Enhancing financial policies dealing with third-countries

John Berrigan

Deputy Director-General, DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

Equivalence in financial services

Recently, equivalence is being frequently mentioned in the context of the UK's withdrawal from the EU and the way how UK firms may continue providing services in the EU. The EU equivalence system is much more than that. It has become a significant tool in fostering integration of safe and efficient global financial markets and cooperation with third countries in about 40 areas of financial services. It supports and enhances regulatory and supervisory cooperation, while at the same time, it maintains open and globally integrated EU financial markets. It is an important policy component in placing the EU in international financial markets.

End July 2019, the European Commission published a communication that outlines the EU equivalence policy in the area of financial services. With over 280 equivalence decisions benefitting over 30 countries, and with recent legislative improvements, the Commission expects its equivalence approach continue to play an important role in strengthening cooperation and narrowing cross-border duplications and possible inconsistencies and thus market fragmentation.

> *"The Commission expects its equivalence approach continue to play an important role in strengthening cooperation and narrowing cross-border duplications and possible inconsistencies and thus market fragmentation."*
>
> \- JOHN BERRIGAN

The communication sets out the EU's approach to assessing non-EU countries' regulatory frameworks and monitoring the performance of the equivalence decisions. The Commission also takes stock of recent reforms of equivalence rules, both in terms of legislative and practical improvements, included for instance in the reviews of the European market infrastructure regulation[1] and the European supervisory authorities[2] or the investment firm review[3]. These reforms ensure that the supervision and rules of third country providers is commensurate with the nature of services and the risks they may raise. They also enhance the powers of the relevant ESAs, ESMA in particular, and the general transparency of the process. At the same time, these reforms send a clear signal that the EU's equivalence >>>

>>> framework remains in place and that the EU is committed to international standards that aim to facilitate safe and efficient global markets.

It is important to stress that the equivalence process needs to preserve the regulatory and decision-making autonomy of the EU, both for the adoption of an equivalence decision and any subsequent amendment or repeal. Third countries may express an interest in being assessed for EU equivalence in a specific area and the Commission will consider it, but there is no right to receive an equivalence decision.

The EU assesses the overall policy context and to what extent the regulatory regime of a given third country achieves equivalent outcomes as the EU rules. In doing so, the Commission applies proportionality in the assessment criteria and follows a risk-sensitive approach. This means it can sometimes be more demanding with countries whose markets have a bigger impact. The recent communication confirms this approach. Recently, some have implied that the Commission would tend to misuse equivalence for political motives, outside the field of financial regulation and that also in relation to UK's exit from the EU. The validity of this criticism must be challenged. First, the Commission still hopes (and has not spared any efforts in this sense) for a deal and for a future cooperative relationship with the UK. Second, the recent changes in regulatory framework and communication are not a reaction to specific actions by any given country. They do reflect a changing landscape of European finance. More broadly, equivalence, as a tool for more efficient, sound and secure global markets, inherently takes into account several dimensions, including prudential and macro dimensions. EU decision makers and supervisors need to act with confidence when they accept to expose EU investors and interests to foreign jurisdictions.

Lastly, as also showed by our recent communication, the Commission understands the need for and shares the objective of a more transparent, robust and effective equivalence system. Beyond the regular engagement and dialogue with the European Parliament and the Member States, the Commission also establishes technical dialogues with the third country authorities to ensure the accuracy of our underlying assessments. ●

1. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/post-trade-services/derivatives-emir_en
2. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision_en
3. https://ec.europa.eu/info/publications/171220-investment-firms-review_en

Steven Maijoor

Chair, European Securities
and Markets Authority (ESMA)

It is a right time to revise the EU equivalence regime

The G-20 Leaders, during the St Petersburg Summit in 2013, agreed that "jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes".

In this context, the European Union (EU) translated this overarching "deference" principle into a comprehensive market access model based on equivalence and recognition. This model, available for a significant number of financial markets >>>

>>> activities, aims at keeping EU markets open. At the same time, equivalence achieves the objective of avoiding unnecessary market fragmentation while supporting financial stability and a level-playing field on a global level.

In its recent report on "Market fragmentation and cross-border regulation" IOSCO recognised that the use of "deference"-related regulatory and supervisory tools has increased since 2015, when IOSCO issued an earlier report on this subject matter. In particular, as stated in the 2019 IOSCO report, this increase has been achieved particularly through the very extensive use of equivalence in the EU.

Looking ahead, the EU approach towards cross-border regulation and supervision needs to change. The fact that, as a result of Brexit, Europe's largest capital market will leave the EU has accelerated a reconsideration of our third-country arrangements. As the UK will continue to be an important capital market for the EU post-Brexit, it is also vital that an appropriate EU framework for third-country regulation and supervision is in place.

