ASSOCIATION FRANÇAISE DES MARCHÉS FINANCIERS

FINANCIAL MARKET PROFESSIONALS

AMAFI /20-29
17 avril 2020

AMAFI POSITION PAPER

REVIEWING THE EQUIVALENCE PROCESS FOR FINANCIAL SERVICES

Equivalence can bring important benefits including increased competition, increased capital flows into the EU, more instruments and investment choices for EU firms and investors[1]. Nevertheless, equivalence also results in specific areas of financial services becoming closely interlinked and too important divergences between the rulebook of a third country recognised as equivalent and EU rules could have negative impacts especially with regards to financial markets stability and to investor protection. Brexit further increases the importance of the equivalence process, considering the central role played by the UK in the functioning of EU financial markets. It is therefore essential to have in place a stricter and more transparent equivalence process where the European Commission would remain fully in charge.

While the schedule to reach a deal on the future EU-UK relationship is already extremely tight, as the transition period should end on 31 December 2020, the British government declared at the end of February its willingness to leave the table of negotiations in June if it estimates that insufficient progress have been made by then. In parallel, both parties have started to assess equivalences between the two regulatory frameworks with the objective to finish by June 2020[2].

At this stage, the risk of an absence of equivalence in specific areas of financial services (e.g. access to UK CCPs and trading venues) cannot be eluded and could have detrimental repercussions on the functioning of EU-27 financial markets. In fact, in the absence of a deal, UK based financial market actors would *de facto* lose their access to the EU Single Market while EU-27 actors' could lose theirs to the UK market and infrastructures which would have major consequences if not assessed and treated carefully.

In that context, while we support the principles stated in the European Commission's Communication from July 2019 [3], we consider it is necessary to review the equivalence process for financial services in light of the two policy priorities which are the achievement of a true Capital Markets Union and the implementation of an ambitious Green Deal. Through this paper we aim at (i) highlighting areas for which targeted equivalences should be considered as a matter of priority to preserve the competitiveness of EU-27 financial market actors and the EU's sovereignty in the financing of its economy and (ii) proposing reforms to improve the transparency and predictability of the monitoring and withdrawal of equivalence.

1. Ensuring competitiveness of EU-27 market actors and sovereignty in financing of EU economy

AMAFI considers two areas which should be dealt with as a matter of priority in light of the strong links between the EU-27 and the UK with regards to financial markets. However, if the European Commission were to grant an equivalence to the UK in respect of Article 46 of MIFIR, we would add to the requests here below the needed amendments of MIFID regulation in order to extend the benefit of this equivalence to third Country branches of EU 27 firms which otherwise would be excluded from its application.

[1] European Parliament report on relationships between the EU and third countries concerning financial services regulation and supervision, Rapporteur Brian Hayes, link.
[2] Political declaration setting out the framework for the future relationship between the European Union and the United Kingdom, p. 180, link.
[3] Communication from the Commission on Equivalence in the area of financial services, p.4, link.

- **Maintaining access to UK CCPs**

UK CCPs play a central role in the clearing of a variety of instruments and because of the lack of alternatives in the EU-27, the absence of an equivalence, resulting in EU financial intermediaries losing access to UK CCPs would lead to new transactions on such instruments becoming extremely expensive, making EU-27 entities hardly competitive (*AMAFI / 18-59*).

While the transitional period is scheduled until 31 December 2020, AMAFI considers EU banks should continue to have access to UK CCPs beyond that date and calls on EU authorities to extend the temporary recognition of UK CCPS to enable the implementation of EMIR 2.2 and the gradual transfer of liquidity from the UK to the EU-27. While AMAFI is supportive of the development of clearing services within the EU, it is likely to be achieved only in the long term, in a progressive and in an orderly way.

- **Exempting EU-27 investment firms branches based in 3rd country from EU STO/DTO and transparency obligation**

In a post-Brexit regulatory environment, one can expect the UK STO and DTO to overlap with those foreseen in MiFIR, creating a conflict of law, unless trading venues are recognized equivalent by both EU and UK authorities. While the easiest way would probably be to achieve some kind of mutual recognitions of trading venues, AMAFI considers that a long term solution would be for the EU to decide not to apply its STO and DTO to third country branches of EU-27 investment firms. Indeed, the application of these rules would have serious impact on the competitiveness of EU entities without contributing to the protection of investors or the integrity of EU markets, so that the application of local rules only should be preferred (*AMAFI / 20-03*). Nevertheless, should equivalence be granted under the STO or as a result of access requests in MiFID, it should be clear that the relevant UK venues continue to be subject to requirements equivalent to those that apply to EU venues, otherwise there is a significant risk that the competitiveness of EU venues could be undermined.

