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Equivalence and Enhancing International Cooperation in Financial Services

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1. Introduction

Ten years on from the G20 Pittsburgh summit and in the context of the UK's prospective departure from the European Union, it is an appropriate time to evaluate the EU's approach to its relationships with third countries regarding financial services. We therefore welcome the Commission Communication on equivalence in financial services (the "Commission Communication")[1] and agree that "it is timely to take stock of the EU's overall approach to equivalence" and consider some of the challenges faced today.

The EU, like other jurisdictions, faces challenges which make international cooperation even more important. These include trends towards greater connectivity in global markets driven by technology, globalisation and market forces, but also risks of greater regulatory fragmentation caused by different policy environments and geopolitical tensions across jurisdictions.

As we have highlighted in our publication *Finance for Europe – Building competitive, resilient and integrated financial markets*[2], the EU should prioritise a growth strategy that focuses on promoting competitiveness, innovation and deeper integration. There are a number of priorities to advance these objectives including enhancing integration within the Single Market and making progress with Capital Markets Union, but this context is also important when evaluating the relationship between the EU and third countries.

Third country regimes should be stable, predictable, and based on sound regulatory and supervisory arrangements to support continued connectivity with international financial markets, minimising unnecessary fragmentation and maximising benefits for end users while effectively managing risks to financial stability, market integrity and investor protection.

This paper assesses the EU's existing equivalence framework and makes a number of proposals to enhance its functioning, taking account of the evolving international regulatory landscape. It does not address the future relationship between the EU and the UK or indeed trading relationships with other third countries, for financial services firms or their corporate clients. In appropriate cases, third country regimes could be supplemented through a Free Trade Agreement or other formal relationship. We will separately address these topics.

Our recommendations include:

- strengthening the stability of relationships with third countries including improving the transparency and certainty of equivalence determinations, monitoring of equivalence and withdrawal of equivalence;
- taking greater account of the sophistication of the parties involved and the consequences for fragmentation in the risk-sensitive, proportionate and outcomes-based approach to assessing equivalence; and
- further enhancing regulatory and supervisory cooperation with third country authorities to support an effective, stable and sustainable relationship including establishing mechanisms for consultation with third-country authorities and engagement with the private sector.

1 European Commission Communication on equivalence in financial services, July 2019, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019DC0349

2 Available at https://www.afme.eu/en/reports/publications/finance-for-europe--building-competitive-resilient-and-integrated-financial-markets/

We also recommend that the European Commission establish a senior level consultative group comprising leading market participants – from the EU and from outside the EU – to provide advice on relationships with third country markets in different areas.

2. The importance of international cooperation and minimising fragmentation in capital markets

We welcome the work commenced under the Japanese G20 Presidency to review market fragmentation and consider tools to address issues where appropriate. The FSB[3] and IOSCO[4] reports on market fragmentation provide a useful review of the status following the post-crisis reforms. We agree with the FSB that "effective international regulatory and supervisory cooperation is an important precondition for integrated financial markets and cross-border financial activity".

While there has been significant progress, we agree with the IOSCO report that "despite these successes, some challenges remain and strengthening cooperation between regulatory authorities could further assist in addressing effects on the financial system stemming from market fragmentation".

As highlighted in the FSB report, it is necessary to consider the nature and causes of fragmentation. In some cases fragmentation may arise from local requirements which are determined to be necessary to enhance resilience, for example for the protection of retail depositors. However, in relation to international markets, as the FSB notes, fragmentation "can reduce opportunities for cross-border diversification and risk management" and "reduce the efficiency of global financial markets".

For example, fragmentation in the interdealer and interbank market (e.g. limiting the ability of dealers from different jurisdictions to transact with one another, or limiting the permissible trading mechanisms such as to effectively prohibit dealing between dealers in different jurisdictions) has direct prudential consequences, as it may slow the transmission of shocks from one region to another, but is likely to increase the reliance of the dealers in a given zone on their peers for their access to liquidity and the management of their risks, and hence the systemic risk within that region. We consider this type of fragmentation to be harmful to international markets and therefore one that should be limited as much as possible.

