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# Relationships between the EU and third countries concerning financial services regulation and supervision

## Comments on European Parliament Report (2017/2253(INI))

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### Comments on ECON own-initiative report

AFME welcomes the opportunity to comment on the own-initiative report undertaken by the European Parliament's Committee on Economic and Monetary Affairs (ECON) on relationships between the EU and third countries in financial services regulation and supervision. A sensible approach to third country relationships is essential to promote regulatory cooperation and convergence on the basis of international standards. In this respect, as noted in the ECON draft report, equivalence can also help to promote regulatory convergence in the interest of the EU and its citizens. It is also important to maintain and develop open capital markets that are able to provide access to global capital pools and funding opportunities while preserving market integrity and fairness of treatment between EU firms and third country entities. We believe that the draft report raises a number of important issues for careful consideration among ECON members and other EU authorities.

The context of the United Kingdom's pending withdrawal from the EU adds particular relevance to this report. As the Brexit negotiations proceed and a trade agreement between the EU and UK is negotiated, it will be necessary to find a sensible approach to third country relationships, to promote regulatory cooperation and convergence. In this respect we note that there are a number of models under discussion. As noted in the draft report, equivalence, or "improved equivalence"<sup>1</sup> is one such model; mutual recognition is another. AFME is not endorsing any particular model and our comments are intended to help improve the ideas under discussion to promote regulatory convergence in the interest of the EU and its citizens.

We are pleased to provide the comments below on specific issues addressed in the draft report.

### Relationships with third countries since the crisis

AFME strongly supports the view put forward in the draft report that the EU should promote global financial regulatory reforms aimed at reducing systemic risk and should work towards an open, integrated and resilient financial system that supports sustainable economic growth, job creation and investment. Increased regulatory and supervisory cooperation at international level is beneficial to financial stability and to the EU's capital markets.

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<sup>1</sup> As referred to by Vice-President Dombrovskis, 24 April 2018, [http://europa.eu/rapid/press-release\\_SPEECH-18-3523\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-18-3523_en.htm)

We also support the recognition in the draft report that cooperation between the EU and third countries has improved global consistency in financial regulation and has made the EU more resilient to global financial shocks.

## **EU equivalence procedures**

### *General views on equivalence*

As highlighted in the draft report and the European Commission’s Staff Working Document “EU equivalence decisions in financial services policy: an assessment” (27 February 2017)<sup>2</sup>, equivalence is an important element of the EU’s international strategy for financial services. Equivalence has benefits in supporting market integrity, financial stability and investor protection in the EU while providing important benefits of maintaining open and globally integrated EU financial markets. As the Commission noted “they are pivotal to promoting regulatory convergence around international standards and they are a major trigger for establishing or upgrading supervisory cooperation with the relevant third country partners”. Another key objective of equivalence is the fair treatment of EU regulated firms and third country entities. Such fair treatment should be a cornerstone of the EU equivalence regimes. These goals are vital for the European Union to continue to develop its capital markets and global influence in financial services legislation.

Sound equivalence regimes should aim to reduce duplication in terms of regulatory and supervisory compliance and facilitate the cross-border conduct of business on the basis of strong regulatory standards. An effective, stable and proportionate approach to equivalence in EU regulations can bring about significant benefits including increased competition, increased capital flow and increased choice for businesses and investors in the EU while preserving market integrity.

In our view the equivalence concept has - so far - provided a reasonable basis to regulate access to EU markets and interactions between the EU and third countries. Nevertheless, we believe that consideration and review of the functioning of the existing equivalence frameworks is an appropriate component of the Better Regulation agenda. The timing of a potential review, as well as the political and regulatory factors that it should take into account, should be carefully considered in consultation with market participants.

We note that, while seeing the experience of equivalence as ‘broadly satisfactory’ to deal with cross-border regulatory issues, the Commission’s Staff Working Document of February 2017 addressed some areas that may require increased attention, though there are likely to be others to consider.

