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A REALITY CHECK ON EQUIVALENCE

Analysis of the EU equivalence regime, how it works, and what it means for UK financial services in the context of Brexit

by Panagiotis Asimakopoulos and William Wright

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> Equivalence is a complex patchwork of nearly 40 different regulatory regimes in EU financial services. It doesn't cover large parts of European banking and finance, is a poor substitute for passporting and it doesn't eliminate the potential disruption from Brexit. But it may provide a temporary and politically acceptable bridge in key sectors for both the EU and UK to adjust to life after Brexit.

An introduction to equivalence

It's not often that an arcane corner of European financial regulation finds its way onto the front pages but over the past few months it has been hard to escape from 'equivalence', the regulatory framework that is likely to form the basis of the UK's access to the EU in financial services on the other side of Brexit from January 2021.

This debate has generated as much noise as it has light: this short paper aims to provide a reality check on how equivalence works, the benefits it provides, the trade-offs involved, its limitations, what it is not and what it doesn't achieve.

It's a technical subject and the jargon can be confusing. This week the UK called for 'comprehensive' and 'permanent equivalence', which is very different to the 'selective' and 'time-limited' equivalence that many people in the industry think might be on offer. Other variants over the past few years have included enhanced equivalence, super equivalence, reformed equivalence and improved equivalence. Some people seem to think that equivalence is a magic wand that will make Brexit go away, while others argue that equivalence is a political tool being used by the EU to impose its rules on the UK or to attract as much business from London as possible. This paper includes four sections:

- Part 1: a short 10-point summary of equivalence
- Part 2: a summary of the likely landing zone for the UK
- Part 3: a more detailed analysis of different aspects of equivalence
- Part 4: a detailed appendix summarising all 39 equivalence regimes

What is equivalence?
Equivalence is a complex series of nearly 40 regulatory agreements that allows financial services firms based in a country outside of the EU (known as a 'third country') to be treated in a similar but not identical way to firms in the EU or reduces the regulatory burden for EU firms operating outside the EU. It is granted by the EU to countries in very specific areas of activity when a) the EU believes that a particular country's supervisory and regulatory framework is sufficiently close to the EU rulebook that it has an 'equivalent effect' and b) crucially, when the EU thinks that providing some degree of regulatory access to non-EU firms will be of mutual benefit to firms and investors in the EU.

The main upside of equivalence in the context of Brexit is that it would reduce but not eliminate the disruption to the financial services industry and its customers from Brexit. The main downsides are that it is a poor substitute for passporting; it would limit the UK's room for manoeuvre in diverging from EU rules in future; it can be unilaterally withdrawn at short notice, and it is a politically charged and unpredictable process.

Other countries operate equivalence regimes, and from January 2021 the UK will also be able to offer equivalence to firms in the EU and other countries. This paper focuses on the EU's equivalence framework in the context of Brexit.

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For more information on New Financial, contact us on:

www.newfinancial.org

william.wright@newfinancial.org
+44 (0) 20 3743 8269

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Part 1 - Equivalence: a summary

As the UK and EU start 11 months of negotiations over the future of their trade relationship in financial services, this paper analyses the equivalence framework that is likely to form the basis for future cooperation on the other side of Brexit. Here is a summary of what equivalence is, how it works, its limitations and - crucially - what it is not:

1. **There is no such thing as 'equivalence':** equivalence is not a single regime that covers the supervisory and regulatory framework of a whole country, a whole industry, a specific activity or even a specific piece of legislation. It is a complex patchwork of micro-regulation: we counted 39 third country equivalence regimes across 16 of the 37 main pieces of EU banking and finance legislation.
2. **Equivalence is not a substitute for passporting:** equivalence is a far less comprehensive framework for accessing the EU than the single market. Less than a third (12) of equivalence regimes provide similar levels of access to the EU as passporting, it doesn't exist in more than half of EU regulations - including investment services to retail clients, some core banking activities, large parts of pensions and insurance, or payments - and hasn't been granted to any countries in a third of the areas where it does exist.
3. **Equivalence is not a long-term solution:** the big risk with equivalence is that it can be withdrawn at as little as 30 days' notice (without consultation). The process for reviewing and withdrawing equivalence is opaque and unpredictable, which makes it an unstable long-term framework for EU-UK cooperation.
4. **Equivalence is not a technical exercise:** equivalence is officially a technical process with determinations made by the European Commission, but it has become politicised - just ask Switzerland, whose stock exchange equivalence was revoked after wider treaty negotiations with the EU reached a stalemate last year. Given its proximity and importance to the EU, the UK is likely to find that it faces a higher bar. The EU will also be wary of setting a precedent with the UK ahead of future negotiations with the US.
5. **Equivalence is not the same as being a 'rule-taker':** equivalence would not make the UK a 'rule-taker' in those sectors. The US has equivalence in 23 areas but few would consider it to be a rule-taker. And it doesn't mean 'the same rules': officially it is about having equivalent outcomes. Having the same rules on 1st January 2021 as it had on 31st December 2020 would reflect the UK's current level of alignment.
6. **Equivalence is not a one-way street:** terms and conditions apply. In each area or sector where the UK is granted equivalence, its room for manoeuvre would be limited if it chose to change its regulations in future or if the EU made significant changes to its own rules. This applies in both directions: from January 2021 the UK will also be able to grant equivalence to other countries to access UK markets.
7. **Equivalence does not eliminate disruption from Brexit:** equivalence would reduce but not eliminate the potential disruption to the City of London and its customers. Even if the UK had equivalence in all 39 areas many UK financial services firms would still need to have a presence in the EU to service clients and do business in the region - not least because it doesn't cover large areas of business - but it should give firms more discretion over how much they move.
8. **Equivalence is not a given:** technically speaking the UK will be 100% equivalent on 1st January having transposed EU law into UK law so it should be relatively straightforward to complete the equivalence assessments by the end of June. But equivalence is gifted unilaterally by the EU and the process for determining equivalence is opaque, lengthy and unpredictable. Most people in the industry think the prospect of achieving anything other than equivalence in a few key sectors is quite remote.
9. **Equivalence is another word for trust:** when the EU grants equivalence to a third country in a particular area it is essentially giving up a degree of control and relying on the supervisory and regulatory authorities of that country. That will require significant trust on both sides - and this trust has been undermined over the past few years by the tone of the political debate.
10. **Equivalence is a work in progress:** equivalence has evolved over the past 20 years and will continue to do so, but changes to EU legislation take time. While both sides recognise the need to improve the system, Brexit has probably reduced the likelihood of any substantial changes in the near future but the EU may agree to revisit the equivalence framework on the other side of Brexit. Talk of super, enhanced, reformed, improved, comprehensive or permanent equivalence is probably wishful thinking for now.

