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EU equivalence policy – a tool for regulatory convergence

The EU is one of the most open financial systems in the world, with very significant financial flows to and from the EU. There are hundreds of non-EU players in the EU market and EU players are present in all financial systems around the world.

The key instrument, with which the EU manages risks deriving from interconnectedness and exposure to third-country financial systems, is equivalence. Equivalence is about risk management - ensuring that financial stability, market integrity, and the protection of EU investors and consumers are safeguarded, even when there is a level of deference to a third-country authority.

The key questions before granting equivalence are: will the third-country authorities manage risks for EU firms the same way as they manage their own? Even more importantly, in case of a crisis, does equivalence ensure that we can really rely on third country authorities to manage risks for our own economic operators?

The Commission has an established practice of deferring to and cooperating with third-country supervisors; 280 equivalence decisions have been granted in respect of more than 30 third countries. With its Communication of 29 July 2019, the Commission has reaffirmed that risk management is the cornerstone of its equivalence policy. It has also reiterated that equivalence requires a risk-based and proportionate approach. This means that the higher the potential impact of a third-country market on the EU, the more thorough the equivalence assessment.

The Communication highlighted that trust is essential to underpin deference and that EU foreign policy priorities are relevant for equivalence assessments, including for instance anti-money laundering arrangements and/or tax governance.

The Communication summarised recent developments, such as the targeted amendments to third-country regimes, in particular for Investment Firms, for CCPs and the enhanced role for the European Supervisory authorities, notably on monitoring equivalence decisions.

On process, the Communication detailed further transparency steps, e.g. through its better regulation practice of public consultation periods before adopting decisions. It presented plans to systematically monitor existing decisions. Normally, this would take place through dialogue with the Commission affording an opportunity for the third country to remedy any gaps identified. If gaps cannot be remedied, equivalence can be withdrawn as in the case of some Credit Rating Agencies decisions in July 2019. If conditions for equivalence were to change more suddenly, the process leading to withdrawal might become more rapid.

Equivalence policy is fit for purpose for the assessments of the UK, as for other any third country. It will be a key tool to handle EU-UK relations in the financial sector in the future. Irrespective of the outcome of equivalence assessments, UK-based financial institutions will lose their access to the single market based on their UK authorisation after the transition period. Those UK institutions that want to guarantee the provision of services to EU clients across the single market are aware that they will need an establishment in an EU Member State. Ultimately, it is a choice for each firm to decide how it organises itself and which clients it wants to serve.

On the risk of cliff-edge at the end of the transition period, the situation is different from the no-deal risk in 2019. The Withdrawal Agreement provides sufficient time for firms to take the necessary steps to cater for the change in their regulatory regime. Firms need to use the months left until the end of transition period to adapt their operations. Overall, counting from the day of the referendum in 2016, they will have had four and a half years to prepare.

The Commission will constructively engage with the UK in all equivalence areas and gather facts, with the intention of concluding its unilateral equivalence assessments by June 2020. However, the deadline refers to the mapping, not to the decisions themselves. Further, the UK's stated intention to diverge from EU rules makes assessments more complicated. Equivalence is typically the outcome of a convergence process but, in the case of the UK, the Commission will need to consider the extent of possible UK divergence in its initial assessments. This implies a thorough and forward-looking assessment of how the UK regulatory and supervisory framework will operate after the transition period, and whether it will deliver similar outcomes as the respective EU framework. ●