PODCAST on third-country access to the single market in financial services

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VOICE 1

You're listening to the European Parliamentary Research Service podcast on third-country access to the single market in financial services.

VOICE 2 (to introduce the topic)

If a German or a Swedish bank wants to offer its services in another Member state of the European Economic Area, or EEA, they can use their single passport rights to do so without additional red tape…

VOICE 1

But what happens with financial institutions coming from third countries? Is "equivalence" the *open sesame* formula to grant them access to the single market in financial services? Stay with us!

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VOICE 2

Since the financial crisis, the EU has worked hard to stabilise and reform financial markets, filling in regulatory gaps and tightening financial supervision to ensure it won't happen again…

VOICE 1

The financial crisis also contributed to reshaping the EU's regulatory approach to relations with third country entities, granting them increasing access to the single market in financial services on the basis of "equivalence". Now, what does this word mean?

VOICE 2

Well, equivalence is a legal concept that has emerged over the past 30 years to facilitate cross border trading between markets that choose to recognise one another's standards. The EU has adopted this concept in many of the recent financial services acts to define the terms of access to its market.

VOICE 1

Basically, third country financial entities coming from a jurisdiction considered to have "equivalent" regulatory provisions are allowed to offer their services in the EU.

VOICE 2

Some experts believe this acts as an incentive for third countries to push their domestic rules up to the EU standards, as non-equivalence increases the costs for companies wanting to provide services in Europe. Others, however, believe foreign service providers can always find ways to adapt…

VOICE 1

But how is "equivalence" determined and who decides on it? MUSIC JINGLE

VOICE 2

Well, technical assessments of equivalence are carried out by financial experts in the European Commission, who verify whether third-country legal frameworks are equivalent to EU rules or not, particularly those concerning legally binding requirements and supervision, and whether they attain the same results as the EU legal system.

VOICE 1

In their assessment, they take into account the technical advice from supervisory bodies such as the European Banking Authority and the European Securities and Markets Authority.

VOICE 2

A decision is then taken by the Commission in the form of an implementing or a delegated act. The difference being that the co-legislators have considerable powers regarding delegated acts. For instance they may oppose such an act by an absolute majority of MEPs or a qualified majority in the Council.

VOICE 1

Equivalence decisions are not granted to specific firms but to the legal framework of a third country or to selected authorities. They can be granted for an indefinite period or for a limited time, and even if the decision is supposedly technical, politics play a big role…

VOICE 2

So, once a third-country has been granted “equivalence”, does it have the same advantages as financial institutions enjoying passport rights?

VOICE 1

Well, not quite… but let's first explain what the term "passport" means in this context. The EU passport is a legal mechanism that allows financial services companies based in the European Economic Area, and authorised by its domestic authority, to do business in other member states solely on the basis of their home state authorisation. It is based on the principle of mutual recognition and harmonized prudential measures.

VOICE 2
So European banks using passporting rights can open branches in other Member States without the need to establish subsidiaries, which is a lot more cumbersome…They can also offer their services across the EU from their home country without the need to have a physical presence in other member states.

VOICE 1
But for third country businesses, it's not quite the same… Unless equivalence provisions state otherwise, they need to obtain authorisation in each Member State in which they wish to operate, and attitudes vary from very protective to quite liberal…

VOICE 2
Another way for third country entrants to access the single market in financial services is by establishing a subsidiary in a Member State and operating from there using passport rights, which seems to be the preferred option…

VOICE 1
Another difference between equivalence and the passport is that whereas the latter is permanent, equivalence can be unilaterally withdrawn by the Commission, although this has never happened in practice…Also, many important financial sectors do not have any equivalence regime in place at all.

VOICE 2

So we can conclude that in general, passporting rights are wider in scope and depth than equivalence regimes granted to third countries… but how does this translate into practice? Let's take a look at the application of the two regimes in different financial sectors…

MUSIC JINGLE

VOICE 1

Let's begin with the banking and wholesale finance sector. Under the Capital Requirements Directive and Regulation, the main business lines covered by the passport are: deposit taking, lending, broking, payment services, securities issuance and portfolio management. The Markets in Financial Instruments Directive provides for a single passport for investment services and activities of trading platforms and brokers in the EEA. Banks can, for example, execute orders for clients, trade or deal on their own account, provide investment advice, foreign exchange services, and underwriting, as well as portfolio management. Equivalence provisions exist in some cases but they don't really mirror passport-like access…

VOICE 2

In the non-banking sector, passporting rights allow the marketing and sale of hedge funds and other alternative funds across the European Economic Area, but there is no equivalence… so the only way for third country entities to market their alternative investment funds to professional investors in EEA countries is to do it on a country-by-country basis, respecting national private placement regimes and subject to strict conditions…

VOICE 1

In markets infrastructure, access conditions for third countries are more extensive… The European market infrastructure regulation establishes a framework for clearing of 'over the counter' (OTC) derivatives and for the functioning and governance of central counterparties, which enjoy passport rights to offer clearing services across the EU. But what about third countries?

VOICE 2
Under equivalence provisions, a third-country clearing house recognized by the European Securities and Markets Authority can provide clearing services in the EEA area without the need to be established there. In addition, transactions may be reported to a non-EU trade repository if it is officially recognized in Europe.

VOICE 1
When it comes to insurance services, passporting means EU insurers are able to sell their products throughout the EU, but this market remains highly inaccessible to third parties… and the same holds true for payment and electronic money services and mortgages. But is there any backdoor to the single market in financial services?

VOICE 2
Well, although non-EU alternative investment funds managed by non-EU alternative investment fund managers are not allowed to sell their products or services in the EU, there is just a little room for manoeuvre through reverse solicitation… but what does this mean?

VOICE 1
It means that where clients, such as professional investors, request a service on their own initiative, there is no requirement for the third-country provider to

be established in the EU or be authorized by the European Securities and Markets Authority in order to provide this specific service…

VOICE 2

However, many experts agree that the possibility to use reverse solicitation as a back door to the single market is rather limited in practice… though clearer guidelines would certainly help!

VOICE 1

What's clear is that, as financial services become increasingly globalised and European markets continue their integration, the question of how much access third countries should have to the single market will need to be answered.

VOICE 2

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