Part 2 – A possible landing zone?

As you might expect in any negotiation there is a wide gulf between the opening positions of the UK government and EU authorities. The UK has called for a 'comprehensive' and 'permanent' equivalence regime, which was almost immediately rebuffed with the EU saying it will not negotiate 'general', 'open-ended' or 'ongoing' equivalence and that the UK should 'not kid themselves'. With the caveat that a lot could change in the coming year, here's what we think a realistic outcome might be:

1. **Timeframe:** the clock is already ticking. The UK and EU plan to complete their equivalence assessments by the end of June this year, which will define whether they consider each other's supervisory framework to be equivalent and in which areas. That is also the deadline for the UK government to ask for an extension to the transition period (which it has said it will not do). This means that any equivalence arrangements will need to be in place by the end of December. The EU may not make any determinations until later in the year - even if it agrees the UK is equivalent, it may decide not to grant equivalence in a particular area - which may mean there is not enough time for some firms to prepare.

2. **What does the UK want?:** the UK is seeking 'day one equivalence' pretty much across the board (the 'comprehensive' part) on the basis that having transposed EU law into UK it will be 100% equivalent on the day after it exits the transition period. Despite public statements that the UK will not be a rule-taker in financial services, day one equivalence would reflect the existing level of alignment between the UK and EU. The UK also wants the EU to reform the equivalence process (the 'permanent' part) and make it more transparent and predictable - perhaps something that could be included in a short chapter on financial services in any trade deal - so that there would be more clarity on how equivalence is granted and how much the UK could diverge before equivalence is at risk of being withdrawn.

3. **The EU response:** the EU is reluctant to offer any equivalence to the UK beyond what it already grants to other countries. Even in areas where the UK will be technically equivalent, the EU may push back for political reasons: it may want to trade access for the UK in financial services with more access for the EU in other sectors, such as fishing. The EU is wary of offering equivalence to a large market on its doorstep that has made clear its desire to diverge, and the EU doesn't want to set a precedent given its current stalemate with Switzerland or ahead of future negotiations with the US.

   Both sides want to establish a formal mechanism for supervisory and regulatory dialogue and cooperation. The EU doesn't want to redesign the equivalence framework for the benefit of the UK but equally will be keen to avoid any collateral damage to its own financial system (particularly French and German banks' access to euro clearing in London) by withholding equivalence in key areas.

4. **A potential solution:** we think there are three potential 'landing zones' for equivalence in the coming year. First, though unlikely, is that the EU and UK agree a comprehensive equivalence deal on an open-ended basis and agree to reform the whole process of equivalence. Second, and most likely, is that the EU and UK agree 'selective equivalence' in a few key sectors probably on a 'time-limited basis' to be reviewed in one or two years. The most critical sectors for both sides are probably equivalence for stock exchanges and CCPs, though it may extend to other technical areas such as capital requirements, which make up nearly half of the 23 equivalence regimes granted to the US. This may come with a commitment to review and reform the equivalence framework in a few years' time. The third and least attractive option is that politics poison the negotiations and the UK doesn't get any equivalence.

   The big variable is broker-dealer equivalence for big investment banks, which has not been granted to any country yet: would the UK consider it a step too far in terms of future alignment with the EU and would the EU be prepared to offer it to such a large part of financial activity?

5. **A longer-term plan:** while both sides will be focused on the short-term deadlines at the end of June and December, they will both be playing a longer-term game. Once the framework for the immediate future is nailed down, the UK and EU may agree to work together and resurrect work on reviewing and improving the equivalence regime to make it more predictable and stable ahead of future trade negotiations with the US and other countries. The EU will be keen for the UK not to drift off into the Atlantic and both sides will be been keen to retain some access to important markets on their doorstep even as they diverge over time in key areas of regulation and supervision.

Part 3 - A closer look at equivalence

This section analyses the different aspects of equivalence in more detail and includes charts and tables to highlight its complexity, benefits and limitations.

1) There is no such thing as equivalence

There is no such thing as equivalence per se: it is not a supervisory and regulatory regime that is applied to a particular country, sector of the financial services industry, specific activity or specific piece of EU legislation. Instead it is a complex patchwork of 39 different equivalence regimes across 16 pieces of EU banking and finance legislation. Of the 37 EU directives and regulations that cover banking and finance, the concept of equivalence does not exist in 21 of them, and different pieces of legislation have different types of equivalence. For example, there are nine different types of equivalence under the EU rules on capital requirements, six types under Mifid, and five under Emir. In each case, equivalence covers a specific part of the legislation, not the entire thing.

Equivalence does not apply to a country's entire financial services activity and there is no such thing as the 'comprehensive equivalence' that the UK chancellor Sajid Javid outlined this week. The European Commission has granted a total of 296 equivalence determinations to 37 countries, but no single country is deemed 'equivalent'. The US has the most with equivalence in 23 areas, followed by Japan on 22, Canada on 20, Australia (19) and Singapore (17). To make matters more complicated, a third of the equivalence regimes that exist are not in use by any countries. And there is no such thing as one equivalence regime for asset managers, one for investment banks or one for stock exchanges. For example, there are five main pieces of EU legislation relevant to market infrastructure - covering trading venues, stock exchanges, CCPs and trade repositories – and they include 10 different equivalence regimes between them.

Not all equivalent regimes are equal: some regimes offer market access (allowing a firm to access the EU market remotely as with passporting) but most do not. Equivalence may be applied to the supervisory framework within an entire sector of activity, or only to part of that market's regulatory authorities. For example, equivalence for the US central counterparty clearing (CCP) regime under Emir is limited to derivatives and commodities clearing overseen by the Commodity Futures Trading Commission and does not cover stock or fixed income clearing that is overseen by the Securities and Exchange Commission.