Continued close connectivity between the EU and third countries is therefore particularly important with respect to capital markets. Capital markets are global in nature and provide a mechanism for efficient financing of growth which benefits consumers and end-users across Europe. For EU capital markets to thrive, alongside developing the EU financial ecosystem, it is important to maintain and continue to develop open capital markets that are able to provide investors and businesses with access to international capital, investment and funding opportunities while preserving market integrity and fairness of competition between EU firms and third country entities. This is complementary to the EU's objective to increase the size and capacity of capital markets within the EU through Capital Markets Union.

3 FSB Report on Market Fragmentation, 4 June 2019, available at https://www.fsb.org/2019/06/fsb-publishes-report-on-market-fragmentation/

4 IOSCO, Market Fragmentation & Cross-border Regulation Report, 4 June 2019, available at https://www.iosco.org/news/pdf/IOSCONEWS533.pdf

3. Key objectives for the EU's relationship with third countries

We believe that the following objectives should underpin the EU's relationships with third countries with respect to financial services:

1. promoting open, competitive capital markets and minimising barriers to cross-border business, and maintaining market integrity, financial stability, fair competition and investor protection in the EU;

2. preserving choice for investors;

3. creating a stable and transparent framework to provide certainty; and

4. developing arrangements for close supervisory and regulatory cooperation.

Effective third country regimes will advance the EU's aims of continuing to strengthen and develop its financial markets, maintaining financial stability and resilience to internal and external shocks; providing efficient, sustainable financing and risk management options for businesses; and supporting growth in all sectors of the economy. They should also support the global competitiveness of EU providers of financial services through greater access to third country markets, connectivity to global capital and liquidity, and reduced fragmentation.

There are several ways in which these objectives can be pursued. These include utilising regulatory third country regimes, exemptions, Memoranda of Understanding and other cooperation arrangements. The precise nature of the relationship will depend upon the relevant third country, but in many cases is likely to involve a combination of these tools. In appropriate cases, this could potentially be supplemented through a Free Trade Agreement or other formal relationship. For example, limited provisions on financial services have been included in the recent free trade agreements with Canada and Japan; the nature of such provisions could be adjusted to the type of relationship or framework developed for different bilateral relationships.

4. Third Country Regimes: an updated equivalence-based framework

The EU's third country regimes provide a mechanism to develop the EU's relationship with third countries in financial services. It is timely to assess the EU's existing third country equivalence regimes and consider how their functioning should be further enhanced to achieve the above objectives. In addition to improving the functioning of the regimes, a key objective should be promoting a sustainable and cooperative relationship with third countries including access to their markets and market infrastructure.

As the Commission Communication highlights, "EU equivalence policy satisfies three objectives:

- it reconciles the need for financial stability and investor protection in the EU, on the one hand, with the benefits of maintaining open and globally integrated EU financial markets on the other;

- it is pivotal in promoting regulatory convergence around international standards;

- it is a major trigger for establishing or upgrading supervisory co-operation with the relevant third-country partners."[5]

There are around 40 different third country regimes in existing EU financial services legislation. Some regimes have not been activated so far, while others have been used in respect of several third countries, with decisions made for more than 30 countries to date.[6] It is worth noting that these third country regimes differ depending on the legislation. For example in some cases equivalence provides a basis for assessing the risk of exposures of an EU institution to a particular jurisdiction (e.g. CRR), in others the ability for EU institutions or market participants to access market infrastructure outside the EU (e.g. EMIR) whereas in some other, relatively limited, circumstances it provides a basis for market access for firms in third countries into the EU (e.g. MIFIR equivalence for investment firms).[7]

Different considerations are likely to apply depending upon the purpose for which equivalence is granted, although there are some general characteristics which are common. The EU equivalence framework is one of the most used and advanced systems to regulate market access and international relationships. Further improvements could support even closer cooperation with third countries. Improvements in a number of areas should be considered to enhance the general equivalence model applicable to all third country relationships.

