

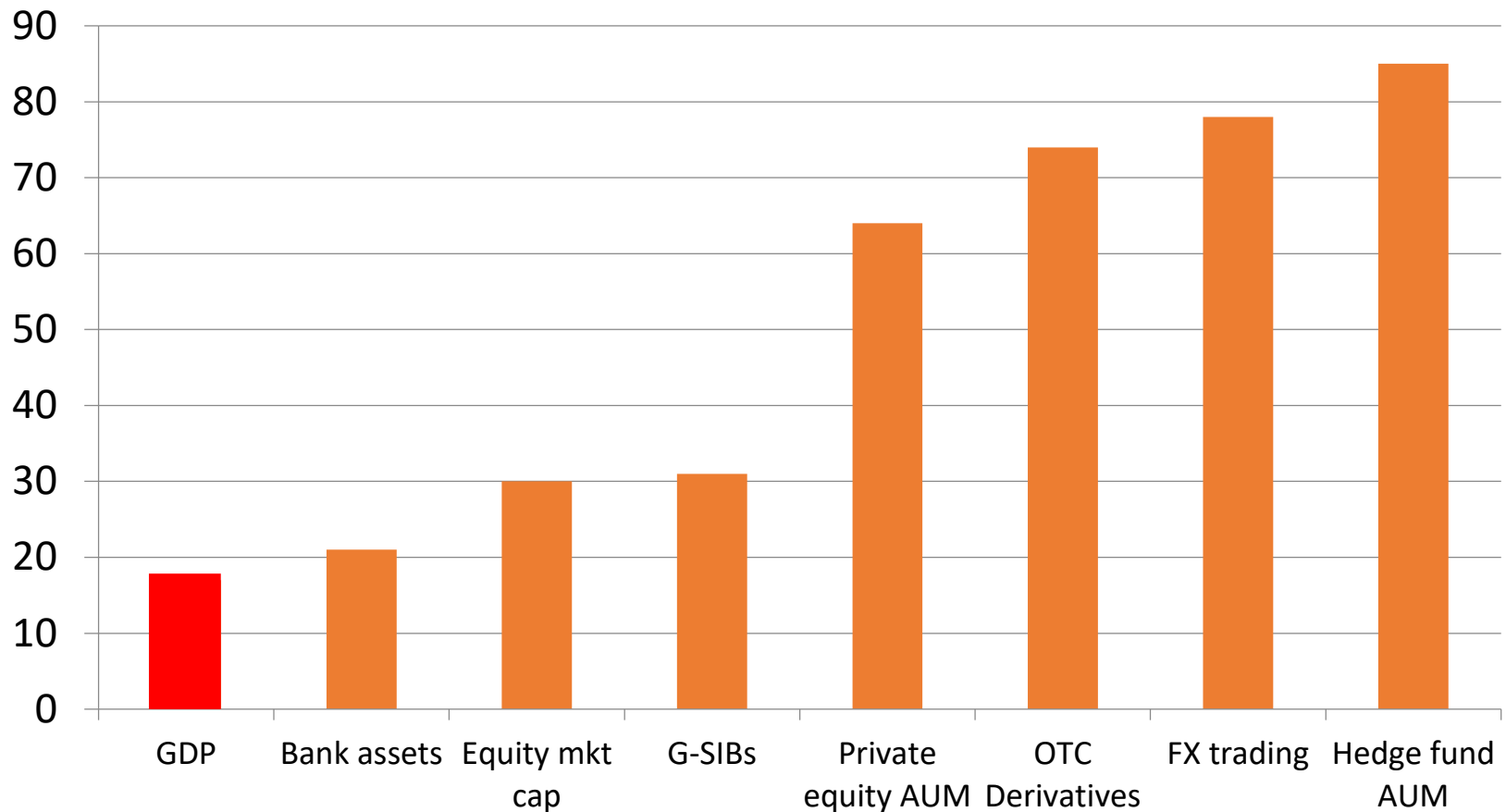
Brexit, Financial Services, and Equivalence

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UK and EU financial services



Overall: 35% of wholesale financial services

Sources: ECB, PRA, The CityUK

UK as wholesale market hub

“The bringing together of investment banking with asset management is the core of the concentration of activity we have in the UK.”

Katharine Braddick, Director of Financial Services, HM Treasury,
evidence to HL SCEU Financial Affairs Sub-Committee, 19 Oct 2016

Why?

- UK financial system traditionally more market-oriented (Carlin and Mayer, 2003; Rajan and Zingales, 2003)
- Agglomeration effects (human capital, netting, regulatory capacity)

Importance for the EU27?