Fig.1 A summary of equivalence regimes
Pieces of EU legislation that include a third country regime

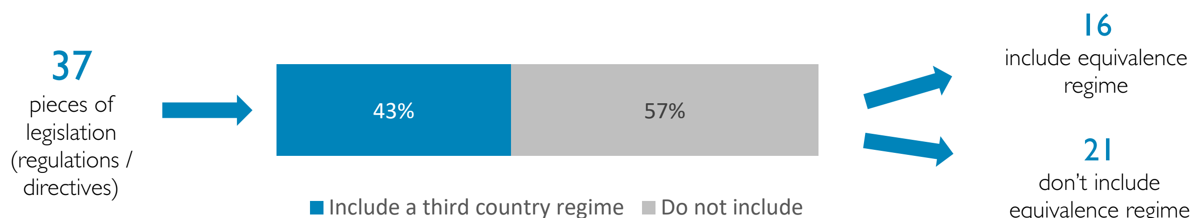
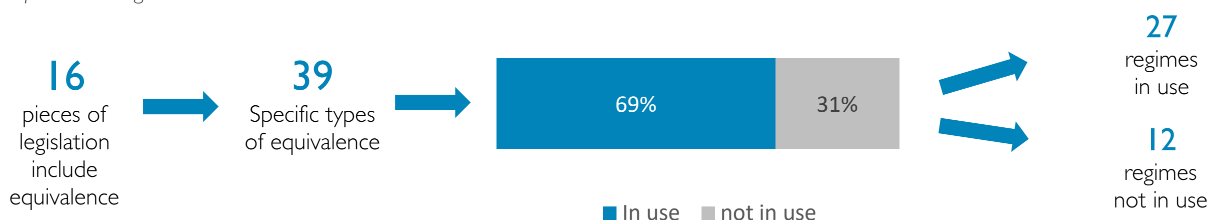


Fig.2 Active equivalence regimes
% of equivalence regimes in use or not



Source: European Commission, European Parliament, New Financial

2) Equivalence is not a substitute for passporting

Equivalence is not a substitute for passporting for at least four reasons: it doesn't cover large parts of banking and finance activity; most equivalence regimes don't offer market access; in a third of areas where it does exist it hasn't been granted to any country; and it doesn't provide a permanent framework (see point 3 below). One way of thinking about it is that you can divide EU legislation into three groups: where equivalence exists and is in use; where equivalence exists but is not in use; and where equivalence does not exist. Not all the equivalence regimes under a particular directive are in use: for example, there are six different equivalence regimes under Mifid, of which three are in use and three are not.

Fig.3 A patchy framework

Summary of EU legislation that includes and doesn't include equivalence
Note: the numbers in blue denote how many equivalence regimes per directive or regulation are in use.
** denotes a directive or regulation where some equivalence regimes are in use and some are not.*

Equivalence regime exists and is used

- Accounting rules directive (1)
- Benchmarks Regulation (BMR) (1)
- Credit Rating Agencies Regulation (CRA) (1)
- Capital Requirements Directive / Regulation (CRD / CRR) (9)
- European Market Infrastructure Regulation (EMIR) * (4)
- Market Abuse Regulation (MAR) (1)
- Markets in Financial Instruments Directive / Regulation (MiFID / MiFIR) * (3)
- Prospectus Directive (PD) (1)
- Solvency II Directive (3)
- Statutory Audit Directive (2)
- Transparency Directive (TD) * (1)

Equivalence exists but is not in use

- Alternative Investment Fund Managers Directive (AIFMD) (1)
- Central Securities Depositories Regulation (CSDR) (1)
- European Market Infrastructure Regulation (EMIR) * (1)
- Financial Conglomerates Directive (FICOD) (1)
- Markets in Financial Instruments Directive / Regulation (MiFID / MiFIR) * (3)
- Securities Financing Transaction Regulation (SFTR) (3)
- Short Selling Regulation (SSR) (1)
- Transparency Directive (TD) * (1)

Equivalence regime doesn't exist

- Bank Recovery and Resolution Directive (BRRD)
- Cross-Border Payments Regulation
- Deposit Guarantee Schemes Directive (DGSD)
- European Long-Term Investment Fund Regulation (ELTIF)
- European Social Entrepreneurship Funds Regulation (EuSEF)
- European Venture Capital Funds Regulation (EuVECA)
- Financial Collateral Directive (FCD)
- International Accounting Standards Regulation (IAS)
- Institutions for Occupational Retirement Provision II Directive (IORP II)
- Insurance Distribution Directive (IDD) (formerly IMD)
- Money Market Funds Regulation (MMFs)
- Motor Insurance Directive (MID)
- Mortgage Credit Directive (MCD)
- Packaged Retail and Insurance-based Investment Products (PRIIPs)
- Pan-European Personal Pension Product (PEPP)
- Payment Accounts Directive (PAD)
- Payment Services Directive (PSD) / Second Electronic Money Directive (2EMD)
- Settlement Finality Directive (SFD)
- Single euro payments area regulation (SEPA)
- Single Resolution / Supervisory Mechanism Regulation (SRR / SRM)
- Undertakings for the Collective Investment in Transferable Securities (UCITS)

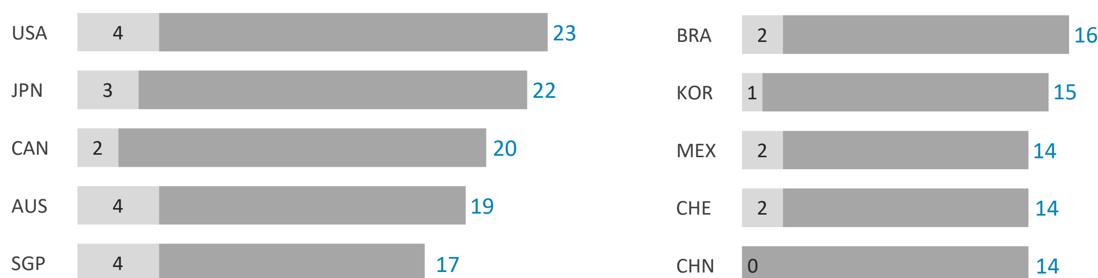
At the same time, equivalence does not always mean market access. Less than a third (12) of the 39 existing equivalence regimes offer the same or similar level of access to the single market that passporting provides. Only half of these 12 regimes are currently in use (covering benchmarks, credit rating agencies, CCPs, trading venues for stocks and derivatives, and reinsurance contracts) and some include additional requirements and conditions. For example, firms from a third country may have to also register with national authorities and ESMA, or follow specific international standards in addition to EU standards.

