for firms to operate in the UK through branches. In terms of supervisory approach, for systemic wholesale branches, the PRA would assess *"the degree of **influence and visibility that it has over the supervisory outcomes for the firm as a whole and the wider group**"* [our emphasis]. This is meant to ensure that the home state supervisor (i.e. ECB in the Banking Union) *"delivers an outcome that is consistent with the PRA's objective"*. Failing appropriate supervisory cooperation mechanism, branches may be requested to 'subsidiarise'.

Cooperation arrangements

In March 2019, [EBA](#) agreed a template for the memorandum of understanding (MoU) governing supervisory cooperation and information exchange between the EU supervisory authorities and the UK authorities. The template is intended to serve as the basis for bilateral MoUs between the relevant EU competent authorities and the UK authorities. On this basis, the [ECB](#), the UK Prudential Regulatory Authority and the UK Financial Conduct Authority agreed in April 2019 on a MoU "that will enable their current cooperation and exchanges of information to continue after Brexit. A wide range of areas are covered in the MoU, including ongoing supervision, authorisation procedures, on-site inspections, the application of supervisory measures, cooperation in emergency situations, and enforcement".

In the same vein, ESMA and the UK authorities have agreed on 4 February [MoUs](#) that will underpin recognition of equivalence for UK CCPs (under EMIR) and CSDs (under the [Central Securities Depositories Regulation](#)) in the case the UK leaves the EU without an agreement. Also in a context of no agreement with the UK, ESMA and the EEA regulators have agreed a [Multilateral MoU](#) setting out cooperation for the purposes of market surveillance, investment services and asset management activities (see part 3 for equivalence and Brexit).

Is there a risk of derivatives contract discontinuity?

Analysis conducted by the industry ([AFME](#) together with ISDA) and the [Bank of England](#) points to the legal uncertainty of over-the-counter (OTC) derivatives contract continuity post-Brexit given diverging national approaches across EU Member States. This concern has recently been echoed by the [IMF](#) and German [BaFIN](#). On other hand, Vice-President Dombroskis at a press [conference](#) in July 2018 took the view that "Overall, even after Brexit, the performance of existing obligations can generally continue," citing derivatives contract as example.

ISDA and AFME consider that Brexit will not make it illegal for firms to perform contractual obligations under existing contracts in most (if not all) Member States, and thus should not affect the legal validity of existing transactions. Nevertheless, firms may need to be authorised in some EU Member States and vice versa in the UK for the performance of some "lifecycle events" (e.g. exercise of options, transfers of collateral...). Licensing requirements vary from one Member States to another.

The Bank of England called for a "public solution" being secured on financial stability grounds to ensure continuity of outstanding uncleared derivatives contracts. In its November 2017 [financial stability report](#), the Bank of England voiced concerns about operational challenges that such repapering would entail: *"Each major dealer will have several thousand counterparties, with whom contracts will require renegotiation,*

potentially impacting tens of thousands of underlying clients". Likewise, in its Article IV report for the Euro area, the IMF has "urged the EU and U.K. authorities take steps, together, to ensure legal continuity in insurance and derivative contracts and proper data sharing to avoid any cliff effects". The UK Financial Conduct Authority recently published a [statement](#) outlining the implications of a no-deal Brexit on EMIR and derivatives.

The European Supervisory Authorities have ruled out any "public solution". In its April 2018 [report](#) on risks and vulnerabilities in the EU financial system, the European Supervisory Authorities' Joint Committee emphasised that *"Financial institutions are responsible for ensuring that they are able to fulfil their contractual obligations under all circumstances, not least with respect to derivatives, liquidity provision, and swap contracts EU 27 parties have entered into"*. In the same vein, in its July 2018 [opinion](#) on firms' preparedness to Brexit, EBA reiterated the need for financial institutions to consider all options with respect to mitigating possible risks to these contracts, including making the necessary changes to those contracts (amendment, novation, transfer, etc.).

