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NORTON ROSE FULBRIGHT

# Examining Regulatory Equivalence

**12 January 2017**

# REGULATORY EQUIVALENCE

## Foreword

Norton Rose Fulbright LLP was commissioned by the Financial Services Negotiation Forum to produce a briefing paper on regulatory equivalence following the UK's decision to leave the European Union.

The objectives of this paper are to examine the approach to equivalence in Europe and elsewhere and to raise awareness of a need for international consensus on the interpretation and measurement of equivalence.

It has been developed to send to the UK Government, policymakers and negotiators to encourage a pragmatic, pro-business and pro-growth approach to UK-EU negotiations for Brexit, as well as to other international bodies. UK financial services firms, trade bodies and pro-business groups within EU Member States may also find this paper of interest.

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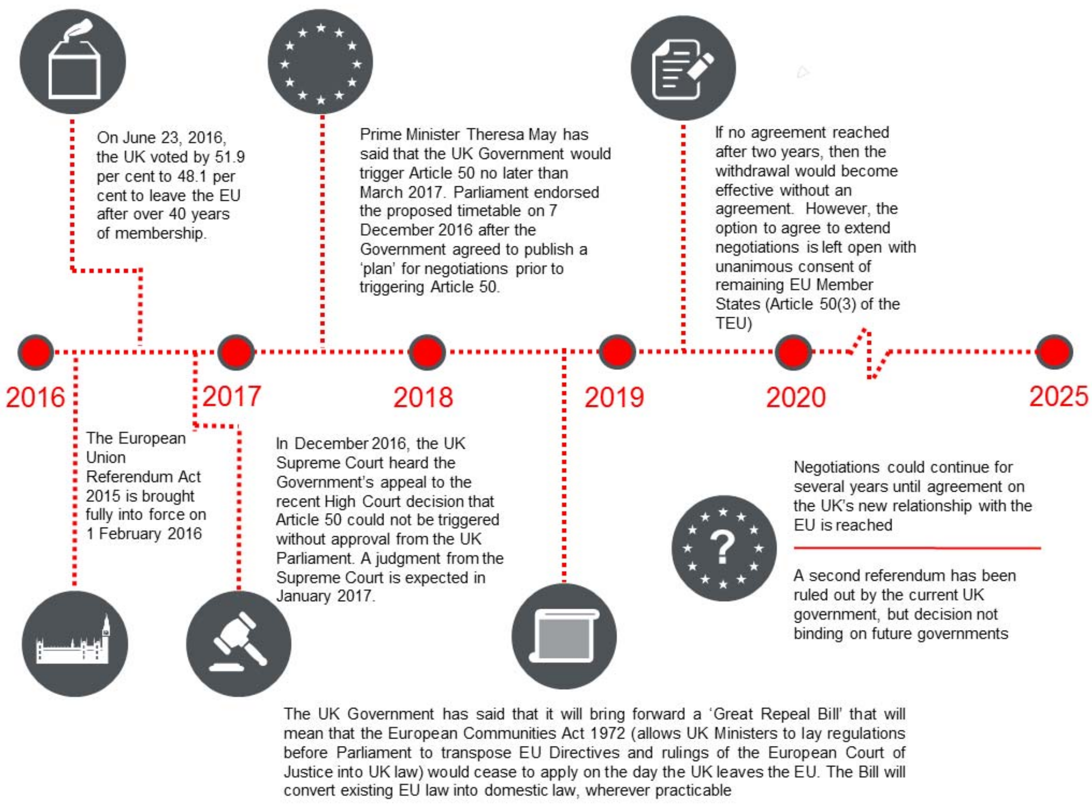
## Section 1: Introduction

In the wake of the UK's decision to leave the European Union on 23 June 2016 and subsequent announcements by the UK Government to trigger Article 50, which will begin Brexit negotiations, before the end of March 2017, the UK financial services industry is attempting to identify the risks and opportunities that the UK's exit may bring.

A crucial aspect of identifying such risks and opportunities in a post-Brexit landscape will be discussions around, and negotiation on, the issue of 'regulatory equivalence'. Arguably, recognition by the EU that the UK is 'equivalent' to it could mitigate some of the damage caused by the loss of the European passport for financial services envisaged in a 'hard' Brexit scenario.

This paper will examine the concept of regulatory equivalence, both on an EU and international level, analysing the approach taken by the EU in assessing equivalence with third countries. The paper will examine the lack of accepted international consensus on what is meant by regulatory equivalence, the level of tolerance for deviation in measuring equivalence and some of the challenges that could be faced by UK negotiators in seeking to establish a level of equivalence with the EU and, where necessary, other third countries, in a post-Brexit world.