- EU27 are ‘over-banked’ (Langfield and Pagano, 2015)
- Flagship Capital Markets Union programme seeks to develop EU capital markets (European Commission, 2015)

EU financial services 'passport'

- Single rule-book
 - Written by European Supervisory Authorities, Enforced nationally
- Approval only necessary once, at “home” jurisdiction
 - ⇒ “passport” to provide services throughout EU

Third country (3C) financial services: basic position

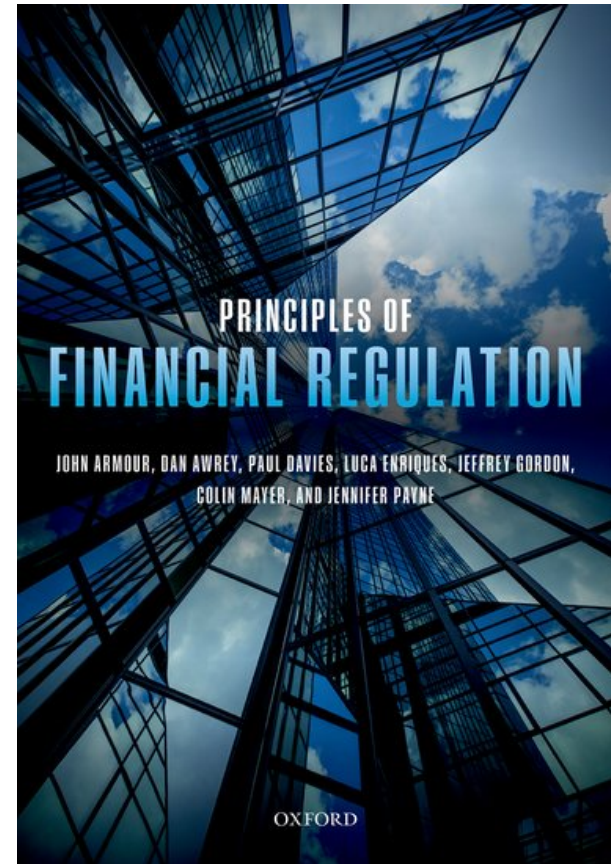
- Decentralisation: every country for itself
 - No EU financial services passport
 - WTO GATS carve-out for domestic financial regulation

⇒ Firms must seek authorisation in each state where want to do business

- MS must not discriminate in favour of 3C firms (authorisation threshold must be \geq EU rules)
- But nothing stops MS discriminating *against* 3C firms

Post-crisis regulation

- Post-crisis, intensity of financial regulation ↑
 - Compliance costs of decentralised regime increasing
 - Concerns about systemic risk, reciprocity
- G20 coordination – Financial Stability Board (FSB)
 - Push to convergence in international financial regulation
 - Implementation monitoring by FSB



See John Armour et al, Principles of Financial Regulation (OUP, 2016)

EU '3C equivalence' concept

- Response to increased *intensity* and reduced *variation* in financial regulation
 - ⇒ Centralised 'equivalence' assessment is easier to implement and of greater utility than before
 - ⇒ Trend has been to build in '3C equivalence' frameworks to EU finreg since c 2009
- Three general points
 1. Not a general framework, a lattice of specifics
 2. Scope, goals, determination process differ *inter se*
 3. A moving target....