Whilst agreeing that no public intervention is necessary²⁸, the [ESAs](#) proposed in November 2018 to amend the Commission Delegated Regulation on the risk mitigation techniques for OTC derivatives not cleared by a CCP (bilateral margin requirements) under EMIR. The amendment aims at introducing a limited exemption to bilateral margining to facilitate the novation of certain OTC derivative contracts to EU counterparties during a 12 month time-window if the UK leaves the EU without an agreement²⁹.

Where a license is needed to perform some life cycle events in accordance with national law, it must be noted that a significant number of Member States have adopted or are considering the adoption of national temporary permission regimes along the lines of the UK framework (see Part 3), as a contingency measure. In a recent [paper](#) ("Brexit: Remaining no-deal risks in financial services, July 2019"), AFME welcomed those legal clarifications: *"we strongly welcome the efforts made at national level in many Member States and the UK to enable lifecycle events to continue to be performed, at least for a temporary period"*.

UK firms are also taking steps to ensure the continued flow of services to EU counterparties and clients, including setting up EU entities from which to provide services. According to Bank of England's July 2019 [Financial Stability Report](#), *"approximately half of the major UK-based banks' EU clients have now completed the necessary documentation in order to be able to enter into derivatives trades with the banks' EU entities"*.

Trading obligation

It has been argued, notably by [AFME](#), that the lack of equivalence for the UK exchanges will lead to diminishing liquidity for investors. In fact, article 23 of MiFID requires EU investment firms to trade shares traded on an EU trading venue only on EU trading venues or third country trading venues assessed as

²⁸ ESMA notes that "As regards non-centrally cleared OTC derivative contracts, these two measures will be the only regulatory measures the ESAs intend to propose to help address the legal uncertainty raised by the withdrawal of the UK from the EU and to ensure a level-playing field between EU counterparties. Counterparties should start negotiating as soon as possible the novations of their transactions which are in the scope of these amending regulations, given the twelve month timeframe to benefit from it."

²⁹ The draft RTS complement a similar [proposal](#) published by ESMA on [8 November](#) with respect to the clearing obligation. These limited exemptions would allow maintaining the regulatory and economic conditions under which the OTC derivative contracts were originally entered into. The Commission has followed up and adopted in December 2018 proposals to amend [two regulatory technical](#) standards under EMIR ([COMMISSION DELEGATED REGULATION \(EU\) .../... of 19.12.2018 amending Delegated Regulation \(EU\) 2016/2251 supplementing Regulation \(EU\) No 648/2012 of the European Parliament and of the Council as regards the date until which counterparties may continue to apply their risk-management procedures for certain OTC derivative contracts not cleared by a CCP and COMMISSION DELEGATED REGULATION \(EU\) .../... of 19.12.2018 amending Commission Delegated Regulation \(EU\) 2015/2205, Commission Delegated Regulation \(EU\) 2016/592 and Commission Delegated Regulation \(EU\) 2016/1178 supplementing Regulation \(EU\) No 648/2012 of the European Parliament and of the Council as regards the date at which the clearing obligation takes effect for certain types of contracts\).](#)

equivalent by the Commission (a sort of a “EU concentration rule”³⁰). The trading obligation only applies to shares that are traded on a frequent basis in the EU. ESMA has clarified in a statement (revised in [May 2019](#)) that the share trade obligation, in case of a non-deal Brexit scenario would not apply to UK shares (shares with a UK ISIN). Pending the UK taking a similar approach, such statement would mitigate the negative impacts imposed on firms.

Other relevant documents published by the European Parliament

- EGOV [briefing](#) “Third-country equivalence in EU banking legislation, July 2017;
- [Understanding equivalence and the single passport in financial services, third-country access to the single market](#), Marcin Szczepanski, European Parliamentary Research Service, February 2017.

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³⁰ The share trading obligation was imposed as part of MiFID II review to ensure that dual traded shares (in an EU trading venue and a non-EU trading venue) are only traded in platforms with regulatory oversight and transparency equivalent to those of the EU.