Comunication by the European Commission on equivalence in the field of financial services. October 2019.

On 29 July, the European Commission (EC) published a Communication on the application of the equivalence regime in the field of financial services.

This process is characterised fundamentally because during this the institution assesses whether the regulatory, supervisory and compliance (enforcement) framework of a third country pursues the same results as those of the European Union (EU). If this is the case, it allows market participants from that third country to operate in European territory subject to a single framework.

In this way, the EU fulfils its commitment to maintain an open and integrated financial market, but without this entailing a decrease in financial stability and investor protection. In addition, through this regime it manages to encourage the promotion of convergence through the application and integration of international standards as well as improve cooperation with regard to the supervision with third countries through the signing of cooperation agreements that help manage cross-border risks.

The Communication places particular emphasis on the fact that on the one hand EC equivalence decisions have to take into account the scope of cross-border activities to the extent that they can affect financial stability, market integrity and investor protection as well as the fair conditions of competition in the internal market and, on the other, the exposures of our financial markets to third country risks.

This document also highlights the monitoring mechanisms that, once the equivalence decisions have been adopted, will correspond to the EC and the European Supervisory Authorities (ESAs) and whose main task will be to monitor the evolution of the regulatory and supervision framework of said third country, as well as that of its market, with the purpose of assessing whether changes have taken place that could have an impact on the activity of the participants from that third country in the EU financial markets.

In fact, both improvements have been introduced in the EU's equivalence regime following a series of regulatory changes that affect ESAs, European market infrastructures and the prudential treatment of investment services companies.

Evaluation and adoption of equivalence decisions

The equivalence regime implies that in order for an entity from a third country to start operating in the EU, the EC must have adopted an equivalence decision beforehand. In reality, these are unilateral and discretionary acts through which this institution, with the assistance of the ESAs, evaluates and decides whether the regulatory, supervisory and compliance regime is equivalent to that established in the Union in a specific area of the financial services of a third country. The objective pursued is not for these evaluations to guarantee that the frameworks of third countries are identical to those of the EU, but that they can achieve the same results.

The regional or regulatory dialogues that the EU maintains with third countries constitute an important source of information for refining the technical assessments prior to the declaration of equivalence as well as for carrying out its subsequent monitoring.

Additionally, the document indicates risk exposure that the third country can generate for the EU financial markets as another of the main aspects being evaluated, which depends, among other elements, on the degree of interconnectedness between the evaluated market and the EU financial markets as well as the need to manage the risks related to the cross-border activity subject to equivalence.

This risk-based approach results in the EC assessing whether third countries with "high impact" represent higher risks for the EU, since if so, this institution will only adopt equivalence decisions based on criteria that entail greater guarantees.

The EC not only evaluates the fulfilment of the requirements contained in EU law through this exercise but also its strategic priorities in areas such as international sanctions, the fight against money laundering and the financing of terrorism or good tax governance globally, just as the principle of reciprocity applies.

Finally, it should be taken into account that, in the case of unilateral and discretionary acts, equivalence decisions may be modified or revoked by the EC at any time, and may even be subject to suspensive conditions pending the third country meeting certain requirements.

Recent improvements in the conception of EU equivalence regimes

As the working document on the EU equivalence regime published by the EC in February 2017 shows, one of the main criticisms of this regime is the lack of a uniform procedure . Each of the legislative acts that regulates it introduces some variation. However, the document declares that the EC has met with the EP to address this issue and they have concluded that the treatment must be heterogeneous provided that common principles such as the proportionality of evaluations are respected, a sensitive approach to the risks in determining equivalent results and greater transparency in relation to the third country concerned and the general public.

Regarding the criticism with regards to the lack of transparency throughout the equivalence process, the EC says it has complied with this requirement by publishing both the aforementioned 2017 working document and the equivalence decisions adopted. Additionally, it has decided to put the draft equivalence decisions up for public consultation, allowing comments to be submitted for a period of 30 days.