Most equivalence regimes cover technical issues such as reporting requirements, prudential requirements, accounting and disclosure standards, or exemptions for central banks and public authorities rather than access. They mainly reduce

overlap in regulation and supervision to benefit firms based in the EU. For example, without US equivalence on the treatment of loans under CRD / CRR, an EU bank would have to hold more capital against a loan to a US firm than a loan to an EU firm. This table shows how limited the level of market access is for most countries.

Fig.4 Market access under equivalence by country

Total number of equivalence decisions by country (in blue) and the number that provide market access (in light grey)



Source: European Commission, European Parliament, New Financial

3) Equivalence is not a long-term solution

Even if the UK is deemed technically equivalent in all 39 existing areas by the end of this year, the complexity, lack of transparency and the risk of equivalence being withdrawn at just 30 days' notice (possibly without consultation) makes equivalence an unpredictable and unstable long-term framework for EU-UK cooperation. The UK has set out its stall asking for 'permanent equivalence' but that concept doesn't yet exist. The EU can grant equivalence on an open-ended basis, whereby it considers the relevant framework of a particular country to be equivalent but reserves the right to change its mind whenever it feels that a country has sufficiently diverged from EU rules that it is no longer equivalent.

Or it can offer 'time-limited' equivalence', whereby it agrees that for a defined period - perhaps a year or two - it considers a country's regime to be equivalent but that it will withdraw that equivalence or formally review it at the end of that period. For example, in December 2017, stock exchanges in the US, Hong Kong and Australia were granted full equivalence with no time limit, while trading venues in Switzerland were given time-limited equivalence for one year. In December 2018, this equivalence was extended by a further six months but then withdrawn. While this degree of politicisation is frustrating, it should not be surprising: ultimately all regulation is political in nature.

Regardless of any timeframes imposed, the European Commission can unilaterally decide to withdraw equivalence at any point, effectively putting the firms in the UK on a permanent 30-day Brexit relocation alert. This lack of permanence is one of the main areas that industry bodies and the UK would like to negotiate with the EU (see point 10 below) to make the process more predictable and to provide a more stable basis for firms to run their business. We think that some form of time-limited equivalence in a few key areas is the most likely 'landing zone' for the UK.

4) Equivalence is not a technical exercise

Equivalence is officially a technical process with determinations made by the European Commission, but it has become highly politicised. The official process is that the Commission conducts an equivalence assessment in consultation with ESMA, EBA and EIOPA and with the relevant national authorities of the country applying for equivalence on whether the rules and supervisory framework of that country are considered to have an 'equivalent effect' as EU legislation, have equivalent outcomes, or, in some cases, that the rules are the same.

These assessments need to be approved by representatives of EU member states but the European Parliament does not have a formal role in the decision. The determination of equivalence would probably also include specific cooperation agreements with UK supervisors and regulators on issues such as co-ordination of supervision and exchange of information. Once a country has been granted equivalence, individual firms that wish to use it have to apply to the relevant EU authority to put it into practice, a process that can take up to 180 days.

However, the actual decision to grant equivalence is ultimately political. Switzerland was granted supervisory and regulatory equivalence in trading for one year, with an extension linked to wider treaty negotiations with the EU, but when these talks reached stalemate a year-and-a-half later Swiss stock exchanges' equivalence was revoked even though both sides recognised that Swiss exchanges were technically equivalent. This politicisation is one reason why some in the European Parliament wants to have a formal role in equivalence decisions: they argue that if the decisions are taken by the Commission they should be strictly technical, but that if they are political they should involve the Parliament.

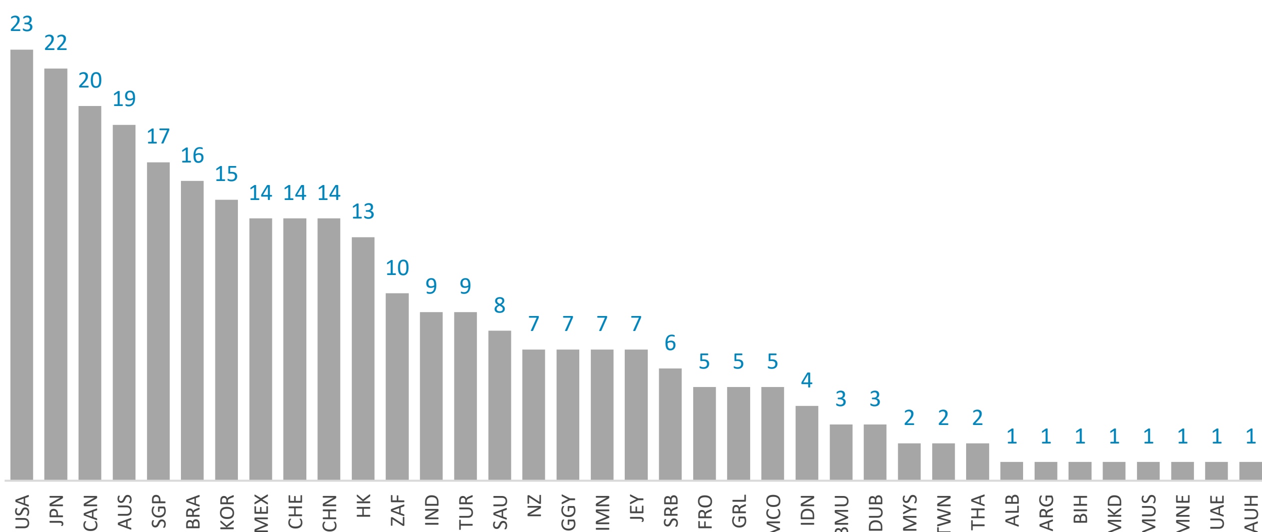
The big political questions for the Commission in terms of granting equivalence to the UK will be whether it is politically acceptable for such a large amount of activity in EU financial markets to take place outside of the single market; whether they are prepared to grant equivalence to a country that may be technically equivalent on day one but which has made clear its intention to diverge; and what precedent might any equivalence decisions for the UK set for future negotiations with the US on financial services. The big question for the UK is whether a technical 'outcome based' equivalence (in other words, an apolitical equivalence decision) is even on offer in the context of the fraught politics of Brexit.