Besides, EU branches face a competitive disadvantage with their UK competitors but also those based in the US and Asia as the EU transparency regime is more stringent. The risk of a divergence in rules would have a detrimental impact on the competitiveness of UK branches of EU-27 firms. Therefore, AMAFI calls for an exoneration of transparency obligations for third country branches of EU-27 firms so they can remain competitive.

2. Improving transparency and predictability in the monitoring and withdrawal of equivalence

While AMAFI welcomes the changes made under the review of the European Supervisory Authorities' Regulations[4] and under the Investment Firm Review[5], it considers the monitoring and the withdrawal of equivalence should be more transparent and more predictable for the industry.

- **The equivalence monitoring process: detecting divergence at an early stage**

An efficient monitoring is essential to enable the identification of divergences which could become severe and thus a threat to financial stability, to investor protection and/or result in an uneven level playing field between EU and third country actors. AMAFI considers that a central issue revolves around ESMA's capacity to detect divergences at an early stage and then to react quickly and in a transparent way when an issue is observed.

[4] Each ESA has to submit an annual confidential report to the European Parliament, the Council, the Commission and other two ESAs on its findings.

[5] The Investment Firm Regulation provides with new assessment criteria and safeguard for 3rd country investment firms providing services to EU clients. Additionally, firms that offer services of systemic nature for the Union are subject to a granular assessment of Commission and ESMA's powers in the monitoring of these firms activities have been strengthened.

On the day one after Brexit, the issue that we are most worried about is remuneration. We have strong concerns that the UK supervisory practices will enable some subtle or even direct circumventing of the rules inherited from the EU notably with the implementation of the reviewed RTS on material risk takers as foreseen in CRD V. This would create an uneven level playing field between the City and the EU-27 and would restrict the capacity of EU financial market actors to attract talents.

In order to avoid such situation, a transversal monitoring should be performed on a continuous basis by ESMA and its conclusions be made publicly available on a regular basis. This would require ESMA to be staffed accordingly. We consider it is the best way for ESMA to have a broad understanding of national supervisory practices and the extent to which third-country industry complies with the legislation.

Besides, we are concerned that the identification of divergences – that can affect legislation or implementation rules – may take several months, while the impacts on financial stability, investor protection and competition can be quite immediate. We hence believe that financial market actors should be given the possibility to raise to ESMA unfair competition practices that would be born of divergences in regulatory frameworks with third countries recognised as equivalent. This could be done by setting-up an inbox for industry representatives to send information via a standardized document providing with the necessary information for ESMA to start an investigation.

Once a divergence has been identified and especially at an early stage, it is key for the EU to be in a capacity to discuss in confidence with its third country counterparts based on recommendations made by ESMA. Assuming a deal is reached between the EU and the UK, we therefore consider that the creation of a Joint EU-UK Financial Regulatory Forum with regular meetings would contribute in facilitating the supervision and coordination between European and British authorities to avoid a withdrawal of equivalence.

- **The withdrawal of equivalence: a last resort measure**

The monitoring of equivalence is critical because if a divergence that one or few actors could take advantage of is not detected at an early stage there is a strong risk that it spreads amongst financial market actors with the possibility that it becomes a common practice and that the withdrawal of the equivalence becomes the only way out.

While withdrawal decisions should primarily be motivated by too important divergences between the EU and a third country regulatory framework and/or supervisory practices, political reasons can also come into play as illustrated by the recent Swiss situation and the withdrawal of equivalence for share trading obligation in 2019. While AMAFI understands the withdrawal of an equivalence can be used by the European Commission in the context of a broader political agenda, it has strong implications from an industry perspective. It is therefore critical for the industry to have as much visibility as possible on the process and associated timing leading to the actual withdrawal of the equivalence in order to follow the procedure and prepare accordingly. Besides, the lack of predictability could also have severe consequences from a financial stability perspective.

About AMAFI

Association française des marchés financiers (AMAFI) *is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.*