EQUIVALENCE DECISIONS TAKEN BY THE EUROPEAN COMMISSION (as at 19/09/2016)		Abu Dhabi	Argentina	Australia	Bermuda	Brasil	Canada	Caymans	Chile	China	Dubai	Egypt	Faroe Islands	Greenland	Guernsey	Hong Kong	India	Indonesia	Isle of Man	Israel	Japan	Jersey	(South) Korea	Malaysia	Mauritius	Mexico	Monaco	N. Zealand	Russia	Saudi Arabia	Singapore	S. Africa	Switzerland	Thailand	Taiwan	Turkey	UAE	US			
PROSPECTUS	Equivalence of prospectuses: Art. 20(3)																																								
	3rd country GAAP with IFRS: Art. 35 of Regulation 809/2004						Y			Y											Y		Y																	Y	
TRANSPARENCY DIRECTIVE	3rd country GAAP with IFRS: Art. 23(4) Sub-para 3						Y			Y											Y		Y																	Y	
	general transparency requirements: Art. 23(4)																																								
ACCOUNTING DIRECTIVE	country-by-country reporting: Art. 46																																								
CREDIT RATING AGENCIES	Equivalence - Article 5(6)		Y	Y		Y	Y									Y					Y					Y					Y								Y		
	Adequacy of audit framework: Article 47(3)			Y		Y	Y				Y					Y			Y	Y		Y	Y	Y	Y								Y	Y	Y	Y	Y		Y		
STATUTORY AUDIT	Equivalence of audit framework: Art. 46(2)	Y		Y		Y	Y			Y	Y				Y				Y	Y		Y	Y	Y	Y	Y		Y			Y	Y	Y	Y	Y	Y		Y			
	Equivalence- Article 46 (2): transitional period				Y			Y				Y																	Y												
EMIR	central bank exemption: Art. 1(6)																					Y																	Y		
	regulated markets: Art. 2a																																							Y	
CSDR	transaction requirements: Art. 13																																								
	CCPs: Art. 25(6)			Y			Y									Y					Y		Y			Y						Y	Y	Y	Y				Y		
SFTR	trade repositories: Art. 75																																								
	CSDs: Art. 25(9)																																								
BENCHMARKS	central bank exemption: Art. 2(4)																																								
	trade repositories: Art. 19																																								
SHORT SELLING	transaction requirements: Art. 21																																								
	Requirements for benchmark administrators: Art. 30(2)																																								
MAR	Specific administrators or benchmarks: Art. 30(3)																																								
	Requirements for markets: Art. 17(2)																																								
MIFIR / MIFID2	Exemption for monetary and public debt management activities: Art 6(5)		Y		Y	Y				Y						Y	Y				Y		Y			Y				Y		Y					Y	Y			
	Exemption for climate policy activities: Art. 6(6)																																								
CRR	central bank exemption: Art. 1(9)																																								
	trading venues for the purposes of trading obligation for derivatives and shares: Art. 23 and 28																																								
	derivatives: trade execution and clearing obligations: Art. 33																																								
	trading venues for the purposes of clearing access: Art. 38 (1)																																								
	trading venues and CCPs - access to benchmarks and licences for the purposes of clearing and trading obligation: Art. 38(2)-(3)																																								
	investment firms providing investment services to EU professional clients and eligible counterparties: Art. 47																																								
SOLVENCY 2	regulated markets for the purposes of easier distribution in the EU of certain financial instruments traded there: Art. 25(4)																																								
	credit institutions for the purposes of Article 107(4)			Y		Y	Y			Y					Y	Y	Y		Y		Y	Y			Y	Y			Y	Y	Y	Y	Y						Y		
	investment firms for the purposes of Article 107(4)			Y		Y	Y			Y						Y		Y		Y		Y		Y		Y			Y	Y	Y	Y	Y						Y		
	exchanges for the purposes of Article 107(4)			Y		Y	Y			Y							Y	Y		Y		Y		Y		Y			Y	Y	Y	Y	Y						Y		
SOLVENCY 2	exposures to central governments, central banks, regional governments, local authorities and public sector entities for the purposes of Articles 114, 115, 116			Y		Y	Y			Y					Y	Y	Y		Y		Y	Y			Y	Y			Y	Y	Y	Y	Y						Y		
	credit institutions for the purposes Article 142			Y		Y	Y			Y					Y	Y	Y		Y		Y	Y			Y	Y			Y	Y	Y	Y	Y						Y		
	investment firms for the purposes Article 142			Y		Y	Y			Y						Y		Y		Y		Y		Y		Y			Y	Y	Y	Y	Y						Y		
SOLVENCY 2	for third-country reinsurers in the EU: equivalent treatment of their activities and of EU reinsurers' activities: Art. 172				Y																	Y																			
	for EU insurers in third countries: equivalence of third-country solvency rules for calculation of capital requirements and own funds: Art. 227			Y	Y	Y	Y															Y					Y												Y		
	for third-country insurers in the EU: equivalence of group supervision exercised by the third-country supervisory authorities: Art. 260				Y																																				

Notes:

1. In view of possible on-going dialogues with third country authorities only information on completed equivalence assessments resulting in a decision is published in this table (relevant entries marked with "Y")
2. Does not include ESMA assessments for CRAR endorsement purposes
3. Exemption under Art. 6(5) MAR for China, India and Singapore concerns only monetary activities.
4. Includes provisional (time-limited) and partial equivalence decisions
5. "Dubai" here stands for Dubai International Financial Center
6. CRR equivalence of Japan's investment firms' regime is limited to Type I Financial Instruments Business Operators
7. EMIR equivalence of the US CCP regime is limited to the framework of the U.S. Commodity Futures Trading Commission. EMIR equivalence of the Japanese CCP regime does not cover commodity derivatives.