There have recently been some changes made to the existing third country regimes for recognition of third country CCPs under EMIR and third country investment firms under MIFIR. These changes have increased the proportionality and scrutiny of equivalence for third country CCPs and investment firms, although the detailed application of the revised framework has not yet been fully specified.[8] Some changes to the role of the ESAs including relating to monitoring of equivalence are also being introduced through the ESAs review.

5. Equivalence determinations

In order to achieve the above objectives, the existing approach to assessing equivalence and the process for making equivalence determinations should be reviewed and further improved. We propose four key principles which should be considered in the context of equivalence determinations:

1. Decisions should be proportionate and risk-sensitive, based on sound regulatory and supervisory arrangements;

2. The equivalence assessment should be focused on alignment of regulatory and supervisory outcomes in the area under consideration;

3. There should be transparency in the decision-making process; and

4. Decisions should be made in a timely manner and provide certainty and stability for market participants.

5 Commission Communication, at page 3

6 Available at https://ec.europa.eu/info/files/overview-table-equivalence-decisions_en

7 In March 2016, AFME published a report which included a summary of the existing third country regimes under EU financial services legislation, available at https://www.afme.eu/globalassets/downloads/publications/afme_referendum2016_final.pdf

8 See AFME/FIA/ISDA response to ESMA consultation papers on tiering and comparable compliance for third country CCPs under EMIR 2.2, available at https://www.afme.eu/globalassets/downloads/consultation-responses/190729-fia_isda_afme--response-to-tiering-and-comparable-compliance-esma.pdf

Principle 1: Proportionality and a risk-sensitive approach based on sound regulatory and supervisory arrangements

Equivalence decisions are relevant to the level of fragmentation in financial markets. The decision to grant or withdraw equivalence should therefore take into account the nature of the risk and the consequence of the decision in terms of fragmentation. It is important to take account of the nature of the relevant services which are subject to the equivalence decision. For example, for decisions involving access of institutional or sophisticated counterparties to third country services and third country market infrastructure, the relevant considerations are more likely to be related to financial stability and the characteristics of wholesale markets, as opposed to the protection of users of retail services. Equivalence decisions should take account of the nature of different markets and the impact on fragmentation in the relevant market.

It is necessary to evaluate the benefits arising from the potential equivalence decision, for example increased choice, competition and access to liquidity which might arise. As set out in the Commission Communication, this involves the Commission assessing the potential benefits for EU market participants.[9] It is also important to balance the impact which any rejection of equivalence would have on EU market participants and third country providers. The denial of access for EU participants to certain third country infrastructures could, for example, itself be a source of systemic risk.

Equivalence decisions should remain proportionate and risk-sensitive. We welcome that the European Commission is already guided by these principles. The nature of interactions between the EU and third countries in financial services varies considerably depending upon the characteristics of financial markets in a given jurisdiction and the relationship with the EU. A risk-sensitive approach should ensure market integrity and financial stability, particularly where services provided from a third country could be of systemic relevance to the EU Single Market.

The assessment should identify any specific risks to the EU financial system which could arise from the relevant cross-border activities with the third country and weigh them against the potential benefits and impacts on EU market participants if equivalence is, or is not granted. Types of risks that should be considered include risks to financial stability, market integrity or investor protection in the EU. The principle of proportionality should also apply to the scope of the assessment, which should be strictly limited to risks arising from the relevant areas of regulation.