*The Brexit timeline*




Following on from the referendum result in June 2016, the UK Government announced that it intends to begin Brexit negotiations by triggering Article 50 of the TEU no later than the end of March 2017. The UK Government has also announced that it intends to repeal the European Communities Act 1972 which currently provides for supremacy of EU law. This 'Great Repeal Bill' would convert all existing EU-derived law into domestic law.

In December 2016, the UK Supreme Court heard the Government's appeal to the recent High Court decision that Article 50 could not be triggered without approval from the UK Parliament. A judgment from the Supreme Court is expected in January 2017 and, in the meantime, Parliament has passed a motion with a substantial majority requiring the Government to publish a 'plan' prior to triggering Article

50. There has been little information as to the level of detail to be included in such plan and no confirmation as to whether it will take the form of a White Paper.

*Why is equivalence important to the UK financial services industry?*

Where the UK is able to achieve equivalence with the EU in a particular area of financial services, it will allow a UK financial services firm, which has registered with the relevant ESA, to offer particular services into Europe without needing to be separately authorised in each Member State in the EU. However, not all areas of European legislation allow for equivalence and the process for determining equivalence by the European Commission is lengthy and can be derailed by political tensions.

However, despite some of the challenges and limitations of the approach to equivalence in Europe, it remains important to give proper consideration to the opportunities that it could present to the UK.

First, parts of the UK financial services industry have emphasised, since the referendum, the significance of its 'passporting' rights into Europe. The single market 'passport' enables a financial services firm authorised in its 'Home' Member State to exercise its right under a relevant single market Directive to provide services in another Member State either by establishing a branch or providing such services on a cross-border basis, without the need for separate authorisation in the second Member State (known as the 'Host' Member State). It is currently estimated that 2250 UK firms are using a passport under MiFID[1] (the Single Market Directive for investment services) to access European customers.

The fundamental concept underlying the European passport is one of equivalence through the observance of identical rules. That is, the harmonisation of rules under a particular Single Market Directive reassures each Member State within the EU that, for example, a French customer will not be put at a greater risk by using a German or UK investment firm. There is 'equivalence' of rules and outcomes between all Member States under a Single Market Directive.

To the extent that the UK and EU agree on transitional provisions following the UK's exit from the EU, this is likely to be based on an assumption of equivalence between the UK and EU. As the UK is currently a Member State, its regulatory framework will be identical to the EU's up until the date of its exit. Once the UK has exited the EU, the ability for the EU to gain comfort that transitional arrangements will not unfairly prejudice or jeopardise other Member States will, in part, be based on an assumption that the UK will not immediately, or significantly, deviate from the objectives and intended outcomes of the EU.

Furthermore, it is important to remember that, concurrently to UK-EU negotiations, the UK will need to negotiate a further suite of trade agreements that it currently benefits from by virtue of being a Member State and may also wish to negotiate new trade agreements with other countries with whom there has previously been no established EU relationship. In negotiating these trade agreements with the rest of the world, achieving equivalence with the EU could enable the UK to significantly reduce the complexity and timeframes for such negotiations (namely, by demonstrating that the UK, where equivalent, will be 'the same out as in' post-Brexit).

For these reasons, and others, examining the concept of equivalence and considering ways in which the UK may be able to benefit from it once it has left the EU will have real significance for determining how Brexit could be achieved.

*How this paper is set out*

Sections 1 and 2 of this paper set out the introduction and an executive summary of the issues discussed. Section 3 examines the concept of regulatory equivalence with reference to other important legal concepts such as 'passporting' and 'characteristic performance', and Section 4 summarises equivalence provisions in European legislation.

Section 5 of this paper considers the international context by observing how equivalence is assessed in other countries and by international regulatory bodies.

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[1] https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/AJB-to-Andrew-Tyrie-Passporting.PDF

Section 6 proposes a bespoke model for equivalence for the purposes of UK-EU negotiations known as the 'building blocks' model of equivalence, aimed at providing greater clarity and structure to the European meaning of equivalence.

Section 7 sets out some issues related to equivalence, focusing on the UK post-Brexit and potential opportunities for its financial services industry. Section 8 sets out some final observations, recommendations and conclusions.

The paper refers to a number of abbreviations and specialised terms, which are defined in a glossary of terms on page 52.

