# Guiding principles for EU Equivalence

## 1. Introduction

FESE welcomes the ongoing reflection by EU policy makers on how the EU equivalence regimes and processes can be strengthened. Appropriate regulation and supervision of financial activities in a cross-border context has been a key regulatory objective against the background of the financial crisis, where a number of jurisdictions were adversely affected by developments outside their jurisdiction. Now, with the full set of post-crisis financial markets regulatory reforms kicking-in, and regulation becoming ever more complex, it is important to highlight that the current EU equivalence processes and determinations need to be reformed to address identified shortcomings, such as transparency and predictability.

While there is a need to recognise that capital flows are global and that the EU financial markets should fit into a globally competitive model, any equivalence regime also needs to preserve stability and a level playing field between the EU and third countries. This overarching goal should not only be interpreted in terms of market access – but also in relation to the broader political objectives enshrined in EU legislation, such as investor protection, financial stability and the overall integrity and efficiency of markets.

Therefore, this paper outlines a set of key guiding principles that may be considered for the planned reforms of the EU's equivalence regimes in different pieces of legislation. These principles will aim to take a holistic and balanced approach, considering the interests of the EU, as well as third country jurisdictions, with the central goal of preserving market stability while also preserving open, competitive and global markets.

This paper covers both general principles applicable to all equivalence situations as well as more specific ones relevant to trading venues and trading obligations.

## 2. Establishing Guiding Principles for the Reform of Equivalence

Regardless of the variety of use cases of equivalence decisions across different EU financial markets regulatory dossiers, we see merit in defining key guiding principles and applying them in a consistent, transparent and harmonised way.

If thoroughly implemented, these principles may guide the overall process around equivalence decisions and serve as a compass for the consistent application of the framework across different legislative files.

**Key principles for equivalence decisions:**

**A. <u>General principles</u>**

1. Equivalence decisions should not undermine the integrity of the Single Market nor financial stability in the EU. They should deliver a continuous level playing field and avoid a "race to the bottom" between the EU and third country jurisdictions.

2. Transparency of the decision-making process should be strengthened by ensuring the co-legislators' (European Parliament and Council) involvement in accordance with the procedure for delegated acts. Importantly, this would ensure that EU legislators gain clearly defined competencies, enabling them to maintain and promote their political and regulatory objectives and exert democratic control over the process. Industry should also be fully involved in the process as should the parties seeking equivalence, where relevant.

3. More granularity in the initial equivalence determinations undertaken by the European Commission should be introduced, especially as regards systemically important jurisdictions and financial services.

4. On-going monitoring by NCAs and ESAs to ensure maintenance of equivalence, in terms of the rules and also with respect to their enforcement and application, should be established. NCAs and ESAs should have clear responsibilities and resources to monitor how equivalence regimes may evolve in order to ensure that the overarching goals required in the relevant law are maintained alongside ensuring that fair competition, financial stability, market integrity and investor protection rules are being complied with.

5. Different approaches to equivalence may be warranted depending on the location of the third country, the characteristics of the trading relationship, the interconnectedness and integration of the markets between the EU and the third country, the systemic risks posed between the EU and the third country, as well as the type of financial services or activity, the type of product and the asset class, in question.

   In all cases, a major priority should be accorded to ensuring a level playing field with a focus on eliminating the potential for regulatory arbitrage arising from significant divergences in regulatory and supervisory approaches. Notwithstanding this, equivalence frameworks should also support and promote policymakers' commitment to thriving EU financial markets and should not act to be so restrictive that they undermine their attractiveness and competitiveness in a global context.

6. Regarding equities, as they are intrinsically linked to EU companies' funding and financing, equivalence provisions should require, on an initial and ongoing basis, tight regulatory and supervisory alignment of third country rules with the EU framework, in respect of jurisdictions which are of systemic importance to the EU and/or which have high levels of existing cross-border market integration, in order to safeguard financial stability, market integrity, investor protection and fair competition.

7. As regards to derivatives, they are predominantly global products, so equivalence should be viewed in the context of ensuring the effectiveness of the derivatives market in a global setting. The regulation of derivatives and the thresholds for assessing the equivalence thereof, should remain aligned with global standards. International coherence is key to avoiding regulatory arbitrage and encouraging global capital flows which support economic growth in Europe.



FESE Avenue de Cortenbergh, 116 B, 1000 Brussels — info@fese.eu — +32 2 551 01 80

FESE considers it crucial to establish an equivalence framework for derivatives which supports and promotes policymakers' commitment to thriving EU financial markets and to preserve their attractiveness and competitiveness in a global context.

It is essential for the European financial services industry that market access arrangements with third countries provide for stability and predictable outcomes, including the potential withdrawal of equivalence determinations. Market participants use derivatives to hedge their risk where the exposure has the potential to extend out from months to decades.

## B. A proposal for a practical mechanism to support the equivalence process

8. Without prejudice to Principle 5 and the broader objective of ensuring the integrity of the EU Single Market, equivalence rules should not unduly restrict market innovation and the ability to provide EU investors with access to global capital markets.

9. The EU concept of equivalence is based on an outcome-based approach to the assessment of third country regulatory regimes. The equivalence framework recognises the possible diverse approaches to the implementation of international standards, whilst simultaneously ensuring that when market access arrangements are established, third country jurisdictions are appropriately regulated and have sufficient levels of supervision.

10. Different options to organise market access can be envisaged, ranging from a standard third country regime to an ad-hoc temporary arrangement. However, for all options, we believe that a specific mechanism should be established with the aim of ensuring a level playing field for financial services providers based in the EU and the third country under consideration.

11. Criteria should be determined to govern *ex-ante* under which conditions this mechanism would be used and the process by which the decision to enable the mechanism would be taken.

12. Under our proposals, this mechanism would, on a constant basis, monitor the alignment of regulation applying to the financial services sector of the EU, on the one hand, and the third country, on the other hand.

13. In addition, given that industry´s level playing field and users´ protection can be undermined by differentiated application of otherwise identical rules, it would be crucial that the mechanism also monitors, on a constant basis, the implementation of regulation and practices.

14. Compared to current and standard arrangements for third country recognition and access to the EU financial market, this mechanism would need to go beyond a mere initial assessment of alignment of legislation and supervision. It would in fact establish an on-going dialogue between the ESAs, EU national regulators, third country financial regulators as well as EU and third country industry participants to focus on identifying cases of divergent regulatory and supervisory outcomes affecting the industry participants´ level playing field or users´ protection.



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15. Should such a case of divergence in legislative, regulatory and supervisory outcomes be identified, a process with the relevant supervisory authorities should be triggered to restore the level playing field or the necessary safeguards. In the absence of adequate remedy, market access could ultimately be restricted or suspended.

16. Importantly, this mechanism should act swiftly and an efficient and time limited process for the identification, acknowledgement and resolution of cases would need to be designed.

17. The mechanism should periodically inform the Council and the European Parliament of its activities.

18. Unless a mechanism with the above features is put in place as a matter of priority, the EU financial industry providers and users may be faced with adverse consequences after Brexit, especially in case the EU and the UK do not conclude a withdrawal agreement.

## C. Brexit context

19. Any interim equivalence arrangements required in the event of a no-deal Brexit should only address critical areas and be limited in scope, both from a content and time perspective. These should be introduced with a view to being replaced by a balanced and holistic approach to equivalence that reflects the terms agreed between the UK and EU as set out in the Political Declaration.

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Avenue de Cortenbergh, 116 B, 1000 Brussels — info@fese.eu — +32 2 551 01 80