Relationships between the EU and high-impact third countries or services which could have a systemic impact should be prioritised and carefully scrutinised. This could include a more detailed assessment of the third country regulatory and supervisory framework where relevant and proportionate to the identified risks. Conversely, the granularity of the assessment should also be adjusted where the risks posed by that jurisdiction to the EU market are lower. Due consideration should also be given to the size and sophistication of the third country market as rules which are as complex and as detailed as the EU's rules may not necessarily be appropriate for a smaller and less complex market, but nevertheless achieve the same outcomes.

Distinguishing between reforms intended to mitigate systemic risk and other reforms has also been proposed as a principle for a revised approach to cross-border application of US swaps rules[10] and has been reflected to some degree in the revised framework for recognition of third country CCPs under EMIR 2.2.

9 See Commission Communication, at pp.3-4

10 See, for example, remarks of CFTC Chairman Giancarlo, 4 September 2018, available at https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo52

Clear criteria should be provided as to which services are determined to be of systemic importance, which requirements are important to manage systemic risk and the identification of "high impact third countries"[11]. For instance, such countries could be identified in view of the size of their capital markets and the degree of interconnectivity with EU markets. It is therefore sensible to consider whether a more tailored approach to certain relationships would be better suited to fulfilling the EU's objectives in the financial services area, balanced with the need for openness, competition and choice for EU investors. As discussed further below, the equivalence assessment should also take account of relevant mitigants to the identified risks, for example through regulatory and supervisory cooperation and clear mechanisms for dialogue between the parties that provide for private sector input.

Where risks have been identified under such a proportionate, risk-sensitive and outcomes-based approach, before declining to grant equivalence or imposing additional requirements on third country firms, the EU should carefully consider how the relevant risks could be addressed through the broader relationship with the relevant third country.

As Steven Maijoor has emphasised, "regulators … should do their utmost to find and use tools to adequately address cross-border issues and support the functioning of global financial markets."[12] There should be a preference for seeking to address any risks or concerns through regulatory and supervisory cooperation as opposed to imposing additional, potentially duplicative, requirements on market participants.

For example, if the Commission and ESAs determine that it is necessary for EU regulators to have access to information relating to a third country firm providing services in the EU in order to ensure that they have sufficient supervisory oversight of risks to EU markets, this data should first be sought through the cooperation arrangements with the relevant third country supervisor before imposing additional requirements on the third country firm itself.

Principle 2: Based on alignment of regulatory and supervisory outcomes

As the Commission Communication notes, equivalence assessments look at the outcomes of third country regulation and supervision and third country regulation does "not need to be identical to the EU framework, but [it does] need to ensure in full the outcomes as set out in that framework."[13] Equivalence should provide a foundation for a comprehensive, stable, and sustainable ongoing relationship. It is therefore important to maintain an outcomes-based approach, ensuring that the outcomes are respected while avoiding excessively rigid approaches which could undermine the overarching objectives of equivalence.

For example, any requirement for an overly granular "line by line" alignment of regulation, even where greater scrutiny is warranted with respect to closely connected markets, is unlikely to provide sufficiently durable relationships because in practice regulation is rarely identical or static. This is particularly relevant in light of the post-crisis regulatory framework which, while based on increasingly detailed global standards, has increased the volume and detail of regulation across jurisdictions.

11 In the recently adopted EU Regulation on investment firms (IFR), the Commission has been tasked with the preparation of a delegated act to specify the circumstances under which the scale and scope of the services provided, and activities performed by third-country firms in the EU are likely to be of systemic importance for the EU. Similarly, the Commission is developing a Delegated Act to further specify the criteria for assessing the systemic importance of third country CCPs under the recently agreed EMIR 2.2 framework.

12 Dinner address at FESE Convention, 4 June 2019, available at https://www.esma.europa.eu/press-news/esma-news/steven-maijoor-address-fese-2019-convention-opening-dinner

13 Commission Communication, at page 7.

Where greater granularity in the assessment of third country regulation is considered necessary to mitigate risks for services with potential systemic implications for the EU, it is important to maintain an outcomes-based approach to the ultimate judgment of equivalence and to maximise the use of comparable compliance, where feasible and appropriate.