In its latest communication on equivalence, the Commission said that while it assesses equivalence based on criteria enshrined in EU law, it also needs to consider whether equivalence decisions are in line with the wider EU priorities at a global level and in areas such as money laundering, tax and international sanctions. The UK will have to wait until June for the EU to complete its equivalence assessments. But with the process running in parallel with wider EU-UK trade negotiations there are concerns that equivalence determinations could be delayed, used as leverage in the negotiations of the future EU-UK relationship, or be linked to the outcome of the trade negotiations.

5) Equivalence is not the same as being a 'rule-taker'

Equivalence in financial services - even in a few key sectors - would not make the UK a 'rule-taker' that is committed to permanently following EU rules on which it has no say. The US has equivalence in 23 areas and Japan in 22, but few people would consider them to be rule-takers. Instead, equivalence is more about an agreed alignment and outlook in specific areas, often based around international standards. Since the UK would have the same rules on 1st January 2021 as it had on 31st December 2020 - and is unlikely to pass legislation on day one to diverge - it could argue that equivalence simply reflects the current level of alignment rather than any commitment to future alignment. Moreover, the broad principle of most financial regulation is decided at an international G20 and Basel Committee level involving the US, EU, UK and other major markets.

Fig.5 Everyone's a rule-taker?
Number of equivalence decisions by country



Source: European Commission

Equivalence is not about having identical regulatory provisions or following EU rules line by line. Equivalence assessments look at whether broadly similar regulations and supervisory frameworks can achieve broadly similar outcomes in areas such as financial stability, market abuse, transparency, and investor and consumer protection.

At the same time, the Commission also considers the risks posed to the EU financial system by the activities of third country institutions, the impact on financial stability, market integrity and whether there is a level playing field. In some areas, such as CCPs, a higher degree of alignment to rules is needed and supervision must be stringent.

6) Equivalence is not a one-way street

That said, equivalence is not a free lunch: terms and conditions apply. In each area where the UK had an equivalence regime, its room for manoeuvre in diverging in future from EU rules would be limited. While this may not be a problem in specific technical areas such as clearing or stock exchanges - where other big markets such as the US, Singapore or Hong Kong have equivalence - it would become more of a problem with every additional equivalence regime.

Initially, this would not be a problem for the UK: on day one, equivalence would reflect the reality of the alignment between the EU and the UK, and the government is likely to have enough on its plate in early 2021 to not be rushing through changes to UK regulation. However, this accommodation could come under strain in at least three ways.

First, if the government decided in future to reform or remove a particular aspect of EU legislation that currently applies to the UK market the EU may decide that it constitutes a technical breach of equivalence. For example, while equivalence does not strictly apply to pay and bonuses, any move to abolish the bonus cap in the UK (which the Prime Minister once described as 'the most deluded measure to come from Europe since Diocletian tried to fix the price of groceries across the Roman Empire') may prompt the EU to reconsider equivalence in another area on the basis of financial stability or harming the integrity of the single market.

Second, given the EU's position on a level playing field, any wider moves in other sectors to replace EU legislation may set alarm bells ringing about competition and prompt the EU to remove equivalence. And third, if the EU decided to significantly change the rules and regulations in a particular area, the UK would have to decide whether to follow suit or risk losing equivalence. It is also worth noting equivalence works in both directions: from January 2021 the UK will have the right to grant equivalence of its own to other countries and will probably be keen to set an example by offering equivalence to the EU and other countries which already have equivalence with the EU. The industry is keen to avoid any tit-for-tat equivalence decisions between the UK and the EU.

7) Equivalence does not prevent disruption from Brexit

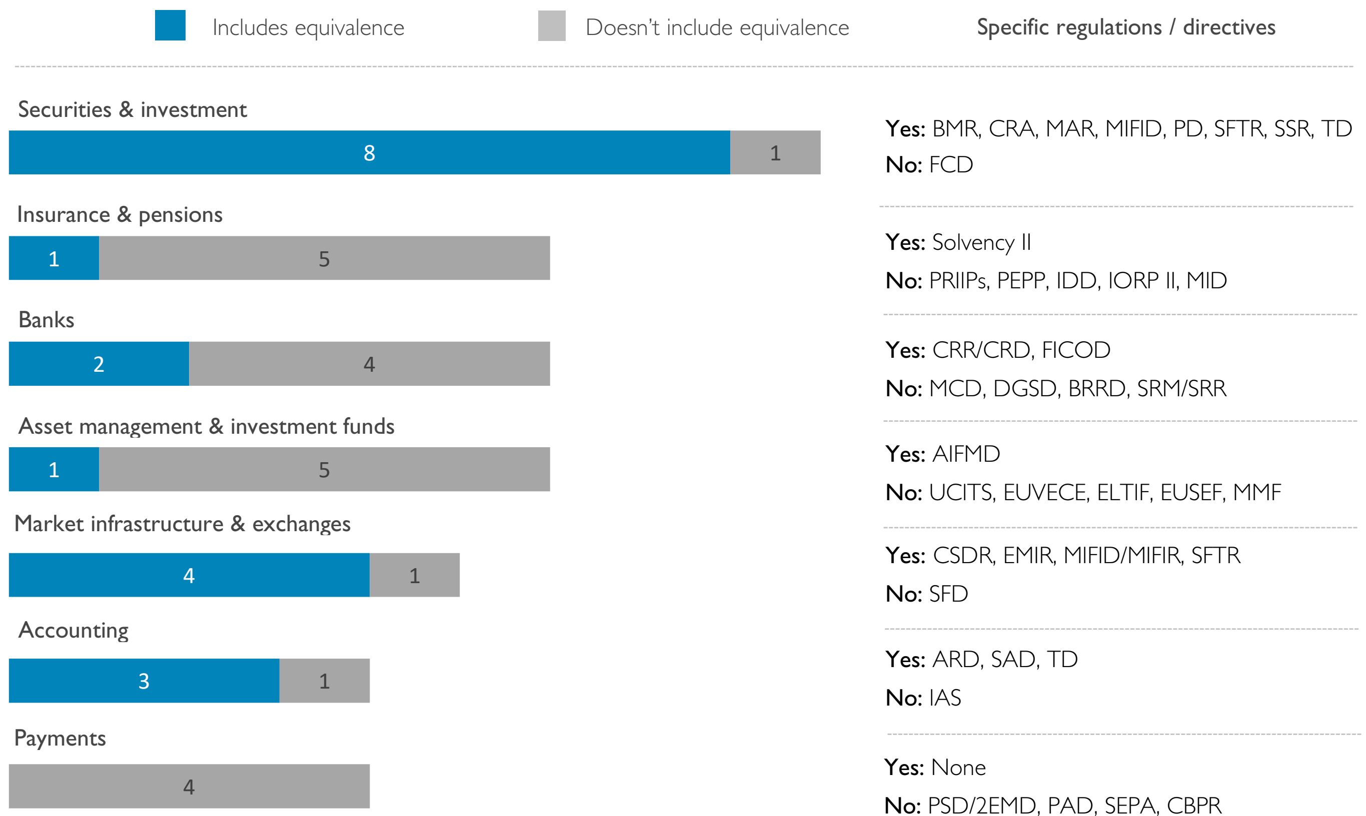
Equivalence is not a magic wand that will make Brexit go away: it would reduce but not eliminate the disruption caused by Brexit. The more areas of equivalence the UK is granted, the less disruptive Brexit will be in terms of the relocation of legal entities, business, assets and staff to the EU. But many firms would still need to implement at least part of their Brexit contingency plans even if all 39 areas of equivalence were granted by the EU. The limited scope and market access provisions of many equivalence regimes means many UK firms would still need to have a presence in the EU in many areas of activity to continue servicing and trading with local clients.