The draft report notes that the granting of equivalence is a unilateral decision taken by the EU and is not applied in a reciprocal manner by third countries. We would like to note other characteristics of the existing equivalence framework that merit consideration in a review, in particular:

- Equivalence has been developed by the legislators with a limited reach and does not cover all services and activities; for example it does not cover deposit-taking or lending. As noted in the Commission Staff Working Document, equivalence is a particularly appropriate tool where key elements of the EU regulatory framework are based on global standards. It is also particularly appropriate for wholesale financial markets which are global in nature.

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<sup>2</sup> Available at: [https://ec.europa.eu/info/sites/info/files/eu-equivalence-decisions-assessment-27022017\\_en.pdf](https://ec.europa.eu/info/sites/info/files/eu-equivalence-decisions-assessment-27022017_en.pdf)

- Existing equivalence decisions are subject to potential unilateral withdrawal at short notice. This approach results in the EU maintaining close control over single market access, however this is counterbalanced by concerns that it does not provide a sufficiently stable basis upon which firms, businesses and investors can rely, which may undermine the benefits discussed above. To address this issue, consideration should be given to transitional arrangements where an equivalence decision may be withdrawn in order to prevent or limit detrimental market and financial stability impact.
- There is uncertainty around the process for triggering equivalence assessments by the Commission and the timing of equivalence determinations. Without undermining the Commission's decision-making capacity, greater transparency and objectivity to the process, would be beneficial in achieving the aims of enhancing regulatory and supervisory cooperation with third countries.
- The process for equivalence decisions varies by file, adding complexity.
- The use of equivalence in EU legislation has varied considerably and has led to questions about consistency and coherence. In this regard we note that:
  - The EU Benchmarks Regulation is an example of a framework where no country outside the EU has put in place a comparable regime, thus making the application and fulfilment of equivalence unworkable;
  - The Securitisation Regulation and STS framework, CMU's initial large initiative, does not include a third country equivalence regime for potential non-EU STS securitisations. AFME was engaged on this topic, arguing that enabling the participation of securitisations from third countries in the EU STS framework would be beneficial to EU investors and the EU securitisation market. We regret that sound proposals from the European Parliament in this area were not supported for reasons that were not clearly justified in AFME's view.
- As discussed further below, it is also important to ensure that equivalence determinations are appropriately monitored.

### *Role of the European Parliament and the ESAs in equivalence decisions*

The draft report puts forward suggestions to the effect of allowing the European Parliament to have a more structured role in the granting or removal of equivalence.

AFME is very supportive of the role played by the European Parliament in financial services legislation and the scrutiny of key decisions and processes. However, we believe that the ultimate decision on third country equivalence status should remain with the Commission, with an improvement in the role of the ESAs in the equivalence process<sup>3</sup>.

We believe that the proposal in the draft report that equivalence decisions should always be scrutinised by the Parliament would add an additional layer of complexity to what is already an onerous and time-consuming process. We strongly agree with the draft report that equivalence decisions should be objective, proportionate, risk-sensitive and be taken in the best interests of the Union and its citizens. For this reason, we are concerned that additional institutional complexity would result in a more politicised and complex process. We believe that the Commission, with robust

<sup>3</sup> We note that the European Parliament Briefing "Third-country equivalence in EU banking legislation", July 2017, states: "While the European Parliament has no formal role in the adoption of equivalence decisions, its observers are invited to the meetings of the so-called Regulatory Committee -composed of representatives of Member States- which examines the Commission draft decision on equivalence." Available at: [http://www.europarl.europa.eu/ReqData/etudes/BRIE/2016/587369/IPOL\\_BRI\(2016\)587369\\_EN.pdf](http://www.europarl.europa.eu/ReqData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf)

technical input from the ESAs, should remain responsible for exercising judgement and ensuring that decisions are objective, proportionate and risk-sensitive.

The role of the ESAs is important and should be strengthened in our view. We support proposals to make the ESAs responsible for the monitoring of the regulatory and supervisory developments in third countries deemed equivalent. This would be best achieved by establishing a strong and continuous engagement with third country regulators. This would ensure that the assessment of the ESAs remains objective and up-to-date in relation to developments in jurisdictions that are deemed equivalent.

As we have argued in the context of the ongoing review of the ESAs, it is important to ensure that the ESAs are equipped with an appropriate level of resources to fulfil an enhanced role in monitoring equivalence.