It is however important to define the outcomes that are to be assessed to ensure market integrity and avoid regulatory arbitrage through strong standards of regulation and supervision, while maximising substituted compliance where feasible and appropriate to minimise fragmentation, duplication and undue complexity. Types of outcomes that could be considered, where relevant, include standards of prudential regulation and levels of consumer protection. A starting point for defining the outcomes should be international standards, where available. As discussed above, it is also important to consider the nature of the service and the associated risk. Transparency over the outcomes against which the assessment is to be made should also facilitate effective cooperation with third countries and third country market participants.

The definition of the relevant regulatory outcomes and granularity of assessment should be proportionate to the identified risks and a balanced approach taken. For example, there could be different considerations depending upon the nature of the consumer of the service where local conduct requirements would be more relevant for the provision of services to retail consumers than in the case of wholesale markets.

Recent amendments to EMIR and the Investment Firms Regulation have introduced more specific criteria for the assessments with respect to (i) third country CCPs which are, or are likely to become, systemic and relevant to financial stability in the EU; and (2) jurisdictions where the scale and scope of services provided by investment firms is likely to be of systemic importance for the EU.

Principle 3: Transparency

There should be increased transparency over the process and timing of equivalence determinations. Enhancing the transparency and objectivity of the process would provide greater confidence to market participants and help support a cooperative relationship with authorities in third countries. We welcome the recognition in the Commission Communication that there should be "enhanced transparency both towards the interested third country and the public at large".[14]

One of the challenges highlighted by the IOSCO report on Market Fragmentation & Cross-border Regulation (the "IOSCO Report") is the "lack of clear processes and procedures, including in the review of whether to revoke a positive recognition decision", noting that "this is particularly true if there no procedures in place to mitigate the impact of a review (e.g. transitional periods)".[15] The report also highlighted that the "lack of transparency about the assessment criteria from the perspective of the jurisdiction being assessed" and the "lack of a clear timeframe for making assessments", "can create risks of competitive distortions in the market" and "lead to a perceived lack of consistency".[16]

We welcome efforts to increase transparency over equivalence processes including the explanation provided by the Commission for the recent withdrawal of equivalence for certain jurisdictions under the Credit Ratings Agencies Regulation. However, we would welcome increased transparency over the process, progress and timing of equivalence processes, without compromising the autonomy of the European Commission in its decision-making.

14 Commission Communication, at p.5

15 IOSCO, Market Fragmentation & Cross-border Regulation, June 2019, at p.20.

16 Above, at p.21

There could be various ways of achieving this including, for example, putting in place clear mechanisms for consultation between the EU and third country authorities, allowing for private sector input, regular updates and dialogue with market participants to ensure that they are kept updated regarding the timing and progress of decisions to grant or withdraw equivalence, including forward guidance on the likely timing of decisions; and transparency over the reasoning for making or withdrawing an equivalence decision.

Principle 4: Timeliness, certainty and stability

It is important that the equivalence framework provides a stable, certain and sustainable relationship with the relevant third country. This is particularly important for third countries or services where there is a significant volume of business affected by the decision.

Equivalence assessments should be completed in a timely manner. It is important that adequate resources are committed to equivalence assessments to ensure a robust and timely process. As contemplated by the IOSCO Report, the European Commission and ESAs should explore ways to make the assessment process more efficient, for example through clarifying in advance the standard information that would be required from the third country authorities and firms, even if certain bespoke information may be required, for example where the systemic nature of the market or the service merits particular consideration.

Equivalence decisions should provide additional certainty for third countries and market participants. As discussed above, decisions should be based on a proportionate, risk-sensitive and outcomes-based approach and should not be used to seek public policy objectives that are not relevant to the decision.

