Third-country EU market access post-Brexit

Katharine Braddick

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The benefits of open markets

In the 18th century the Scottish economist Adam Smith said 'in general, if any branch of trade, or any division of labour, be advantageous to the public, the freer and more general the competition, it will always be the more so'. When we focus on the minutiae of the issues facing the financial services sector, as most of us attending the Eurofi conference will do from time to time by necessity, we can lose sight of the real-world impacts of the decisions and choices that we make. Though now several centuries in vintage, Smith's words have never been more relevant.

We live in an increasingly globalised world, one in which the trade in financial services and the flow of capital across borders provide tangible benefits to the firms and people of Europe, indeed to the growth of our economy in general. Financial markets provide competitive insurance for our firms and citizens, investment and loans for our industries, and enable people to provide for their and their families' futures through funds and pensions. Fragmentation of these markets would reduce the flow of investment and increase the costs of finance for firms and citizens.

> *"Trade in financial services and the flow of capital across borders provide tangible benefits."*
>
> \- KATHARINE BRADDICK

It is clear then that open markets and cross-border trade in financial services benefit individuals, firms large and small, and the health of the economy more widely. It is essential that across the world, including in Europe, that legislators and supervisors keep these facts at the forefront of our thinking as we develop the regulatory regimes of the future. The world around us may be changing rapidly, developments in fintech, cyber and cryptoassets certainly present a challenge for firms and regulators alike, but they also present great opportunities. We must seize these opportunities together, ensuring that we develop consistent regulatory regimes that continue to enable rather than fragment our open markets and provide an increasingly resilient and stable system.

The work of international organisations such as the Financial Stability Board (FSB) is vital in this regard. At the request of the G20 the FSB continues work to >>>

>>> complete the implementation of post-crisis reforms, seeking to build a resilient financial system grounded in agreed international standards that facilitates trade and sustainable economic growth. A key part of this work is evaluation and assessment of the effects of those reforms, examining the effects on the structure and functioning of our global financial system. In this context, the FSB are undertaking specific work on market fragmentation under Japan's G20 Presidency, assessing the cross-border consistency of reforms and exploring issues around market fragmentation, how it can emerge, and its potential impact. The aim is to identify tools that can be used to address the risk of market fragmentation arising.

The UK is host to an open, internationalist, and diverse financial centre, and the resilient and credible regulatory regime in the UK is what underpins this. The UK worked with the rest of Europe on the post-crisis reforms and we will continue to do so in the future, working together to strike the right balance between protecting stability and driving innovation, ensuring that we continue to foster the competitiveness of the European economy. That includes maintaining our commitment to work with our partners through organisations like the FSB, Basel and IOSCO and pursue what the British Chancellor of the Exchequer has called the regulatory "race to the top".

The EU and the UK share a commitment to financial stability and high standards for the financial services sector, and a confidence in the value of open markets. In the future, trade between us in financial services will be managed through equivalence frameworks. It is clear and without question that this change in the regulatory architecture presents challenges.

But it is not an inevitability that we must face damaging levels of fragmentation and friction in our relationship. It is a false choice to say that we must choose between protecting our respective financial stability and maintaining open trade. Are our third country equivalence regimes in need of improvement? Without a shadow of a doubt. Are we capable of getting this right and putting in place co-operative regimes that will enable continuing and vibrant trade in financial services to the benefit of Europe's citizens and firms? Absolutely. ●

Steven Maijoor

Chair, European Securities
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Evolving EU equivalence regime

In the context of the post-crisis regulatory reform, the EU developed a market access model based on equivalence and recognition. This model, which is available under EU law for a number of areas in financial markets, aims at keeping EU markets open and therefore limiting market fragmentation on the one hand, while preserving financial stability and investor protection on the other.

The most widely known example is the equivalence of Central Counterparties (CCPs) supervision regimes, and subsequent recognition of individual non-EU (Third-Country, TC) CCPs by ESMA. Since the application of EMIR, the European Commission has adopted 16 equivalence decisions and a total of 32 non-EU CCPs from 16 jurisdictions have been recognised by ESMA.

This model, while being quite open for global market participants, however brings certain concerns from the perspective of EU financial stability. These concerns >>>

>>> were already flagged by ESMA in its EMIR review reports in August 2015. In particular, the EU's approach sets out a full reliance on third country rules and supervisory arrangements. The cooperation arrangements that ESMA has concluded, and will continue to conclude, give ESMA very limited powers to intervene should risks arise related to a TC-CCP that are specifically relevant from an EU perspective.