### *Approach to assessing equivalence*

AFME believes that the approach to assessing equivalence could be improved. Equivalence decisions by the Commission, including the technical advice given by the ESAs in this context, should be proportionate and outcomes-based, favouring regulatory dialogue, international supervisory cooperation and deference. Such decisions should take into account additional factors such as the overall quality of the regulation and supervisory bodies/frameworks (enforcement authority, toolbox, etc.), and the degree of development of local financial markets.

We have the following comments in relation to other proposals on the equivalence process put forward in the draft report.

- The draft report proposes that equivalence decisions be reviewed at least once every three years by the relevant ESA. We recommend that a better approach would be for the ESAs to be responsible (and appropriately resourced) for monitoring the regulatory, supervisory and market developments in equivalent jurisdictions and for there to be regular dialogue with third country authorities to foster continued supervisory convergence. Where necessary, the Commission could launch reviews of the equivalence status. Prior to this, ongoing monitoring by the ESAs of third countries for which equivalence decisions have been taken appears as a much more effective approach to foster regulatory convergence than the proposed periodic review (every three years) by the ESAs of the equivalence decisions.
- We are also unconvinced that there is a case for requesting that the Commission conducts an in-depth review of *all* equivalence decisions taken in order to determine the successes and failures of the current equivalence regime. Some equivalence decisions in the MiFID II/MiFIR context have been taken very recently. A more practical approach would be for the Commission to maintain a regular dialogue with stakeholders and market participants in order to form a view on individual decisions and the functioning of the equivalence regime.

### *High-impact third countries*

AFME agrees with the view in the draft report that close consideration should be given to the equivalence regime across legislation in relation to high-impact third countries for which stable and resilient regulatory relationships are important to financial stability owing notably to the significant

volume of cross-border business. To an extent this is already provided in the proportionality and risk-based approach to equivalence under the existing framework, but it is clear that the nature of interactions between the EU and individual third countries in financial services varies considerably depending on the characteristics of financial markets in a given jurisdiction and the relationship with the EU.

Relationships between the EU and high-impact third countries should be prioritised and carefully scrutinised. Such countries could be identified in view of the size of their capital markets, degree of interconnectivity with EU markets and the characteristics of the bilateral relationship. For example, the existing equivalence framework was not designed with the UK in mind<sup>4</sup>. 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.

### **The EU's role in global standard-setting for financial regulation**

We agree with the view in the draft report that a consistent implementation of international standards is needed in order to achieve better regulatory cooperation with other jurisdictions and to improve global financial stability.

Global frameworks, such as Basel III, encourage a level of consistency across markets, avoid regulatory arbitrage, and reduce the possibility of importing financial stability risk from cross-border provision of services. AFME is convinced that greater emphasis on regulatory cooperation and international standards would also make future equivalence decisions easier to achieve, limiting the need for extraterritorial rules which cause market fragmentation and inefficiencies.

The EU – through the EU institutions and Member States – has played a central role in the regulatory reform programme at global level, which is an important underpinning of an equivalence framework. The EU has also led the way in global standard-setting in specific areas, such as in the early adoption of International Financial Reporting Standards (IFRS). We therefore urge EU authorities and Member States to continue to champion global standards and strong supervisory cooperation frameworks between jurisdictions. As part of this objective, consideration could be given to whether the European Commission or ESMA could seek “ordinary member” status in IOSCO to facilitate EU-level representation in IOSCO's standard-setting work,

The Global Financial Markets Association (GFMA), AFME's global umbrella organisation, recently released a paper entitled “Principles for Achieving Consistent Regulatory Regimes and Supervisory Practices.” The paper provides a set of principles that global financial regulators can support to design regulatory cooperation arrangements to develop consistent regulatory regimes and supervisory practices<sup>5</sup>. AFME encourages the EU and other global policymakers to establish regulatory cooperation arrangements that are: (i) Forward-looking; (ii) Enhance cross-border investment and market integrity; (iii) Supportive of similar outcomes; (iv) Predictable; (v) Transparent; (vi) Evidence-based; (vii) Proportionate; (viii) Enhance market certainty; (ix) Strengthen supervisory coordination; and (x) Supportive of conflict mitigation.