In some areas equivalence would significantly reduce the disruption. For example, broker dealer equivalence under Mifid II (a recently updated regime that is not in use by any country) would enable a large investment bank with significant operations in the UK to continue to deal with institutions across the EU (but not retail investors) from London. That could be the difference between moving a few hundred staff to the EU and moving many more. And for other sectors of the industry, it would be binary: with stock exchange equivalence under Mifid II, UK-based firms would be able to continue to offer trading in EU securities. Without it, they would need to have a separate trading venue in the EU.

For large parts of the industry, equivalence provides only patchy coverage of its activities, and for some key financial sectors and areas of business it doesn't exist all - such as investment services to retail clients and some core banking activities, including deposit-taking, lending and payments.

Fig.6 **Equivalence by sector**

Number of pieces of legislation with and without equivalence regimes in different sectors



Source: European Commission, European Parliament, New Financial

8) Equivalence is not a given

On paper at least, the UK's aim of securing 'day one equivalence' across the board should be a relatively easy task. After all, having transposed EU law into UK law, the UK will have exactly the same rules and regulations in place when markets open for business on Monday 4th January 2021 (when the UK is likely to have exited the transition period) as it did on Thursday 31st December 2020 (when it will still be subject to EU rules). Technically speaking, the UK will be equivalent and there should be no trouble for the EU and UK in completing the equivalence assessments by the end of June as outlined in the negotiating timetable.

However, it is important to remember that equivalence is a unilateral decision by the EU and since determinations by the European Commission will be judged in part on the risks associated with a third country's financial system, the UK may face tougher scrutiny in some areas than other countries. The closer a market is to the EU, the higher the volume of cross-border activity and the more integrated it is with the EU economy and financial system, the higher the bar.

While no other jurisdiction in the world has such a formal regime to provide access or reduce overlap in regulation and supervision, the actual EU process for determining equivalence is opaque. Officially, the criteria for assessing equivalence are enshrined in EU law, but the European Commission's application of stricter requirements to some determinations can be unpredictable and inconsistent (and of course, political - see point 4). The Commission only publishes equivalence decisions when it grants or rescinds equivalence: there is no public register of countries that have applied for equivalence and been rejected with an explanation of the reasons why. While this may be frustrating for the UK and firms based here, in practice it is not much different from decisions in other countries about which firms can and cannot access their markets.

9) Equivalence is another word for trust

One of the most common mistakes many people make when thinking about equivalence is that it is a technical or even political process. Instead, it is effectively another word for trust. Whenever the EU decides that a country is equivalent in a particular area it is essentially giving up a degree of control and relying on the supervisory and regulatory authorities of that country. That requires a high degree of trust on both sides. As a result, the EU will often set additional requirements and conditions to an equivalence decision, such as registration of firms with EU authorities or formal cooperation agreements between supervisors and regulators on the co-ordination of supervision and regulation, and the exchange of information.

One example is the joint supervision by EU and US supervisors of dollar clearing houses based in the EU, that may be a model for granting equivalence to clearing houses in London on the other side of Brexit. The high level of trust is all the more important because this cooperation by definition will take place outside of existing formal EU channels such as the European Council, Ecofin or the ESAs (EBA, EIOPA, and ESMA), where the UK will no longer have a seat at the table. UK authorities have already signed a number of bilateral cooperation agreements with national supervisors in the EU, and the EU has established formal supervisory and regulatory dialogue with countries like Canada, Japan, Singapore, Switzerland the US to encourage this sort of collaboration.

The big challenge for the UK on the other side of Brexit will be regaining the trust of EU member states after several years of political wrangling and public calls by some politicians for wholesale deregulation and divergence from EU rules since the UK voted to leave the single market. While it is important to distinguish between Westminster and Whitehall - politicians tend to use livelier language than civil servants - there is a limit to the trust that regulators and supervisors can build with each other when the key questions are decided at a political level.

10) Equivalence is a work in progress

The framework for equivalence is not set in stone, but that does not mean that the EU is likely to introduce wholesale changes to the process or regime for the benefit of the UK as it walks out the door. Brexit has prompted discussions within the EU about the need to reform the equivalence regime - for example, the European Parliament started a project to review and improve equivalence before the referendum - but the UK should not expect a radical overhaul of the existing regime in the near future, or any special treatment.

Since the referendum various industry bodies, politicians and officials in the UK have advocated improving the process of granting equivalence, monitoring it, resolving disputes and withdrawing it. This had led to a number of ambitious proposed variants of equivalence, from 'enhanced equivalence' and 'super equivalence' to 'reformed equivalence', 'improved equivalence', and most recently 'permanent equivalence'. Most of this work has focused more on improving the process than extending market access, in particular on improving the decision-making process and increasing transparency, codifying the criteria for assessments, and a clearer system of warnings, consultations and reviews before any decision to withdraw it.