At the same time, the majority of non-EU jurisdictions consider TC-CCPs as systemically relevant infrastructures and apply much closer scrutiny. In general, their processes envisage full registration in the relevant jurisdiction. As part of the authorisation process the third country authority may decide to rely on certain rules of the home jurisdiction of the CCP and certain cooperation arrangements with the home authority of the CCPs, however the CCP would become subject to the rules and the authority of the jurisdiction registering it.

EMIR 2.2 will address some of ESMA's key concerns and therefore introduce a more proportionate approach. In particular, EMIR 2.2 will introduce an enhanced recognition regime for systemically important TC-CCPs (Tier 2 CCPs), whereby such CCPs will have to comply with EMIR requirements and be subject to certain ESMA supervisory powers. Concerning all non-systemic TC-CCPs, the current arrangement with ESMA's full reliance on non-EU supervision will continue to apply.

I believe that this proportionate approach to systemic and non-systemic non-EU market players, assessed from the perspective of EU financial stability and combined with direct supervisory powers at European level, as envisaged by the EMIR 2.2 proposal, should become a guiding principle in an improved equivalence model that will be applied in the future.

This improvement is even more urgent and justified in the context of Brexit, whereby a very large market will move into the third country regime while still being very important for EU capital markets. I therefore also very much welcome the proposal made by the Council regarding non-EU Investment Firms (under the Investment Firms Review (IFR) legislation), which I understand has received support from the other co-legislators.

A more proportionate and balanced approach to the EU equivalence model is required. With a single point of entry for non-EU market providers and certain direct supervisory powers at the European level, the EU is moving one step closer to corresponding approaches of other jurisdictions, while at the same time limiting the risks of fragmentation of global markets. ●

Felicia Stanescu

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Equivalence or how to build bridges over regulatory fault lines

Today several pieces of EU financial regulation stipulate that the Commission may adopt equivalence decisions concerning third country jurisdictions.

Under a typical equivalence decision, the EU recognises that the regulatory or supervisory regime of a non-EU country is equivalent to the corresponding EU regime. That, in turn, allows authorities in the EU to rely on supervised entities' compliance with equivalent rules in a non-EU country. It means, in practice, that an equivalence decision may reduce or even eliminate overlaps in compliance requirements for both EU and foreign market players. In some areas, like credit rating agencies or audit, it can make the services, products or activities of non-EU companies marketable and acceptable for regulatory purposes in the EU. There are also other, more specific, gains: for example, equivalence under EU capital requirements rules allows a less burdensome prudential regime to apply to EU banks and other financial institutions with exposures in equivalent non-EU countries.

With over 280 equivalence determinations benefitting over 30 >>>

>>> jurisdictions the EU has emerged as the undisputed leader in forging regulatory and supervisory ties with partners across the globe that are like-minded. We operate a system that allows eliminating overlaps in cross-border rules and oversight as long as such outcome preserves financial stability, investor protection and the integrity of the internal market.

We have been among the early adopters of most international regulatory standards and our approach to equivalence closely reflects our strong commitment to multilateralism in regulatory and supervisory relations.

It is not surprising therefore, that the European Parliament, the Member States, third country jurisdictions and financial players with cross-border activities are all very keen participants in the debate on the future of EU equivalence policy. We all share the ambition to see the EU equivalence consolidate its role as an instrument of choice to deal with cross-border regulation challenges.

"The EU has emerged as the undisputed leader in forging regulatory and supervisory ties with partners."

\- FELICIA STANESCU

As such, it needs to be even more robust, measured and effective: EU decision makers and supervisors should be able to act with confidence when they accept to expose EU investors and consumers to foreign regulation and supervision. Supervisory and cooperation arrangements with the third countries must be fit for purpose. There also needs to be a process whereby a granted equivalence may be reviewed over time and the decision may be withdrawn if necessary.

Equivalence empowerments do not confer a right to third countries to be assessed or receive a positive determination. The decision remains a unilateral and discretionary act of the EU, both for its adoption and any possible amendment or repeal. However, it does not mean that the Commission turns a deaf ear to individual requests and submissions made by the interested parties in this context. We are committed to robust dialogue with third countries and the market participants. ●

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Sylvie Matherat

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EU and UK relationship post Brexit – avoiding fragmentation

International banks drive growth by channeling capital investment to where it can be most effectively deployed and by facilitating distribution of risk to those with the appetite and ability to manage it. To support companies and investors in a globalised economy, banks need to be able to operate across borders, creating bridges between pools of liquidity and capital. The value of access to deep and liquid capital markets was recognised with the European Commission's Capital Markets Union initiative.

