

Equivalence decisions under the Markets in Financial Instruments Directive and Regulation (MiFID II/MiFIR)

Committee on Economic and Monetary Affairs
Scrutiny Session of 25 January 2018

This briefing has been drawn up to support ECON's work on the scrutiny of delegated acts, in particular as regards the discussion of 25 January 2018 on equivalence decisions under the Markets in Financial Instruments Directive (**MiFID II** - [2014/65/EU](#)¹) and Regulation (**MiFIR** - [600/2014/EU](#)²).

The briefing includes a section (page 4) on the [Regulatory Technical Standards on Strong Customer Authentication and Secure Communication](#) as adopted by the Commission on 27 November 2017 under Article 98 of the revised **Payment Services Directive (PSD2)** [2015/2366](#), to be discussed at the end of the scrutiny session.

In brief

On 3 January 2018, the Markets in Financial Instruments Directive (**MiFID II**) and Regulation (**MiFIR**) became applicable. They provide an updated legal framework for the requirements applicable to investment firms, regulated markets, data reporting services providers and third country firms providing investment services or activities in the EU. Under this framework, provisions applicable to third country firms are related to their type of clients. A Member State (MS) may request that the third country firm opens a branch on its territory or firms can register with the European Securities and Markets Authority (ESMA) - provided, among other conditions, that the Commission adopted a positive equivalence decision for the third country. This briefing describes the process concerning the adoption of equivalence decisions, the relevant provisions of the MiFIDII/MiFIR framework, as well as recent equivalence decisions.

THE MiFIDII/MiFIR THIRD COUNTRY FRAMEWORK

Whilst the first Markets in Financial Instruments Directive (**MiFID I**) did not provide a harmonised framework for 'third country firms' (i.e. *'firms that would be a credit institution providing investment services or performing investment activities or an investment firm if its head office or registered office were located within the Union'* - MiFID II, Art. 4(1)(57)), its recast, the Markets in Financial Instruments Directive (**MiFID II**), and Regulation (**MiFIR**) include such a framework in various third country provisions.

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¹ 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, OJ L 173, 12.6.2014, p. 349–496.

² 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, OJ L 173, 12.6.2014, p. 84–148.

Access to EU regulated markets depends on the type of clients the third country firm intends to provide services to:

- For retail and elective professional clients, a national authority has the discretion to require the third country firm to **establish a branch** within its territory - this is subject to certain conditions for the firm as well as for the third country.
- For professional clients and eligible counterparts, cross-border activity is possible without establishing a branch, provided that the firm **registers with ESMA** and informs its clients that it is *not* subject to EU supervision - among other conditions, this requires a **positive Commission equivalence decision**.

COMMISSION EQUIVALENCE ASSESSMENTS

A **positive equivalence decision** means that the Commission considers that the third country's legal and supervisory arrangements ensure firms authorised in the country comply with legally binding prudential and business conduct requirements that are equivalent to requirements set out in the relevant EU legislation and that the third country's legal framework provides for an effective equivalent system for the recognition of investment firms authorised under third country legal regimes (MiFIR, Art. 47(1)).

Equivalence decisions under MiFID II/MiFIR are usually implementing acts, with the exception of the [delegated act](#) as regards the exemption of certain third countries central banks (MiFIR Art. 1(9), *see table 1*). They are preceded by **assessments of the regulatory and supervisory frameworks** under the Commission's 'examination procedure' - an assessment that follows the conditions laid-down in the basic act, is based on the principle of proportionality and follows a risk-based approach.

Any equivalence assessment is initiated at the Commission's own initiative but MS may indicate their interest for countries to be assessed. Throughout the procedure, the Commission is assisted by the **European Securities Committee (ESC)** that is composed of representatives from the MS. The ESC receives the draft implementing act, often for a vote through written consultation, and provides its opinion by qualified majority. However, as the Commission notes in a [staff working document](#) of 27 February 2017, when taking its decision, the **Commission will ultimately exercise the discretion** conferred upon it. An equivalence decision may be changed or even repealed by the Commission at any moment.

Unlike for Delegated Acts, **Parliament does not have a formal scrutiny role** for implementing acts. If Parliament opposes an equivalence decision, this does not affect the validity of the measure, but gives a political signal.

MIFIDii/MIFIR EQUIVALENCE DECISIONS ADOPTED TO DATE

Equivalence decision under Articles 23 and 28(4) of MiFIR

Third-country trading venues may be considered as regulated markets for the purpose of the trading obligation (TO) for shares and derivatives under MiFIR (Art. 23 and 28(4)), if the Commission considers the third-country is equivalent. Whilst the Commission is preparing a number of equivalence decisions for jurisdictions whose shares are traded '*systematically and frequently*' in the EU, it has thus far only adopted **one equivalence decision**, concerning the [United States](#) (*see table 1*). The decision recognises certain trading venues authorised by the US Commodity Futures Trading Commission (CFTC) as eligible for compliance with the TO for derivatives. According to the [Commission](#), the decision ensures that '*EU counterparties can trade the derivatives instruments that are subject to the TO, such as interest rate swaps and index-based Credit Default Swaps (CDS), on CFTC-authorized Designated Contract Markets and Swap Execution Facilities in the US*'.

In an updated [Q&A of 13 November 2017](#), ESMA notes that the absence of further equivalence decisions might be problematic for investment firms wishing to trade in non-EEA shares in primary listing venues. For cases where no equivalence decision exists, ESMA indicates that the '*Commission has currently no*

evidence that the EU trading in shares admitted to trading in that third country's regulated markets can be considered as systematic, regular and frequent'. Some [stakeholders](#) have interpreted this as a reduction of the TO's scope, allowing trade on venues for which equivalence was not determined.

