Position Paper

Prudential Review of Investment Firms – Third country equivalence & MiFIR tick size regime amendments in EP draft report

June 2018

General comments & purpose of this paper

AFME generally welcomes the European Commission's proposal for a new prudential regime for investment firms (IFR proposal) as prudential rules that are tailored to the business models and risks assumed by investment firms should help contribute to the development of the EU's Capital Markets Union.

This paper comprises two parts:

- Part 1 focuses on third country equivalence issues as follows:

  (a) amendments in the European Commission proposal on third country equivalence provisions under MiFIR Articles 46-47;

  (b) amendments in the European Parliament ECON draft report (11 April 2018) on third country equivalence provisions under MiFIR Articles 46-47;

- Part 2 addresses Amendment 27 in the European Parliament ECON draft report (Regulation text) which focuses on MiFIR tick size regime, a separate issue not featured in the Commission's proposals on the review of the prudential framework for investment firms.

AFME has prepared a separate position paper focusing on prudential issues relevant to AFME members in the IFR proposals, notably classification for class 1 firms, the ability for class 2 firms belonging to banking groups to opt in to the CRR2 and links with the CRD5/CRR2 proposals (both in terms of the Pillar 1 section and the IPU in particular).

Part 1: Third country equivalence and proposed amendments to MiFIR provisions

(a) European Commission proposals [COM (2017) 0790] on third country equivalence

AFME notes that within the review of the prudential framework for investment firms the Commission has proposed to amend the Articles in MiFIR dealing with third country rules for investment firms providing wholesale services (Articles 46 and 47). According to the proposals, where the services provided by third country firms are likely to be of systemic importance for the Union a detailed and granular equivalence assessment will have to be undertaken.

AFME acknowledges the importance of a robust and well-functioning approach to third country equivalence in EU legislation. We agree, as highlighted in the Commission's Staff Working Document "EU equivalence decisions in financial services policy: an assessment" (February 2017), that equivalence regimes should aim to balance the need of preserving financial stability and the integrity of markets in the EU on the one hand with the benefits of maintaining open, competitive and globally integrated financial markets on the other. We understand that the targeted changes proposed by the Commission to the existing MiFIR equivalence regime

for third country firms (Articles 46 and 47) are intended to maintain a level playing field between EU firms and third country firms. We share this objective and believe that an effective, stable and proportionate equivalence regime can bring benefits including increased competition, increased capital flow and increased choice for investors in Europe while preserving fairness of treatment between EU firms and third country firms.

AFME notes however that the proposed amendments to MiFIR Article 47 introduce substantive changes to the existing equivalence regime, aspects of which would require clarification. In particular:

I. The proposed changes provide that, where "the services provided, and the activities performed by third country firms in the Union are likely to be of systemic importance for the Union", the Commission will carry out a "detailed and granular" assessment of the equivalence of the third country prudential and business conduct requirements. As described in the aforementioned Commission Staff Working Document, AFME understands that Commission equivalence assessments already involve a high degree of technical analysis, including a primary focus on risks to the EU financial system. We agree that a "detailed and granular" assessment is necessary in relation to activities from third countries that are likely to be of systemic importance. However, the introduction of this new language in Article 47 should not require the Commission to rely on strict line-by-line comparability in its assessments as equivalence frameworks have a track record of being effective with the use of outcomes-based approaches to assessing comparability amongst jurisdictions. We would therefore welcome confirmation that, while in some cases the Commission may assess a third country's regime in a more detailed and granular manner as would be required under this provision, the Commission will continue to adopt equivalence decisions informed by the proportionate and risk-sensitive approach it has followed to date which focus on the regulatory objectives pursued and the outcomes delivered by the third country framework in question to ensure that the financial stability, market integrity and investor protection in the EU are not put at risk.