While the EU has pushed back on these reforms, the equivalence regime has not remained static. The system has evolved in an ad hoc way over the past 20 years and were it not for Brexit there would probably have been more political will to make it more stable and predictable. In the past few years, the EU has specifically revised equivalence to reflect Brexit: equivalence for CCPs has been revised to set stricter conditions, and a third country provision has been added to the Markets in Financial Instruments Directive II for investment firms. But there is little appetite for widening market access in other areas.

A key challenge for the EU in the longer term is that if it makes it too hard for the UK to get equivalence in the areas it wants, it could remove the incentive for other countries around the world to converge with EU rules and regulations and reduce the attractiveness of applying for equivalence at all. This would in turn reduce the EU's influence in shaping the agenda for global regulation and supervision in banking and finance.

Perhaps in a few years, once some of the heat has come out of the Brexit debate, there will be an opportunity for a more measured and collective approach to reforming and improving equivalence.

Part 4 - Appendix on equivalence

This section is a four-page appendix that provides a summary of the 39 separate equivalence regimes that exist under EU banking and finance legislation. It is divided up by the directive or regulation under which the equivalence regime exists and summarises the function or activity to which the equivalence provision relates, the number of third countries that have been granted it, whether it allows market access, and what having equivalence (or not having it) would mean for the UK.

Type of equivalence	No. of countries	Market access?	What having equivalence (or not having it) would mean for the UK
Accounting Rules Directive			
Reporting requirements for extractive and logging industries	1	No	EU firms active in UK extractive and logging industries can report payments made to UK governments in their country of origin. Without equivalence EU firms must comply with UK and EU reporting requirements.
Alternative Investment Fund Managers Directive (AIFMD)			
Management and marketing of funds to professional clients	0	Yes	UK firms can market - and manage - EEA/non-EEA private equity funds, hedge funds, funds of funds and real estate funds to EU institutional investors from the UK. Without equivalence, UK firms must set up a subsidiary in the EU and possibly set up authorised branches to access national markets.
Benchmarks Regulation (BMR)			
Use of financial benchmarks	2	Yes	UK-based firms must be registered with ESMA and apply IOSCO benchmark principles for their benchmarks to be used by EU customers. Without equivalence, UK firms must set up an EU subsidiary for EU firms and individuals to use their benchmarks.
Credit Rating Agencies Regulation (CRA)			
CRA ratings and activities	9	Yes	UK-based credit rating agencies whose activities do not pose a threat to the financial stability of one or more EU countries can sell products to EU clients from the UK, and EU firms will be able to use their ratings. Without equivalence, UK firms must set up a subsidiary in the EU for their ratings to be used by EU clients.
Capital Requirements Regulation (CRR) / Capital Requirements Directive (CRD)			
Credit institutions (treatment of exposures)	23	No	EU banks' exposures to UK firms will be treated more favourably and may have the same risk weights as exposures to EU firms. Without equivalence, EU banks' exposures to UK firms may be considered riskier and more costly.
Credit institutions (treatment of exposures to central banks and governments)	23	No	EU banks' exposures to the Bank of England and UK government will be treated more favourably and may have the same risk weights as exposures to EU central banks and governments. Without equivalence, EU banks' exposures to these UK authorities may be seen as riskier and more costly than those to EU central banks and governments.
Credit institutions (treatment of exposures to regional government and local authorities)	23	No	EU banks' exposures to UK regional and local governments will be treated more favourably and may have the same risk weights as exposures to EU regional and local governments. Without equivalence, EU bank exposures to UK regional and local governments may be considered riskier and more costly.
Credit institutions (treatment of exposures to public bodies)	23	No	EU banks' exposures to UK public bodies will be treated more favourably and may have the same risk weights as exposures to EU public bodies. Without equivalence, EU bank exposures to UK public bodies may be considered riskier and more costly.

Type of equivalence	No. of countries	Market access?	What having equivalence (or not having it) would mean for the UK
Credit institutions (large financial sector entity, use of internal ratings-based approach)	23	No	UK banks considered to be 'large financial sector entities' can use the internal ratings-based approach to credit risk. Without equivalence, this won't be possible.
Confidentiality regimes (ESA participation)	16	No	UK supervisory authorities may participate in EU supervisory colleges on supervision of EEA banking groups with international activity. Without equivalence, UK participation won't be possible.
Treatment of exposures to exchanges	13	No	EU firms' exposures to UK exchanges will be treated the same as exposures to EU exchanges. Without equivalence, these exposures may be seen as risker and more costly.
Investment firms (large financial sector entity, use of internal ratings-based approach)	13	No	UK investment firms considered to be 'large financial sector entities' can use the internal ratings-based approach to credit risk. Without equivalence, this won't be possible.
Treatment of exposures to investment firms	13	No	EU firms' exposures to UK investment firms will be treated the same as exposures to EU investment firms. Without equivalence, EU firms' exposures to UK firms may be seen as risker and more costly.
Central Securities Depositories Regulation (CSDR)			
CSDs (provision of services)	0	Yes	UK CSDs can serve EU clients from the UK. Without equivalence, UK CSDs must set up an EU subsidiary to provide services to EU clients, and possibly set up branches to access national markets.
European Market Infrastructure Regulation (EMIR)			
CCPs (provision of services)	15	Yes	UK CCPs can provide clearing services to EU clearing members and trading venues from the UK. Without equivalence, UK CCPs must set up an EU subsidiary to provide clearing services in the EU.
Regulated markets (treatment of derivatives traded in third countries)	5	No	Derivatives trading on UK trading venues will not be considered as over-the-counter, meaning lower risk weights and costs for counterparties. Without equivalence, all derivatives trades in the UK will be OTC and counterparties face higher risk weights and costs.
Transaction requirements (counterparties)	2	No	EMIR transactions between UK firms and EU firms can avoid duplicative or conflicting requirements. Without equivalence, UK and EU firms must comply with requirements and rules in both markets.
Trade Repositories (provision of services)	0	Yes	UK trade repositories can provide services to EU firms from the UK. Without equivalence, UK trade repositories must set up an EU subsidiary.
Exemptions for central banks	2	No	The Bank of England will be exempt from certain EMIR requirements on derivatives contracts with an EU entity. Without equivalence, it must comply with EMIR derivatives requirements.
Financial Conglomerates Directive (FICOD)			
Supervision of conglomerates	0	No	EEA-regulated entities of UK financial groups will be supervised by UK supervisory authorities. Without equivalence, UK firms' EEA businesses must be supervised by both UK and EU authorities.
Market Abuse Regulation (MAR)			
Exemptions for central banks and public bodies	13	No	The Bank of England and UK public bodies will be exempt from certain MAR disclosure requirements and rules. Without equivalence, they must comply with all MAR requirements.

