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The longevity of the equivalence framework in a post-Brexit world

The enhancements proposed to the EU approach towards cross-border regulation and supervision of third country entities include a more granular perspective in respect of determinations of equivalence where there is systemic risk and ongoing monitoring of compliance with applicable standards by the European Supervisory Authorities (ESAs). However, the increased scrutiny and consequent increased risk of withdrawal of equivalence poses serious risks to business continuity for market participants and the wider health of the European economy as there is an inherent paradox where compliance with internationally agreed standards does not result in the maintenance of equivalence. This is particularly the case when equivalence is used as a political tool rather than to promote the integrity and resilience required for the financial markets to flourish. Outcomes-based equivalence, based on compliance with international standards (such as the Basel accords), should therefore be the preferred option and we urge policymakers to prioritise the principles of objectivity, proportionality and risk sensitivity.

There will be greater scrutiny of delegation, outsourcing and material risk transfers (such as back-to-back business) to third countries by the ESAs, which is welcomed to ensure effective supervision and enforcement in respect of third country players, provided that the regime is proportionate and the rules are clear as to what is permitted. The increased cooperation of the ESAs with third country regulators is welcomed; as seen in the Japan / EU EPA, regulatory cooperation should reduce the risk of regulatory arbitrage and ensure a level playing field for non-EU players. It is important to remember that although the enhancements to the third country regimes have arguably been motivated by Brexit, the changes will also affect any non-EU firms operating on a cross-border basis into the EU (including those in the US and Asia). This strengthens the argument that any changes in enforcement should be proportionate. For this reason, special consideration should be given to equivalence regimes between the EU and third countries to develop stable and resilient regulatory relationships that do not significantly affect financial links between the EU and these jurisdictions.

In relation to Brexit, both UK and EU financial markets will inevitably be harmed by the UK's withdrawal. Although marginally differing regulatory regimes may be necessary to respect sovereignty, material gold-plating of requirements may trigger third country banks to consider the extent of their presence and business model in Europe. Regulatory divergence would result in (i) operational inefficiency due to the need for greater investment to set up operations in each jurisdiction, losing the economies of scale of a centralised model (ii) higher transaction and compliance costs, caused by different procedures and documentation required under different regulations, (iii) reduced liquidity if, for example, investors in the EU cannot invest in certain UK markets, ultimately impacting investor demand and (iv) more restrictive market access, which is highlighted by the potential loss of an EU passport for UK incorporated financial institutions after the transition period. Specifically, we would welcome UK CCPs being declared equivalent after the transition period to ensure that EU participants may continue to use them for clearing. Another market concern seems to be that UK and EU derivatives trading venues should be declared equivalent so as not to adversely affect liquidity and to allow UK and EU market participants to trade on the same venue (known as the derivatives trading obligation under MiFID II).

Therefore, we would welcome the EU maintaining close cooperation and dialogue with the UK post-Brexit, to preserve a consistent regulatory and supervisory framework and to encourage investment in the region as a whole. The reduction of market fragmentation was highlighted as a key priority during Japan's presidency of the G20, as well as by IOSCO and the FSB. We hope there will be a move towards greater globally harmonised financial regulation through increased home state recognition of regulatory and supervisory frameworks. ●