II. AFME believes that it should be clarified – as in the case of the enhanced equivalence regime proposed for the recognition of third country CCPs under EMIR – that the "systemically important" assessment under this provision will be of the relevant activities and services of individual firms that would benefit from the equivalence decision and not a general consideration of whether or not a third country is systemically important to the EU. Moreover, guidance should be provided on the criteria to be utilised to determine that the activities and services of individual firms which would benefit from the equivalence decision are likely to be of "systemic importance" for the EU.

III. It should be clarified that the assessment of the "supervisory convergence" between the third country in question and the EU concerns the comparability of the supervisory arrangements in place in that third country to ensure that its prudential and business conduct requirements that are deemed equivalent by the Commission are effectively applied and the possibility to establish if necessary enhanced cooperation arrangements between the relevant third country and EU authorities.

IV. Without undermining the Commission's decision-making capacity in equivalence assessments, greater transparency and predictability to the equivalence process, would be beneficial in achieving the aims of enhancing regulatory and supervisory cooperation with third countries. This will ensure stability and legal certainty for end investors and for financial services provision within the EU. In the same vein, appropriate transition arrangements should be provided for the withdrawal of Commission equivalence decisions and related ESMA registration decisions in order to prevent and/or limit detrimental market impacts.

V. Finally, AFME believes that in introducing any changes to MiFIR Article 47, the European Parliament and Council should weigh in potential implications and knock on effects in regulatory relationships with third countries.

With regards to the proposed reporting requirements proposed under MIFIR Article 46 (6a), we believe that these should be proportionate and make the following comments:

I. AFME agrees that is it important for ESMA to have access to up-to-date information to monitor on a regular basis the relevance of the equivalence granted. We believe that, where possible, ESMA should seek information from NCAs and third country authorities before requesting it from firms. It is important to avoid duplicative requests and the focus should be on improving cooperation arrangements between ESMA, NCAs and third country authorities to support access to relevant information. We recommend EU authorities to consider whether the mechanism currently in place under MiFIR Article 47 (2), where ESMA is required to establish cooperation arrangements with the relevant third country competent authority and the mechanism for the exchange of information, should be utilised to enable EU authorities to obtain the information they require.

II. The suggested amendments to MiFIR Article 46 (6a)(c) imply that for third country firms to be on ESMA's register they must provide each year to ESMA a detailed description of the investor protection arrangements they have in place with EU clients. AFME notes that an investor protection assessment is made in the course of the equivalence assessment of third country regimes. AFME would therefore suggest that third country firms should be required at the time of their application for registration to provide ESMA with a detailed description of the arrangements and procedures they have in place to comply with MIFIR Article 46 (6), which requires third country firms before providing any service to EU clients to offer to submit any disputes relating to those services to the jurisdiction of a court or arbitral in a Member State.

Further, AFME notes that the proposal is scheduled to apply 18 months after the publication of the legislation in the EU Official Journal. AFME would request clarification that this timetable, if adopted as in the proposed amendments, will not have the effect of delaying equivalence decisions under the current MIFIR framework in the interim.

(b) European Parliament draft report [PE619.410] - proposals on third country equivalence

In the European Parliament's draft report [PE619.410], the rapporteur is proposing significant amendments to the European Commission's proposal regarding the MIFIR third country equivalence regime, including:

i. *Amendment 28* - a third-country firm from a jurisdiction that has been granted an equivalence decision would not be able to deal on its own account or underwrite financial instruments and/or place financial instruments on a firm commitment basis without establishing a branch in the EU.

ii. *Amendment 29* - the Commission would be required to adopt equivalence decisions in accordance with Article 50 of MiFIR, such that an equivalence decision adopted by the Commission would enter into force only if the European Parliament or Council does not object.

AFME's comments on these proposed amendments are as follows:

Amendment 28

Most, if not all, investment firms offer a range of investment services and activities as set out in Section A of Annex I to Directive 2015/65/EU (MiFID 2). Currently, third-country firms from jurisdictions that have a regulatory and supervisory framework that would be deemed equivalent by the Commission are allowed to provide and/or perform all the services set out in Section A of Annex I of MiFID 2 to clients established throughout the EU without having to establish a branch in the EU.