The time required to complete assessments and reach decisions should be taken into account during the legislative process when third country regimes are being introduced or amended. This is particularly important where equivalence assessments have significant implications for market participants. It is important that sufficient time is provided in the relevant legislation and/or transitional provisions are put in place to bridge to the equivalence decision being made. In a number of circumstances there has been insufficient time built in for new legislation which has led to uncertainty in the market.

6. Monitoring of equivalence

Equivalence is not a one-off determination but should be supported by ongoing monitoring as part of the continuous relationship with the third country, particularly for high impact third countries. The monitoring of equivalence should form part of the ongoing regulatory and supervisory dialogue with the third country as discussed further below.

The ESAs review strengthens the role of the European Supervisory Authorities in the process of preparing equivalence decisions, and provides a clear mandate to "verify whether the criteria, on the basis of which those decisions have been taken and any conditions set out therein, are still fulfilled" on an on-going basis.

As the Commission Communication highlights, "effective monitoring is possible only if good cooperation has been put in place between the Commission and the European Supervisory Authorities on the one side, third-country authorities and supervisors on the other side."[17]

17 Commission Communication, p 10

We note in the ESAs review that the ESAs "should, where possible, develop administrative arrangements with third-country competent authorities to obtain information for monitoring purposes and for coordinating supervisory activities enhanced supervisory regime [to] ensure that third country equivalence is more transparent, more predictable for the third countries concerned and more consistent across all sectors."[18] It is important that this work provides an efficient and effective framework for monitoring.

7. Withdrawal of equivalence

There is currently a lack of clarity for third country authorities and market participants over the process and timing of any potential withdrawal of equivalence. While the principle of autonomy over equivalence determinations necessarily requires the possibility that equivalence can be withdrawn if the relevant criteria cease to be satisfied, the unilateral withdrawal of equivalence should be viewed as a last resort and follow a clear procedure including dialogue with the relevant third country and affected market participants.

In practice we understand that the European Commission would be very unlikely to unilaterally withdraw equivalence without such dialogue and clear warnings. We welcome the confirmation in the Commission Communication that any review of a decision "involves careful dialogue with the third-country authorities concerned" and understand that the Commission informed the jurisdictions affected about its intention to repeal their equivalence and offered the opportunity for third country authorities to respond before withdrawing equivalence for certain jurisdictions under the Credit Rating Agencies Regulation[19]. However, setting this principle out clearly and with certainty, generally and also in bilateral cooperation arrangements, would enhance trust and stability of the relationships with third countries and provide greater assurance to firms and their clients which make use of the relevant decision. It is also important that there is appropriate dialogue with affected market participants in addition to dialogue with the third country authorities.

Further stability could be achieved by acknowledging the need to avoid abrupt withdrawal of equivalence where this would be likely to give rise to market disruption. For example a formal 30 days' notice would be insufficient for end users and market participants to make necessary adjustments to their business, particularly in areas such as access to important third country market infrastructure, or to provide certainty on continuity of existing contracts. Any withdrawal of equivalence should be accompanied by appropriate transitional measures to avoid a cliff edge and provide time for businesses to adapt to the change.

The option to issue time-limited equivalence determinations should be used only in exceptional circumstances and subject to concrete justifications, to avoid a cliff edge or gap while a full equivalence assessment is undertaken. Where this option is used, timely information should be provided to market participants on renewal decisions and appropriate guidance and adjustment periods put in place in cases of non-renewal. The lack of communication around the decision not to extend the equivalence decision of the Swiss Confederation in the context of the MIFIR Share Trading Obligation in June 2019 is a recent example of a situation that involved significant uncertainty for market participants and risks of adverse market impacts.

18 ESAs review, recital 19

19 Commission Communication, p.9

8. Scope of equivalence

It is important to note that the existing scope of equivalence providing access to the EU Single Market is limited to a narrow range of activities and services. With respect to our focus on wholesale capital markets, we believe that the priority should be to build upon the existing third country regimes to put in place improved, stable, equivalence-based relationships for the existing scope of equivalence.