Another aspect that was highlighted in the 2017 working document was the suitability of implementing monitoring mechanisms that would guarantee the continued compliance by third countries of the conditions contained in the equivalence decisions. The co-legislators have taken advantage of the revision of the regulations concerning the creation of ESAs to introduce improvements in this regard. Once the aforementioned reform enters into force, these authorities will have the power to closely monitor the decisions adopted by the EC with the purpose of determining whether the developments of the regulatory and supervisory regime of the third country in question, as well as the evolution of their market, signify an alteration of the initial conditions that justified the granting of equivalence. In addition, they must submit an annual report to the EP, Council and EC, as well as the other two ESAs, which contains a summary of the main findings.

On the other hand, the revision of the European Market Infrastructure Regulation, EMIR 2.2, introduces a more risk-sensitive approach as well as a better application of the proportionality principle depending on the importance of the first. Therefore, the central counterparties that imply systemic risk for European markets and may therefore affect the financial stability of the Union, may be subject to certain EU rules or even propose their establishment in this territory.

In addition, the new regulations that will regulate the prudential treatment of investment services companies

also introduce developments that affect the regime of third countries. Once this reform enters into force, foreign entities will be subject to a new obligation consisting of the presentation of an annual report with different data related to their activity, such as the scale and scope of services, turnover, the value of the assets, a description of consumer protection agreements or their risk management policy. A granular analysis of the regulations applicable to those entities whose activity in the EU could be considered systemic is also proposed.

Finally, in terms of the benchmark indices, as of 2022 the European Securities and Markets Authority (ESMA) will have the power to recognise the administrators of benchmark indices of third countries.

Monitoring of equivalence decisions

As mentioned, one of the most relevant aspects of this Communication is that the EC emphasises the importance of adequately monitoring equivalence as a useful means of ensuring the stability of the agreements adopted.

Although this is a task shared between the EC and the ESAs, the document indicates the main role that the latter will begin to play as a result of their position. Specifically, the work that these authorities will carry out in this regard will be to monitor the evolution of the regulations of third countries and their supervisory history while promoting cooperation between EU supervisors and those of the third countries.

For its part, the EC will be responsible for checking whether equivalence decisions 1) continue to meet the EU objectives under which they were adopted, 2) could pose new risks to financial stability, market integrity or protection of investors and if the activities of the companies or services to which the decision concerns respect the integrity of the EU internal market and preserve the fair conditions of competition in this territory and 3) the third country is not included in the list of non-cooperative countries and territories for tax purposes or in third-country high-risk countries that present strategic deficiencies in their systems to combat money laundering and terrorist financing.

In reality, the EU seeks to understand the evolution of the markets and regulations of third countries through this monitoring work, as well as their supervisory practices, evaluating the way in which the financial institutions in those countries which provide services in the EU make use of equivalence decisions.

Finally, the priorities that the EC has set for this monitoring work for 2019-2020 are the following: 1) review of equivalence decisions based on changes introduced in the EU legislative framework; 2) review of equivalence decisions affecting high-impact areas or third countries; 3) review of equivalence decisions with an imminent end date and 5) monitoring of market developments, both to identify changes in market segments and evolutions in the use of equivalence decisions by participants from third countries in EU financial markets.

Review of equivalence decisions

By reviewing equivalence decisions, the EC examines whether all the equivalence criteria and specific conditions contained in a decision continue to be respected. Generally, it involves a thorough dialogue with the authorities of the third countries in order to better understand if their regime continues to pursue results similar to those of the EU regime. This exercise can be carried out ad hoc or periodically and may even result in the EC unilaterally revoking equivalence.

Finally, the EC had adopted 280 equivalence decisions in relation to 30 countries at the time of publication of this communication.

Links of interest:

Communication by the Commission to the European Parliament, the Council, the European Central Bank, the

European Economic and Social Committee and the European Committee of the Regions: Equivalence in the field of financial services

COMMISSION STAFF WORKING DOCUMENT. EU equivalence decisions in financial services policy: an assessment.