Type of equivalence	No. of countries	Market access?	What having equivalence (or not having it) would mean for the UK
Markets in Financial Instruments Directive (MIFID) / Market in Financial Instruments Regulation (MIFIR)			
Trading venues for the purpose of trading obligation for derivatives	2	Yes	EU firms can use UK trading venues to trade derivatives. Without equivalence, EU firms won't be able to trade derivatives on UK venues.
Derivatives trade execution and clearing obligation requirements for counterparties	0	No	Derivatives trading between UK and EU firms on UK trading venues will meet EU trade execution and clearing requirements. Without equivalence, this won't be the case.
Trading venue & CCP access to benchmarks and licences for the purpose of clearing and trading obligations	0	Yes	UK trading venues and CCPs may access EU trading venues and CCPs, and use EU benchmarks and licences. Without equivalence, UK trading venues and CCPs must set up an EU subsidiary to access EU trading and clearing venues, benchmarks and licences.
Investment firms (provision of services to professional clients)	0	Yes	UK investment firms can provide services to EU institutional clients and counterparties from the UK. Without equivalence, UK investment firms must set up an EU subsidiary - and possibly an authorised branch to access a national market - to service institutional clients in the EU.
Trading venues for the purpose of trading obligation for shares (stock exchange equivalence)	3	Yes	Shares listed and traded in the EU can be traded on UK trading venues. Without equivalence, EU-listed shares cannot be traded on UK venues.
Exemptions for central banks	13	No	The Bank of England may be exempt from certain requirements if its transactions are for regulatory purposes. Without equivalence, it must comply with all MIFIR requirements.
Prospectus Directive (PD)			
Use of prospectus	5	No	Prospectuses of UK firms can be used in public offerings of securities in the EU. Without equivalence, all UK public offering prospectuses must be approved by the EU.
Securities Financing Transaction Regulation (SFTR)			
Exemptions for central banks and public bodies	0	No	The Bank of England and the UK public debt management office may be exempt from certain requirements on transparency of securities financing transactions. Without equivalence, they must comply with all these requirements.
Trade Repositories (provision of services)	0	Yes	UK trade repositories can provide services to EU firms from the UK. Without equivalence, UK trade repositories must set up an EU subsidiary to provide services to EU clients.
Disclosure requirements for counterparties	0	No	Transactions between UK and EU firms can avoid duplicative or conflicting disclosure requirements. Without equivalence, UK and EU firms must comply with requirements in both markets.
Short Selling Regulation (SSR)			
Market making activities	0	No	UK firms need not notify EU authorities of significant net short positions in shares and sovereign debt for purposes of market-making if UK authorities have been notified or those positions are publicly disclosed. They are also exempt from EU restrictions on uncovered short sales. Without equivalence, UK firms must comply with EU and UK disclosure requirements on short positions, and with EU restrictions on uncovered short sales.
Solvency II Directive			
Equivalent treatment of reinsurers' activities	3	Yes	UK reinsurers can enter into a contract with an EU insurance firm from the UK. Without equivalence, UK reinsurers must set up a subsidiary in the EU.

Type of equivalence	No. of countries	Market access?	What having equivalence (or not having it) would mean for the UK
Solvency rules for calculation of capital requirements & own funds of insurers	8	No	EEA insurance and reinsurance groups with UK entities may use UK rules to calculate the capital (own funds) and solvency capital requirement for that entity. Without equivalence, UK arms of EEA firms must comply with UK rules and EU Solvency II requirements.
Equivalence of group supervision by third country supervisory authorities	2	No	EEA branches or subsidiaries of UK-based insurers and reinsurers can be supervised by UK authorities. Without equivalence, EEA subsidiaries of UK-based insurers and reinsurers must be supervised by UK and EU authorities.
Statutory Audit Directive			
Equivalence of audit framework (exemptions in registration and oversight for auditors & audit firms)	22	No	UK auditors and audit firms providing audit reports or financial statements for UK firms whose securities are traded in an EU regulated market do not need to register in the EU or be overseen by EU authorities. Without equivalence, UK audit firms must comply with EU and UK rules on registration and oversight.
Adequacy of competent authorities	14	No	EU authorities can share with UK authorities audit working documents relating to EU companies that have issued securities in the UK or groups that issue consolidated financial statements in the UK. Without equivalence, UK authorities cannot receive these confidential audit documents on EU companies with UK-listed securities or that report consolidated financial statements in the UK.
Transparency Directive (TD)			
General transparency and disclosure standards requirements	0	No	UK firms subject to EU transparency rules can comply with UK transparency and disclosure standards when reporting financial and shareholder information. Without equivalence, UK firms must meet UK and EU transparency and disclosure standards.
Consolidated financial statements (third country GAAP with IFRS)	5	No	UK firms subject to EU rules on transparency and prospectuses can present their consolidated financial statements according to UK requirements on financial statements and accounting standards. Without equivalence, UK firms must meet EU and UK financial statements and accounting standards.

EU legislation where there is no provision for equivalence:

Bank Recovery and Resolution Directive (BRRD)	Mortgage Credit Directive (MCD)
Cross-Border payments Regulation (CBPR)	Motor Insurance Directive (MID)
Deposit Guarantee Schemes Directive (DGSD)	Packaged Retail and Insurance-based Investment Products (PRIIPs)
European Long-Term Investment Fund Regulation (ELTIF)	Pan-European Personal Pension Product (PEPP)
European Social Entrepreneurship Funds Regulation (EuSEF)	Payment Accounts Directive (PAD)
European Venture Capital Funds Regulation (EuVECA)	Payment Services Directive (PSD) / Second Electronic Money Directive (2EMD)
Financial Collateral Directive (FCD)	Settlement Finality Directive (SFD)
Institutions for Occupational Retirement Provision II Directive (IORP II)	Single Euro Payments Area regulation (SEPA)
Insurance Distribution Directive (IDD) (formerly IMD)	Single Resolution / Supervisory Mechanism Regulation (SRR / SRM))
International Accounting Standards Regulation (IAS)	Undertakings for the Collective Investment in Transferable Securities (UCITS)
Money Market Funds Regulation (MMFs)	