Equivalence decisions under Article 25(4) of MiFID II

To date, the Commission has also recognised four countries providing trading venues under Article 25(4) that are equivalent to EU venues: the [Unites States](#), [Australia](#), [Hong Kong](#) and [Switzerland](#). The TO applies to shares listed on exchanges in these countries and in the EU ('dual listings'), on condition that EU trade constitutes a significant percentage of shares' global trading volume. In its [press release](#), the Commission furthermore notes that it considers that shares only listed on exchanges in Australia, Hong Kong and the US ('single listings') are *not* traded significantly in the EU and that trade in these shares can continue.

The decision for Switzerland was limited to one year, to allow for the [Commission](#) to 'closely monitor the impact of [the] decision and consider the broader political context, notably the progress in the negotiation of the institutional agreement with Switzerland'. During the equivalence assessment process, concerns about U.S. alternative exchanges and so-called '[dark pools](#)' have furthermore led the Commission to reduce the list of exchanges in the final decision to only those that trade in shares admitted to one of the US national exchanges.

TRANSITIONAL PROVISIONS

The provisions (MiFIR, Art. 54) include the possibility for MS to allow third-country firms to continue to provide their services until three years after the adoption of an equivalence decision. Furthermore, in the absence of equivalence decisions, MS may allow firms from third countries to provide services to eligible counterparties and per se professional clients, in accordance with their national regimes.

Table 1. MiFID II/MiFIR Equivalence decisions³

	Article		Countries covered
MiFID II	25(4)	Regulated markets for the purposes of easier distribution in the EU of certain financial instruments related there	Australia, Hong Kong, Switzerland, US
MiFIR	1(9)	Central bank exemption	Australia, Brazil, Canada, Hong Kong, India, Japan, Mexico, Republic of Korea, Singapore, Switzerland, Turkey, US (and BIS)
	23, 28(4)	Trading venues for the purposes of TO for derivatives and shares	US
	33	Derivatives: trade execution and clearing obligations	None
	38(1)	Trading venues for the purposes of clearing access	None
	38(2)-(3)	Trading venues and CCPs - access to benchmarks and licences for the purposes of clearing and TO	None
	47	Investment firms providing investment services to EU professional clients and eligible counterparties	None

³ Source: Commission Staff Working Document, 'EU Equivalence decisions in financial services policy: an assessment', SWD(2017) 102 final, 27 February 2017.

PSD2 RTS on Strong Customer Authentication & Secure Communication

In brief: PSD 2 RTS on SCA

Regarding security of payment services, Article 98 of the revised *Payment Services Directive (PSD2)* [2015/2366](#) requires *Regulatory Technical Standards on strong customer authentication and secure communication* (RTS SCA). The Commission has [adopted the RTS](#) (C(2017) 7782 final) on 27 November 2017. The RTS set out how SCA will be implemented. One **main issue of discussion** concerns the **fall back option in the communication interface**, accompanied by a waiver possibility for national competent authorities (NCAs) provided that certain requirements are met and maintained. ECON held four scrutiny sessions during the development of these RTS, see timetable below (abbreviations in previous briefings).

The RTS adopted **deviates significantly from the [EBA draft](#)** of February 2017 and also to some extent **from the previous [Commission 'amended RTS'](#)** which were published in May 2017; in particular:

- An exemption from SCA is added to cover **electronic payment transactions** performed through **dedicated payment processes used by corporates**, where security is achieved through other means than individual authentication, and NCAs approve provision of at least equivalent levels of security.
- In relation to the use of exemptions to SCA, payment service providers should **report the outcome of their monitoring and the methodology used to calculate the fraud rate** under the exemption based on using transaction risk analysis **to the EBA and** to the NCA (Articles 18(3) and 20(2)).
- The **'fall-back option'**: The Commission also adopted a compromise position so that if a dedicated interface of a bank is unavailable or performing inadequately, service providers are **allowed to access information using the customer interface** (Article 33, Recital 24). NCAs may exempt banks from establishing such a fall-back mechanism, provided the dedicated interface meets certain criteria. This could mean that banks and providers may face different SCA requirements depending upon which Member State they are operating in. But to facilitate the assessment process, the Commission is **setting up a market group** for vetting the different national and pan-EU standardised dedicated interfaces.

The discussion of stakeholders (banks, providers and EBA/NCAs) focusses *inter alia* on the modalities of the fall-back mechanism and the conditions for exemptions from providing the fall-back mechanism.

TIMELINE	RTS SCA
25 November 2015	PSD2 adopted (published 25 December 2015, in force as of 12 January 2016)
8 December 2015	EBA publishes discussion paper / 26 April 2016 : ECON scrutiny slot on PSD2
12 August 2016	EBA publishes consultation paper (see scrutiny briefing 29 November 2016)
23 February 2017	EBA publishes final draft RTS SCA (see scrutiny briefing 27 March 2017)
24 May 2017	Commission sends letter to the EBA with amended draft RTS
29 June 2017	EBA comments on amendments, (EBA/OP/2017-09)
27 November 2017	Commission adoption of the RTS (see scrutiny briefing 21 November 2017)
13 January 2018	PSD2 is applicable.
27 February 2018	<i>3 months scrutiny period of EP/Council ends (3+3, Art. 13(1) EBA Reg. 1093/2010)</i>
Between Feb.-June 2018	<i>Publication of the RTS in the Official Journal (if not opposed by EP and/or Council)</i>
Between Sept.-Dec. 2019	<i>the RTS to become directly applicable 18 months after its entry into force (i.e. the day following OJ publication), see Article 115(4) PSD2</i>

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