SNAPSHOT

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Equivalence in EU financial services legislation – providing genuine value or adding confusion?

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Equivalence in financial services legislation used to be a topic which did not provoke a lot of excitement. More recently, more questions have been raised than answers – and rightfully so. Global media outlets have followed the recent equivalence discussion with Switzerland in countless articles and the Financial Times, Bloomberg and Reuters have pointed to the impact Brexit could have on the process. All of which have led to boardroom discussions on a topic which is not necessarily new. Equivalence provisions have been a feature in EU financial services legislation since the financial crisis. To date, the European Commission has adopted close to 300 equivalence decisions for over 30 countries. So, why is something so familiar and seemingly effective being put into question now?

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Increased interest

As the world, particularly financial markets, has become increasingly global and interconnected, the importance of equivalence decisions (or the lack thereof) can have vast consequences. Equivalence decisions determine EU market access and the conditions for global financial services firms to be active in it. At the same time, the world is also becoming increasingly polarised, and the benefits of globalisation are being questioned by citizens and politicians alike.

From the EU perspective, relationships with third countries have become more important – across all policy areas; the area of financial services is no exception. Several legislative proposals in the last legislature contain extensive rules on the treatment of third countries or third-country entities. This has been seen specifically with the re-location requirement for clearing of financial instruments in the so-called EMIR 2.2 legislation and increased capital requirements for certain third-country Investment Firms active on the EU market in the legislation on revised prudential rules for Investment Firms (IFD/IFR). Some would argue that these requirements are demonstrations of the politicised application of the power of equivalence and a clear move away from the purely technical assessment. Brexit is and will to continue to lead to further politicised debates on equivalence.

For many observers, the politicisation of the issue was evident in the recent Switzerland case, with the (non-) equivalence decision on the trading obligation for shares under MiFID II. The initial equivalence was granted for a limited time, with a view to motivating the Swiss to make progress on the negation of the Interinstitutional Framework agreement, which sets out the overall conditions for the relationship between Switzerland and the EU. When this did not happen, the equivalence was let lapse. This case has attracted attention both from a political level, as well as contributed to confusion in the financial market community. It is interesting to note that no-one has stated that the Swiss are technically not equivalent with MiFID. The same would be the case for the United Kingdom that fully applies MiFID at this point in time but would still have to be subject to an equivalence decision in the event of a hard Brexit.

The stakes have been raised

For financial market participants – who crave certainty and continuity – this setting of politicisation and confusion is not an optimal situation to be in. So, when the European Commission was rumoured to review its approach towards equivalence, many hoped for a new, streamlined and more predictable process. This was also what the European Parliament asked for in its own-initiative report on the topic from 2018. Unfortunately for those who are unhappy with the current equivalence regime(s), it does not look like the Commission will change its approach anytime soon.

What does the future hold?

In a recently published Communication on Equivalence in the area of financial services, the Commission maintains its conviction, that the current system is fit for purpose and will continue to deliver genuine added value to financial markets and the regulatory and supervisory framework. The only real development is the focus on monitoring and follow-up of equivalence decisions, where close cooperation with the European Supervisory Authorities (ESAs) is planned.

Not everyone will agree with the approach to make very little changes to the current regime. For market participants, the process around equivalence remains opaque and unpredictable – especially as it is increasingly politicised. Some Member States and the European Parliament are also unhappy about the limited influence they have over equivalence decisions. This may not have drawn major attention with MEPs and Member States in a situation where they were purely technical but would be expected to gather increased resistance in an increasingly politicised environment.

Regardless of whether the status quo is preserved or if the Commission will be pressured to rethink its approach on equivalence, the area will remain difficult to navigate for the financial services industry and for third countries. The experience from the Swiss equivalence decision, in combination with the potential for a no-deal Brexit, demonstrates how critical it will be for businesses to be plugged into the thinking on the technical elements and the political motives related to equivalence decisions.
One point to bear in mind. It might well be that the European Commission will at a later point in time still consider a more fundamental review of equivalence regimes. However, it would not be appropriate to do that just before a new Commission takes office, effectively tying new decision-makers to strategic and impactful change of policy.

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