## Section 2: Executive Summary

This paper examines the European approach to equivalence, together with some of its challenges and limitations. It considers whether the wider question of why equivalence is needed, examining established concepts such as characteristic performance and reverse solicitation. In addition, it considers whether certain alternative structures, such as outsourcing, delegation and Member State discretion, could provide adequate access to the EU for UK financial services firms, and their corresponding limitations.

It also summarises some alternative approaches to equivalence on the international stage and considers whether any helpful aspects of it can be used to build a bespoke model of equivalence for the purposes of the UK's exit from the EU. The bespoke model of equivalence suggested in this paper is known as the 'building blocks' model.

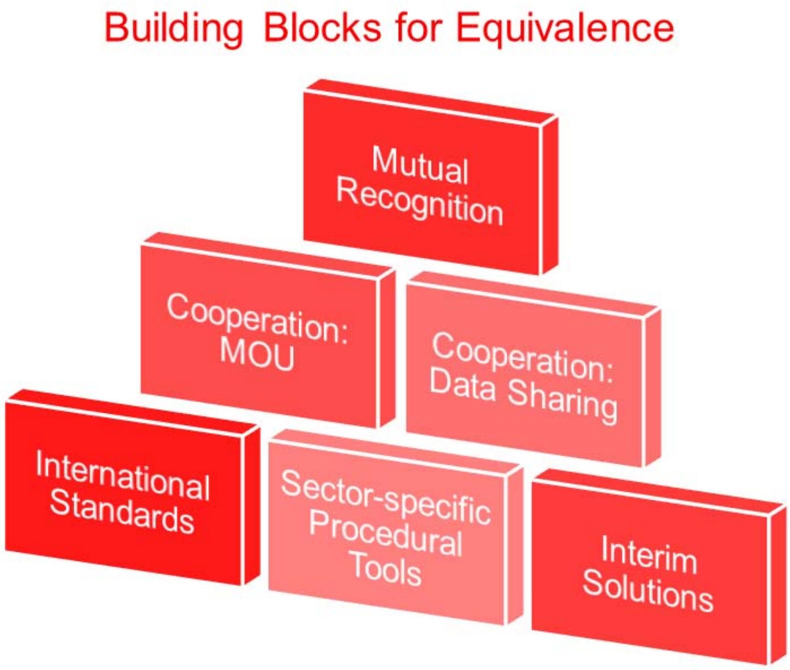
The paper does not suggest that this bespoke model, or even the concept of equivalence itself, can be a 'silver bullet' solution to replace the European passport or overcome many of the political or legal tensions around the UK's exit from the EU. For example, other recent commentary has considered the advantages of the European passport and whether a solution as close to the passport as possible can be achieved by the UK.

The purpose of this paper is specifically to examine the concept of regulatory equivalence and consider a possible solution for UK access to the European market from a 'bottom up' approach. In other words, if the European passport's wide-ranging access is not available to the UK and the starting point is the existing equivalence provisions in European legislation, can this be built upon to provide a pragmatic, mutually beneficial model for financial services for the UK and EU? The building blocks model is intended to explore some of these potential solutions, noting that building upon existing and established concepts on the European and global stage may be more palatable to politicians and industry alike.

**The building blocks model of equivalence**

The UK has already indicated that it considers a bespoke model of equivalence may be required for Brexit and we set out our version of this bespoke model in the 'building blocks' model of equivalence. The building blocks model is intended to deal with some of the existing challenges to European equivalence, namely the risk of politicisation of Commission equivalence decisions, the lack of clear benchmarks for third countries to ascertain how an equivalence determination is made and the 'static' nature of a Commission decision on equivalence (i.e. that it is made at a particular moment in time and does not take in account a potential future divergence of the two regimes).

Made up of six building blocks discussed further in Section 6 at page 31 onwards, each block builds upon an established feature in various equivalence models across the globe to represent a bespoke approach to equivalence that could be used by the UK:




Underpinning the building blocks model is a clear definition of 'equivalence' as follows:

**Equivalence between two regulatory regimes can be determined where there are the following features:**

- **Parity in public policy objectives**
- **Shared regulatory principles**
- **A shared regulatory ethos**
- **Shared intended outcomes**

**Building Block 1** advocates the use of international standards as equivalence benchmarks, enabling the UK and EU to apply a clear set of principles and objectives which must be met in order to determine equivalence. As discussed further below, this could help to remove the suspicion of political interference, which has been suggested of recent Commission equivalence decisions.