<sup>4</sup> See AFME, “The UK Referendum, Challenges for Europe's Capital Markets”, March 2016, for further analysis of the existing framework. Available at: <https://www.afme.eu/en/reports/publications/UK-Referendum-Challenges-for-Europe-Capital-Markets/>

<sup>5</sup> GFMA encourages global policymakers to establish regulatory cooperation arrangement(s) that (are): (i) Forward-looking; (ii) Enhance cross-border investment and market integrity; (iii) Supportive of similar outcomes; (iv) Predictable; (v) Transparent; (vi) Evidence-based; (vii) Proportionate; (viii) Enhance market certainty; (ix) Strengthen supervisory coordination; and (x) Supportive of conflict mitigation. The paper is available at: <http://www.gfma.org/news/press-releases/2018/gfma-releases-principles-for-achieving-consistent-regulatory-regimes-and-supervisory-practices/>

We support the draft report's proposal for the EU-US Financial Markets Regulatory Dialogue to be upgraded to include more regular meetings. We would welcome steps to expand and deepen the regulatory dialogues with other jurisdictions. We also stress the importance of the European Commission maintaining a regular dialogue with market participants and consulting in advance of key meetings with other jurisdictions.

The European Parliament has an important role to play in the dialogue with third countries. We support the periodic ECON delegation visits to meet counterparts in other jurisdictions and would encourage a more systematic dialogue with market participants around such outreach efforts.

## **Additional considerations**

### *Impact of a review on existing equivalence decisions*

When undertaking a review of the existing equivalence framework and in any forthcoming legislative proposal, it is important to provide clarity to third countries and market participants that existing equivalence decisions will not be adversely affected.

### *Avoiding the creation of unnecessary barriers*

Once equivalence has been granted, it is also important that EU frameworks do not impose overly burdensome regulatory requirements for third country entities which could create unnecessary regulatory barriers for these entities and deter them from providing financial services in the EU. This would be likely to limit investor choice. AFME has provided examples of such impediments in a separate paper, which we will be pleased to share with MEPs.

For example, we note that under the recent proposals on the prudential review of investment firms, new reporting requirements have been proposed to the effect of requiring third country firms to submit on an annual basis to ESMA information about the scale, the scope of services provided in the EU, their turnover, their investor protection policies and their risk management. Where possible ESMA should seek information from NCAs and third country authorities before requesting it from firms. We believe that it is important to avoid duplicative requests and the focus should rather be on improving cooperation arrangements between ESMA, NCAs and third country authorities to support access to relevant information.

### *The Capital Markets Union project*

AFME agrees with the Commission's Communication on completing the CMU by 2019, published on 8 March 2018, when it says:

*"A successful Capital Markets Union also needs to open-up markets to give better access to finance for EU businesses and more and innovative investment opportunities for savers, who today have greater means to understand how their investments are used and a greater appetite for investor choice."*<sup>6</sup>

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<sup>6</sup> European Commission Communication on completing the Capital Markets Union by 2019. Available at: <http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-114-F1-EN-MAIN-PART-1.PDF>

We believe that the approach to relationships between the EU and third countries in financial services should be particularly considered taking into account the objectives of the CMU project. AFME believes that as we enter the next phase of the CMU, EU policymakers should develop policy measures that balance market resiliency, market integrity and appropriate supervision that ensures the level playing field while keeping Europe's capital markets sufficiently open and competitive to grow their capacity. A consideration of the equivalence regime is important to support this objective.

## **AFME Contacts**

### **Oliver Moullin**

Managing Director, Brexit  
General Counsel and Company Secretary

[oliver.moullin@afme.eu](mailto:oliver.moullin@afme.eu)

+44 (0)20 3 828 2712

### **Pablo Portugal**

Director, Advocacy

[pablo.portugal@afme.eu](mailto:pablo.portugal@afme.eu)

+32 (0) 2 788 3974

### **Stevi Iosif**

Associate Director, Advocacy

[stevi.iosif@afme.eu](mailto:stevi.iosif@afme.eu)

+32 (0) 2 788 3976