Source: European Commission
(updated 29.09.2016)

3CE: scope

- Many 3CE regimes are about *supervisory coordination*
 - Recognising 3C supervisors as part of a supervisory college
 - Facilitate oversight and reduction of systemic risk in SIFIs
- Others are about *market access*
 - Prudential equivalence: EU firms may use 3CE firm's services consistently with EU prudential regulation (eg CCPs)
 - 3C passport: 3C-authorized firms may passport local authorisation into EU

3CE: scope (2)

Sub-sector	Legislation	Supervisory coordination	Market access
Retail	Prospectus Directive, UCITS V, MiFID II, etc	No	Some (Prospectuses)**
Insurance	Solvency II	Yes	Some (reinsurance)
Commercial Banking	CRD IV	Yes	No
Asset Management (professional clients)	AIFMD*	Yes	(Yes)
Wholesale markets	MiFIR*, EMIR, CSDR*, SFTR*, Benchmarks*, CRAs	Yes	Yes

* Not yet in force or no determinations yet made

** New regime to be introduced under revised Prospectus Directive

MiFIR: 3C Passport Scope

Activity	Covered	Not covered
Brokerage	X	
Prime brokerage lending (ancillary)	X	
Underwriting	X	
Market making	X	
Structured finance	X	
M&A advisory	X	
Proprietary trading	X	
Commercial lending		X
M&A lending (not ancillary)		X
M&A securities	X	

3CE: process

Country-level requirements

Commission:
'equivalence'
determination

+

Cooperation agreement:
NCAs / ESAs

+

Firm-level requirements

3CE: process

Commission must determine

1. Equivalent **substantive rules** (likely advised by ESAs)
2. Effective **supervisory framework**
3. (in some cases) **Compliance**
4. (in a few cases) **Reciprocity**

(In many cases) must also be **cooperation** agreement between ESA and 3C NCA.



Discretionary: No right to a determination

Reversible: Determination can be revoked

Which countries are equivalent?

Banking

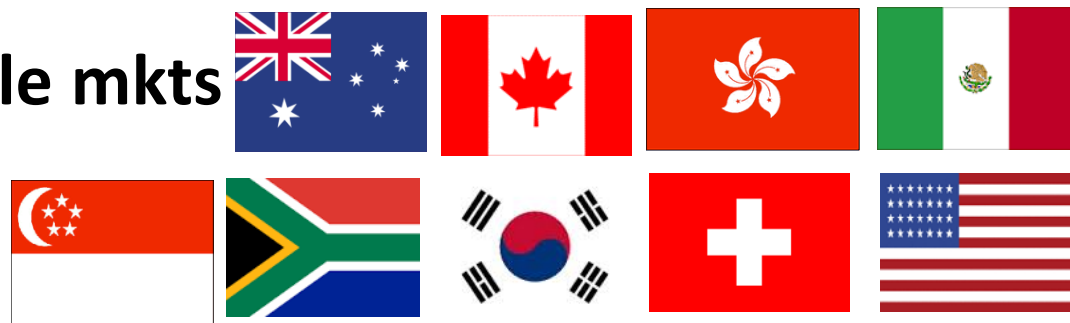


Insurance



Wholesale mkts

(EMIR CCPs)



3CE process: key considerations

Consideration	Issues
Politicisation	Much discussed, likely overblown. Commission (advised by ESMA) makes decision, not Parliament. Technocratic decision-making is what the EU stands for. Long list of existing determinations makes it hard to find UK not equivalent.
Delay	Less discussed, but more serious. Time to <i>first</i> EMIR determination from implementation: 2 years. Commission's discretion when to start (3C has no entitlement). MiFIR not implemented until 1 Jan 2018...
Dynamism	Need to ensure continued equivalence. Some mechanism for automatic implementation of EU measures. Twin track regime?
Reversability	Credibility of UK's dynamic commitment to equivalence is key, or firms will not be willing to invest.

Outlook

Outlook

Opportunities	Threats
3CE frameworks 'fit' UK's comparative strength (EU27's comparative weakness) in wholesale markets	Banking is not covered. US banks likely to have limited rationale for UK base
EU will struggle to replicate UK contribution quickly (agglomeration effects)	US may seek to compete directly as 3C. (Would need adjustment to US rules to permit reciprocity)
UK will be equivalent on exit	Need to maintain dynamic equivalence
3CE determination is technocratic	Hard to complete by 2019
FSB provides opportunities to maintain influence on finreg agenda	Trump regime hostile to FSB