MiFID II and the Benchmark Regulation already recognise the benefits of using international standards (in both cases, using IOSCO standards). This building block develops this further to suggest that international standards should be used in all areas in which equivalence is available.

The use of international standards should allow the assessment of equivalence between the UK and EU regimes to be more streamlined, potentially quicker and objectively justifiable. It should also allow for an element of 'future proofing' for the UK; once an equivalence decision has been made, any deviations in the UK regime can be assessed in advance against those international standards and allow the UK to determine if a change to its regulatory regime could endanger its equivalent status with the EU.

**Building Block 2** advocates the use of a set of procedural tools to help enforce against UK firms once equivalence has been determined and, where mutual recognition is established, to enable enforcement against EU firms accessing the UK.

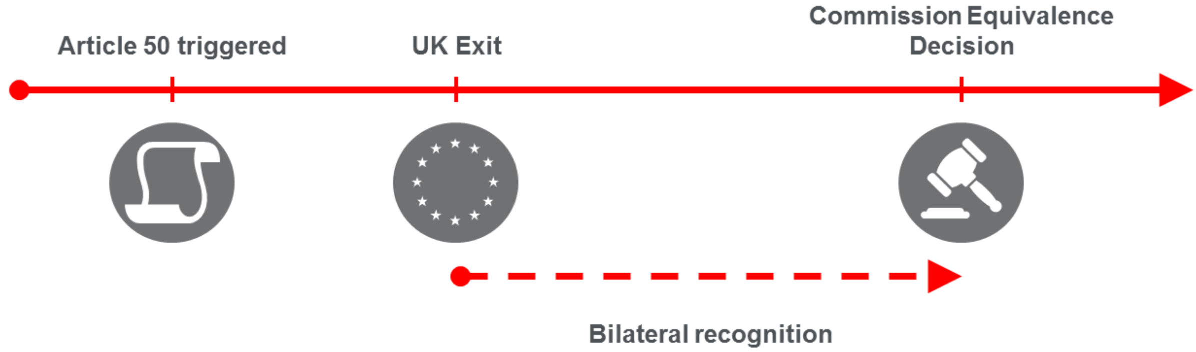
These tools are specific to different sectors of the industry with, for example, clearing houses subject to stricter enforcement powers by the EBA as a way of maintaining euro clearing in the UK. It also recognises the need for the appropriate placing of resources by regulatory supervisors according to specific types of firms:


This building block is intended to provide a pragmatic solution to the issue of the location of, in particular, clearing services. There has been political tension around the relocation of euro clearing organisations from London to another Member State following Brexit and it is envisaged that the EU will be reluctant to accept a lack of direct enforcement or oversight over euro clearing organisations based in London following Brexit.

In order to overcome this hurdle, the sector-specific procedural tools suggest that UK clearing organisations agree to a more direct form of supervision and oversight by the EU, by using an existing US concept known as ‘consent to jurisdiction’. A firm-specific solution, it requires that a UK clearing organisation seeking access to the EU contractually agrees to accept the direct jurisdiction of the ECB, allowing it to directly enforce against the clearing organisation where appropriate. It is hoped that this could be an attractive proposition for the UK, as it ensures that the ECB has more direct control over UK clearing houses, avoids the disruption of moving euro clearing to another Member State and utilises a concept already accepted by UK clearing organisations which access the US market.

Recognising that this level of oversight and direct enforcement is not appropriate for all types of UK financial services firms, this building block provides a spectrum of oversight options for the UK. For example, for banks and systemically important firms, it may be appropriate that the UK and European regulators harmonise their supervision through a supervisory college. For the vast majority of UK firms seeking access to Europe (i.e. smaller and non-systemically important firms), the EU could defer to the UK regulatory authorities for appropriate oversight.

**Building Block 3** sets out a suggested interim solution for the UK prior to an equivalence decision being taken, so as to avoid significant disruption to the UK financial services industry whilst it awaits the Commission decision:




Certain European legislation already considers transitional provisions for third countries awaiting a Commission decision on equivalence, namely in MiFIR and the Benchmark Regulation.

This building block utilises the ‘recognition’ regime already established in the forthcoming Benchmark Regulation, which allows a third country benchmark administrator to be recognised on a Member State-by-Member State basis. Building upon this idea, this building block provides an interim solution for UK financial services firms awaiting a Commission equivalence decision, by enabling individual Member States to recognise a UK firm seeking access to its market.

The Member State would be able to rely upon a certification by the UK regulators to provide regulatory comfort and assess the UK’s compliance with any relevant international standards.