The departure of the UK from the EU risks fragmenting European financial markets, with the activation of new regulatory barriers between financial services firms and their clients in the EU and important pools of liquidity and financial market infrastructure in the UK. Equivalence decisions offer a path through those barriers, providing for continued cross border access in a safe and secure regulatory environment.

Whilst equivalence can help to mitigate the risk and reduce the costs of fragmented markets, it also comes with some drawbacks. The process for granting equivalence can be cumbersome – relying on both political and technical decision makers who are resource constrained and can create bottle necks.

It is also reflected in a patchwork of different provisions with different checks, thresholds and process for assessment. The implications of these weaknesses are much more acute when looked at in the context of cross border access for EU firms and investors to Europe's main international centre in London.

This fact has already triggered discussion amongst EU policy makers and moves towards overhauling the existing equivalence regime. To date the focus of changes to the framework has been on enhancing protections for EU market participants rather than increasing cross border trade. That is understandable but suboptimal.

"To avoid market fragmentation there must be an improved and expanded equivalence regime."

\- SYLVIE MATHERAT

To avoid market fragmentation there must be an improved and expanded equivalence regime. To achieve this, three conditions need to be met: first there must be strong cross border regulatory and supervisory cooperation – without that it will be unrealistic to expect any streamlining of equivalence decisions; second there needs to be greater consistency in the approach to equivalence – this will improve the efficiency of the regime and reduce the burden on regulators; and finally, there needs to be greater predictability in the way in which divergence or disputes are addressed – in order to improve confidence of market participants in the durability of equivalence decisions.

Improving the existing EU equivalence regime along these lines would not only help address the fragmentation risk arising from Brexit, but would cement the EU's regime as one of the most advanced in the world. ●

Simon Miller

Managing Director - Head of Legal and Compliance, Mizuho Bank, Ltd.

The role of equivalence in business planning for post Brexit EU

The withdrawal of the United Kingdom from the European Union presents financial services groups headquartered in Third Countries with unique, and unwelcome, challenges. Unwelcome as these challenges may be, if we are to serve our customers effectively in future, we must accept the political realities of the situation and adapt our business model accordingly.

Mizuho Financial Group is a diversified international financial services group headquartered in Japan. In common with many of our global peers, our EMEA operations are centred in London. However, it has never been our approach, to coin a phrase, to put all our eggs in one basket. While London represents a large part of our business resources in EMEA, Mizuho Bank has had significant businesses in several major continental European cities for several decades.

This presence of Mizuho Bank in the EU27 countries includes branches of the Third Country incorporated bank, locally incorporated entities (often referred to as subsidiaries) and branches of such locally incorporated entities. It might therefore be more accurate for us to describe our business in Europe as that of a European Bank. Certainly, EMEA based colleagues and the local supervisory board would see it that way.

For Mizuho Securities, the securities part of the business, for whom the demands of the so-called firewall under Japanese law require a strong degree of separation between their banking and securities business, the challenges posed by Brexit are more substantial. This is because the securities business for Europe and the wider EMEA region has been conducted from London via a UK incorporated entity, which upon Brexit loses its passporting rights into the EU27. Mizuho Securities has therefore established a new European securities business incorporated in Germany and based in Frankfurt.

From this description of Mizuho Financial Group, it will be apparent that we are not relying on equivalence arrangements in the future EU-UK relationships to serve our customers in the EU. Although we are not relying on equivalence, we recognise its importance and value. Brexit will cause our cost base to increase and our business to fragment, and we look to future progress on equivalence discussions between the UK and the EU to reduce its impact and mitigate its cost.

While we recognise equivalence is of course a political process, and as a result may not always give us the certainty we need, we can see that recent political cooperation involving Japan and the EU is much to the benefit of institutions such as ourselves. The recent EU Japan Economic Partnership Agreement incorporates the requirement for close regulatory dialogue in advance of legislative change in either market. While a little way short of formal binding obligations, this approach will promote orderly change and reduce the risk of regulatory divergence and unwelcome fragmentation.

> *"MHFG's existing business model would benefit from UK-EU equivalence but does not depend on it."*
>
> - SIMON MILLER

Brexit is a cause for regret for our business, since irrespective of the ultimate outcome any form of Brexit will harm the competitiveness and attractiveness not just of the UK but of the whole EU. When the dust has settled from this rupture in the fabric of Europe, we see that meaningful progress on EU-UK equivalence is an important part in enabling institutions such as ours to recommit to making the most effective contribution to the prosperity, growth and wealth creation of both the EU and the wider European region. ●