It is legitimate for EU authorities to ensure that, after equivalence is granted, firms active in EU markets continue to meet robust regulatory and investor protection standards. However, AFME believes that Amendment 28 is unnecessary. The provision requiring "a detailed and granular" equivalence assessment for third country firms that are likely to be of systemic importance for the EU, if introduced as foreseen in the Commission's proposals, would provide additional mechanisms, on top of existing requirements, to ensure that third country firms do not benefit from a more favourable treatment than EU firms in terms of regulatory and supervisory requirements in providing services to EU professional clients, as seems to be the concern behind Amendment 28.

We do not understand the reasons why allowing third country firms to benefit from equivalence decisions based on the robust framework that is currently foreseen in respect of "dealing on own account in financial instruments" or "underwriting financial instruments or placing financial instruments on a firm commitment basis" would potentially put such firms in a more favourable position than EU firms to provide such services to EU professional clients and eligible counterparties.

In AFME's view, preventing third country firms which, by being registered under MIFIR Article 46 in the register of third country firms kept by ESMA, are considered to comply with the legally binding prudential and business conduct requirements determined as equivalent under MIFIR Article 47, from providing the two aforementioned services will place those third country firms at a disadvantage in comparison to EU firms for the provision of investment services in the EU, rather than ensuring a level playing field. We believe that this would make EU markets less competitive and attractive.

Further, an equivalence decision that prevents third-country firms from dealing on own account or underwriting financial instruments and/or placing financial instruments on a firm commitment basis would result in increased costs in terms of third country firms having to reorganise their delivery of the aforementioned services. For example, branches in the EU would need to be staffed with the necessary experts and the infrastructure (both physical and technological) would need to be put in place to execute the aforementioned services.

Amendment 29

This amendment proposes to amend Article 47 of MiFIR to require the Commission to adopt a decision in relation to third-country equivalence by the process set out in MiFIR Article 50, which allows an equivalence decision adopted by the Commission to enter into force only if the Parliament or Council does not object.

We believe that the decision on third country equivalence status should remain with the Commission, with an improvement in the role of the ESAs in the equivalence process. Changing the framework for assessing third-country equivalence to give the European Parliament or Council a veto right would introduce increased uncertainty and institutional complexity. Our view is that the Commission, with robust technical input from the ESAs, should remain responsible for exercising judgement and ensuring that decisions are objective and risk-sensitive in the best interests of the EU and its citizens.

Part 2: European Parliament draft report [PE619.410] - proposals for application of a revised tick size regime for systematic internalisers

Article 14, MiFIR, stipulates that quotes by systematic internalisers should be made public below Standard Market Size (SMS) which taken together with ESMA's recently proposed amendment to Article 10, RTS 1 (fully consulted and awaiting endorsement from the Commission), would align these below SMS quotes with the tick size regime. AFME notes that Amendment 27 in the IFR ECON draft report (Regulation text) now proposes that the MiFIR tick size regime should be extended for systematic internalisers across all quote sizes, without consultation to evaluate its impact.

AFME, after consulting with the German Investment Funds Association (BVI) and the UK Investment Association (IA), believes this proposal should follow the established legislative steps and be subject to the full process of impact assessment and consultation with market participants with a view to considering the impact on the functioning of the relevant markets. The Tick Size Regime has been under consideration separately, outside the context of the IFR proposals, through ESMA's consultation on proposed amendments to RTS 1. ESMA has now submitted an amended RTS 1 dealing with matters in this area to the European Commission for endorsement. Following an endorsement from the Commission, the European Parliament and Council would have the opportunity to scrutinise the amended RTS during the applicable scrutiny period.

The buy side associations, the Investment Association and the BVI, responded to ESMA's proposed amendment that any extension of the regime, without full consultation to understand its consequences, could risk detrimental effects. AFME endorsed the BVI and IA position.

We therefore propose that amendment 27 is NOT supported.

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