To take one example, a well-known area where the EU equivalence approach is applied concerns CCP supervision. Access to the EU market for central clearing is allowed after a positive assessment of the third-country's regulatory framework by the European Commission, and subsequent recognition of individual Third-Country CCPs (TC-CCPs) by ESMA. Since the application of EMIR, the European Commission has adopted 16 equivalence decisions. In addition, a total of 34 TC-EU CCPs from 16 jurisdictions have been recognised by ESMA.

> *"EMIR 2.2 will introduce an enhanced recognition regime for systemically important TC-CCPs."*
>
> \- STEVEN MAIJOOR

This model, while providing the possibility of full access by global market infrastructures to the EU clearing market, entails certain concerns from an EU financial stability perspective. The EU approach entails full reliance on third country rules and supervisory arrangements, while giving ESMA very limited powers to intervene should a risk emerge from a TC-CCP affecting EU stability.

With the recently agreed amendments under EMIR 2.2, the EU will address the key limitations of the current system and introduce a more proportionate framework. In particular, EMIR 2.2 will introduce an enhanced recognition regime for systemically important TC-CCPs, whereby such CCPs will have to comply with EMIR requirements and be subject to certain supervisory powers from ESMA. At the same time, with regards to 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 non-EU market players, assessed from an EU risk perspective, and combined with direct supervisory powers at European level, should become a guiding principle of an improved equivalence model. Looking beyond CCPs, similar changes have been politically agreed regarding non-EU Investment Firms (under the Investment Firms Review legislation).

In that context, I am looking forward to the European Commission's assessment of the need for strengthening the third country arrangements regarding non-EU Trading Venues and non-EU CSDs, in line with the political agreement achieved in the ESAs review.

Finally, in view of the extensive use of the equivalence model, including its expected application to post-Brexit UK financial markets, there is an increasing need for closer and ongoing equivalence monitoring of relevant developments in third-countries. To this end, I welcome the new competences and resources in this regard under the ESAs review package. ●

Takanori Sazaki

Regional Executive for EMEA,
Mitsubishi UFJ Financial Group

Enhancing comparability of regulatory regimes to help close the fragmentation gap

In the current climate of rising trade tensions and slow economic growth, the regulatory community is faced with an ongoing challenge of seeking the right balance between ensuring resilience of the financial system and promoting economic growth. While the goal of ensuring resilient financial institutions has been addressed through a globally agreed regulatory framework, there are also concerns that certain markets are at risk of becoming fragmented along jurisdictional lines.

MUFG welcomes Japan's leading role in the debate on market fragmentation by putting it on this year's G20 agenda. It is also encouraging to see that the Financial Stability Board (FSB) has recognised the need to address the risk of market fragmentation and its potential impact. According to the FSB, market fragmentation arises for various reasons, most notably due to differences in national regulations and supervisory practices, governing financial activities that are international in their nature.

One of the potential paths to close the gap, particularly in the interest of reducing regulatory and supervisory overlaps between jurisdictions, could be to further enhance processes of mutual recognition – also known as equivalence in the EU. The aim of these processes is to avoid that two (or more) regulatory regimes are being applied to the same market or activity. For a diversified globally operating financial services group such as MUFG, mutual recognition of regulatory regimes is an important element for continuing our cross-border activities in the jurisdictions where we operate. It also provides our home regulator with a sense of comfort about the foreign regulator's supervisory oversight.

It has been recognised that the EU process for granting equivalence needs to be further improved and streamlined for cross border activities. Supervisory and regulatory cooperation is key in this process.

The G20 and FSB can play an important role in specifically targeting fragmentation by defining a consensus approach and overall framework for these various types of cross-border regulatory cooperation and coordination. The assessment process could focus on more of an outcome-based approach that avoids line-by-line compliance and facilitates comparability. The most recent report published by IOSCO provides a number of practical examples where early cooperation between regulators on recognition assessments, methodology and criteria has resulted in some practical solutions for the ongoing work in this area. The use of memoranda of understanding (MoUs) and potentially creating a repository of these agreements, could be part of the solution to enhance regulators' access to the information required to make equivalence decisions in a more effective manner.

Further work to enhance comparability of regulatory regimes is not only important for the globally standards agreed today, it will become even more important when formulating the regulatory framework for risks that face the financial system tomorrow. Continuous dialogue, not only between regulators, but also taking into consideration the timely input from foreign entities whose cross-border activities are being impacted at an early stage of implementation, is crucial when focusing on prevention of future proliferation of inconsistencies.

We hope to see constructive mutual recognition discussions between EU and UK post Brexit, but given that fragmentation is happening on a global basis, we need a framework to address the global level fragmentation as well as regional (i.e. EU/UK) framework, that allows proper functioning of capital markets and lending activities. ●

Markus Ronner

Group Chief Compliance and Governance Officer, UBS Group AG

An outcomes-focused equivalence framework is key to delivering the EU's Capital Markets Union

There is broad agreement among regulators, policymakers and market participants on the risks that market fragmentation present to financial resilience. The G20, the FSB and IOSCO have all recognised recently that a coordinated policy response is needed to address these risks. IOSCO has acknowledged a role for deference in the regulation of capital markets, complemented by other measures to strengthen regulatory and supervisory collaboration. Despite this recognition, divergent implementation and reluctance among regulators to recognise each other's rules remain prominent.