There is no third country regime providing market access for banking services. Frequently businesses demand wholesale banking services to be provided alongside MiFID investment services to provide them with the suite of financing and risk management services which they need to manage and grow their business.

The possibility of expanding the scope of equivalence should be reviewed over time. Additional areas for consideration include introducing a third country regime to the STS Securitisation framework and the Settlement Finality Directive.

An example of a current gap in the scope of equivalence which has been recently brought into focus through no-deal Brexit planning is settlement finality. This is an area where there is a strong case for a third country equivalence framework to confirm the recognition of settlement finality for EU firms participating in third country payment and settlement systems under the Settlement Finality Directive. A number of Member States have addressed this by amending national law in the context of the possibility of the UK leaving the EU without a Withdrawal Agreement, but this would be better addressed through an EU equivalence determination.

Considering to expand the scope of equivalence to banking services for wholesale clients is likely to require careful consideration and we would be happy to provide further input should the political will emerge on this in the EU.

9. Beyond equivalence: third country exemptions and licensing regimes

In addition to specific third country regimes in EU legislation, there are a number of additional exemptions and licensing regimes which facilitate cross-border business in certain circumstances. These play an important role in facilitating access to international liquidity and are generally subject to certain conditions, limited services and categories of counterparties.

For example national third country regimes under MiFIR provide a much needed mechanism for third country firms to provide MiFID investment services to sophisticated counterparties in the relevant Member State in the absence of equivalence. However, there continue to be a number of different national regimes across Member States which creates a challenge for third country firms and inconsistency in sophisticated clients' choice in accessing cross-border services across Member States. These should be reviewed with a view to harmonisation.

Interdealer exemptions

We welcome the clarification in France regarding interdealer trading[20] between banks in France and third countries and strongly encourage ESMA and other Member States to provide similar clarification. It is important that clarity is provided that dealers in the EU and third countries can

20 See decree under Loi Pacte, https://www.legifrance.gouv.fr/eli/decret/2019/6/27/ECOT1911362D/jo/texte following guidance from the French regulators http://www.amafi.fr/index.php/news/en/interdealer-market

transact with one another to provide liquidity by dealing on own account. This is vital to enable liquidity provision and effective risk management. Care should also be taken to ensure that limitations to the permissible means of trading between dealers does not effectively amount to a prohibition of dealing between dealers in different jurisdictions. The derivative and share trading obligations in MiFID II are an example of such potential limitation.

Fragmentation of the interdealer and interbank market (e.g. limiting the ability of dealers from different zones to conclude transactions with one another) would be particularly damaging, having direct prudential consequences by likely increasing the reliance of the dealers of a given zone on their peers for their access to liquidity and the management of their risks, and hence the systemic risk within that zone. A lack of clarity could particularly impact smaller banks which rely on access to liquidity from larger international dealers.

10. Regulatory and supervisory cooperation

Regulatory and supervisory cooperation arrangements are essential to support integrated financial markets and cross-border financial services. Regulation in the EU and third countries is dynamic rather than static. Ongoing regulatory dialogue is important to build trust and enhance cooperation amongst legislators with the aim of minimising fragmentation and obstacles to cross-border trade. Dialogue and cooperation are not only a prerequisite to establishing market access arrangements but can play a key role in addressing systemic risks and supporting the ongoing monitoring of equivalence.[21] As the European Commission notes, "cooperation contributes to building mutual understanding and trust among jurisdictions, which is a pre-requisite for managing cross-border risks."[22]

The EU should continue to strengthen its participation in multilateral fora such as the FSB, Basel Committee and IOSCO. Consideration could also be given to establishing regional dialogues, for example with the UK (post Brexit) and Switzerland.