In the EU, the Capital Markets Union (CMU), which aims to broaden the funding base for European corporates and households, is expected to remain a key project as the new European Commission and Parliament take shape. Global firms like UBS would like to contribute to making the CMU a success by continuing to facilitate capital, liquidity and investment flows into Europe. The CMU is fundamentally about breaking down barriers to these flows in Europe's capital markets and >>>

>>> as such is an important channel through which market fragmentation issues can be addressed. However, achievement of this goal risks being undermined by the lack of clear political willingness and insufficient cross-jurisdictional cooperation arrangements between home and host regulators, both within and beyond Europe.

The EU has over time developed an equivalence framework which could become a powerful tool to allow cross-border business to be conducted safely and to high standards, to the benefit of EU firms, households and the economy overall. In order to achieve this, equivalence decisions must be grounded in a technical analysis that focuses on whether third-country rules achieve the desired outcome, taking into account relevant international standards; and to deliver legal certainty, the process must be consistent and transparent.

In addition to enacting global reforms, Switzerland, for example, has substantially reformed its regulatory framework in recent years to align with MiFID II standards. Yet the recent expiry of EU equivalence for Swiss trading venues illustrates the lack of legal certainty third-country partners face with the current system, given that Switzerland meets all technical requirements for unrestricted equivalence. The absence of a reliable equivalence mechanism will lead to more fragmented markets, to the detriment of businesses and investors both in the EU and Switzerland. And should this approach proliferate, financial integration will erode, to the detriment of financial stability, savers and investors in the EU.

To achieve the full benefits of an efficient and safe EU-wide and globally integrated capital market, any temptation to establish new barriers that could ultimately inhibit the CMU's ability to deliver increased competition, choice and innovation should be resisted.

"A CMU that integrates an outcomes-focused and consistent equivalence framework must be a priority."

\- MARKUS RONNER

Building the CMU in a way that integrates an outcomes-focused, transparent and consistent equivalence framework must be a priority. It will lead to more legal certainty, lower costs and higher productivity for all market participants and customers. ●

Sébastien Raspiller

Assistant Secretary, French Treasury, Ministry of Economy and Finance, France

Strengthening the European equivalence framework

The European equivalence framework has come under increased scrutiny in recent times. This is not unexpected, since in the context of the UK withdrawal, the EU has insisted that the equivalence framework is the only possible future framework that preserves both the EU and the UK capacity to adopt their own rules, to ensure a level playing field, and to act in the interests of their financial stability. Why is it so?

Equivalence refers to a process by which the European Union assesses and deems a third country's regulatory and supervisory framework equivalent, which allows it to defer to the third country's regulatory and supervisory framework to grant its entities access to the EU financial services market. Two key elements need to be highlighted. First, the objective of the equivalence framework is not liberalization per se, even though the European Union is a proponent of market openness. It is first to reduce overlaps and facilitate the compliance with regulatory requirements by EU firms that might have exposures to third countries. Second, the equivalence framework applies to all third countries and is not meant to be tailored to a jurisdiction's specific preferences. Consequently, changes to any piece of the equivalence framework might have far-reaching consequences and particular care must be taken when modifying them to avoid unintended consequences.

The EU may review and, when needed, enhance its equivalence rules to ensure they are fit for purpose in the evolving landscape of cross-border services provision of which the EU is part with its trading partners. For instance, certainty is needed that the equivalence criteria are robust enough, and that provisions are in place to ensure that EU authorities have adequate oversight over third country risks.

Within such a review some key characteristics of equivalence regimes should be stressed. Firstly, the definition and implementation of equivalence regimes is a unilateral competence of the European Union. The autonomy of the EU to ultimately grant or withdraw equivalence decisions is not negotiable.

Secondly, reviewing and improving the framework essentially means that the existing equivalence regimes should be reinforced across several dimensions, especially the clarity of their requirements and the monitoring of equivalence decisions.

On the clarity of requirements, the equivalence process should be made even more transparent and predictable. "Equivalence" does not mean "line-by-line alignment". But the EU should be prepared to ensure that outcomes are only deemed equivalent in a very robust and significant sense. Moreover, strengthening the equivalence framework does not entail creating new equivalence regimes.

On the monitoring function, the EU needs to be able to react with regard to possible evolutions in third-country regulation and supervision. Likewise, the EU should not grant equivalence without an end-limit or a realistic withdrawal framework. This would be contrary to the need for the EU to be able, at any time, to safeguard and protect its financial stability.

Finally, the EU has constantly been willing to engage in close regulatory cooperation. As a matter of fact, the Commission has extensive experience in such regulatory dialogues with third countries. Nevertheless, regulatory cooperation should not hamper the autonomy of rulemaking of the EU. ●