Alongside multilateral dialogue, the EU should expand and strengthen its bilateral regulatory dialogues and supervisory cooperation with key third countries. In April 2018, our global association GFMA published Principles for Achieving Consistent Regulatory Regimes and Supervisory Practices.[23] Through GFMA, we proposed that regulatory cooperation arrangements should meet the following principles: (1) be forward-looking; (ii) enhance cross-border investments and market integrity; (3) supportive of similar-outcomes; (4) predictable; (5), transparent; (6) evidence-based; (7) proportionate; (8) enhance market certainty; (9) strengthen supervisory cooperation; and (10) supportive of conflict mitigation.

Cooperation with third country jurisdictions should build upon existing dialogues and fora, such as the EU US Regulatory Forum, to facilitate the exchange of information, regulatory consistency, supervisory convergence and effective oversight of financial markets.

Particular areas which should be enhanced include:

- expanding and strengthening bilateral regulatory dialogues with key third countries, comprising both more formal/structured discussion and ongoing informal dialogue at working level;

21 The FSB Report on Market Fragmentation, 4 June 2019 finds that "Greater cooperation has fostered a better understanding of supervisory practices and outcomes and this has led to an increase in the extent to which authorities are prepared to defer to or rely on each other's supervisory or authorisation processes

22 Commission Communication, p.1

23 Available at https://www.gfma.org/wp-content/uploads/0/83/197/231/64665979-572d-4887-9edf-5ebebbe6dd27.pdf

- greater dialogue at an earlier stage in policy development and implementation to identify and discuss forthcoming regulation and potential impacts on the EU and the third country;
- dialogue regarding regulatory outcomes which are required to be met under third country regimes in the EU and the third country;
- identifying areas of unintended fragmentation and considering ways to address them;
- aiding mutual understanding of regulatory and supervisory approaches in the respective jurisdictions;
- facilitating equivalence assessments and ongoing monitoring;
- providing for engagement with industry stakeholders and private sector input; and
- improved governance and increased transparency including publicly communicated terms of reference, schedules of meetings, agendas and outcomes, while respecting the need for confidentiality to facilitate an open discussion in the meetings.

In addition to regulatory cooperation, it remains vital to continue to strengthen cooperation and information sharing amongst supervisory and resolution authorities. This can build upon existing structures and Memoranda of Understanding to address macro and firm-specific issues. Given the importance of supervisory cooperation and oversight over third country institutions to the objectives of financial stability and market integrity, a structured approach to supervisory cooperation and information sharing would be beneficial, particularly for high impact third countries.

Utilising close cooperation and information sharing arrangements should be preferred to EU authorities obtaining information directly from the third country entity, in order to give appropriate deference to the third country regulator and to avoid duplicative supervision.

The EU supervisory and resolution authorities should maximise coordination and cooperation with their third country counterparts through existing international fora such as Crisis Management Groups, bilateral arrangements through Memoranda of Understanding, participation in colleges and related arrangements.

11. Conclusion

The EU's equivalence system is one of the most advanced and widely used third country regimes for financial services and plays an important role in supporting the Union's growth strategy by effectively regulating market access and international relationships.

We have made proposals for key objectives for the EU's relationship with third countries and core principles which should underpin the equivalence framework. We have also made a number of recommendations to further improve the functioning of the regime and strengthen relationships with third countries to ensure continued connectivity with international financial markets while effectively managing risks to financial stability, market integrity and investor protection.

We hope that our recommendations provide the basis for further enhancements to support the EU in strengthening its third country engagement, improving international cooperation and minimising harmful fragmentation in capital markets.

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/ About AFME

The Association for Financial Markets in Europe (AFME) is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues.

We represent the leading global and European banks and other significant capital market players.

We advocate for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society.

We aim to act as a bridge between market participants and policy makers across Europe, drawing on our strong and long-standing relationships, our technical knowledge and fact-based work.

Focus
on a wide range of market, business and prudential issues

Expertise
deep policy and technical skills

Strong relationships
with European and global policymakers

Breadth
broad global and European membership

Pan-European
organisation and perspective

Global reach
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