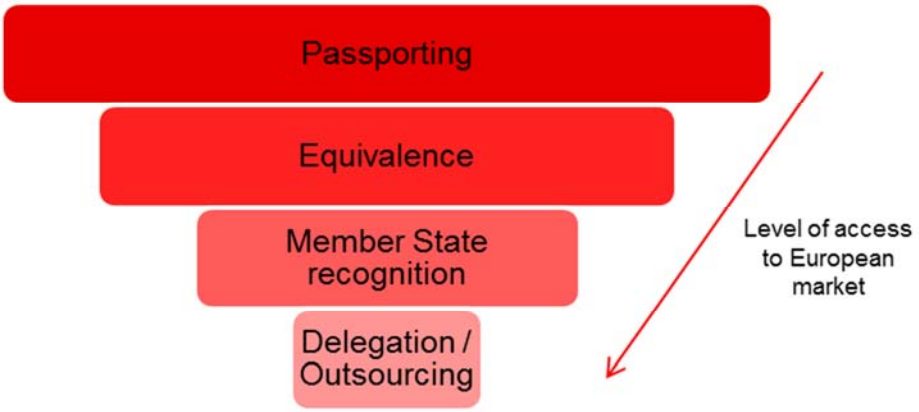
This interim solution could also require a UK financial services firm to have a legal representative in that Member State to allow appropriate oversight and accountability in that jurisdiction.

**Building Blocks 4 and 5** focus on cooperation arrangements between the UK and EU through a comprehensive memorandum of understanding and the importance of data sharing.

Finally, **Building Block 6** examines the benefits of mutual recognition between the UK and EU, including promoting a more efficient transition for the UK and reducing costs for EU and UK financial services firms, which can be achieved through legislative or non-legislative measures.

**'Cascading' European access**

The paper briefly considers the 'cascading' opportunities of European access in a post-Brexit world in the event that equivalence cannot be achieved for the UK, including a form of Member State recognition, delegation and outsourcing.




The paper concludes by noting that the divergent approach to equivalence across the globe means that there is no internationally agreed definition or set of benchmarks by which to determine whether one country is equivalent to another.

However, there are some common features (such as cooperation arrangements, comparable regulatory frameworks and data sharing) which suggest that a framework of equivalence could be established, possibly by an international body such as IOSCO, to ensure a harmonised approach to equivalence in the future. In the immediate future for the UK, the focus will be on whether the UK wants to achieve equivalence, how this can be achieved and whether the UK can prevent political tensions with the EU from spilling over into a legal analysis of equivalence.

Finally, it is noted that the heightened political atmosphere around Brexit has resulted in an emotive lexicon which can, at times, impede a neutral discussion of concepts such as 'passporting' and 'equivalence'. It is possible that, for the purposes of the Brexit negotiations, a new lexicon to describe European-UK access (for example, a 'relationship framework') may be helpful.

## Section 3: What is regulatory equivalence?

**A European approach to equivalence**

In certain cases, the EU may recognise that a third country's legal, regulatory and/or supervisory regime is equivalent to a corresponding EU framework. The Commission identified that the recognition of equivalence in a third country 'brings benefits to both the EU and third-country financial markets' by:

- reducing or eliminating overlaps in compliance;
- inferring that certain services, products or activities of firms in that third country are acceptable for regulatory purposes in the EU; and
- enabling a less burdensome prudential regime to be applied to EU financial institutions' exposures to an equivalent third country[2].

In addition, the recognition of regulatory equivalence between countries can help to avoid confusion for customers in assessing parity between products and potentially reduce business costs for firms in both the EU and the relevant third country.

In particular, the additional advantages for both customers and firms include:

- liberalising end user (i.e. customer) access to non-domestic markets and services;
- reducing the cost of cross-border business for firms and customers; and
- the mitigation of legal risk in firms having to comply with conflicting or duplicative rules.

*Where are equivalence provisions set out?*

Not all EU financial services legislation enables the recognition of a third country framework as equivalent. Although there is some commonality to the approach and assessment of equivalence decisions in the EU, it is necessary to consider each separate piece of financial services legislation produced by the Commission (i.e. a Directive or a Regulation) to assess whether, in that area of financial services, equivalence is a possibility.

A table setting out equivalence decisions taken by the Commission as at September 2016 is set out in full in Annex A.

*The equivalence process*

Broadly speaking, a technical assessment of equivalence will be undertaken by European Commission services (in the context of financial services, by the Directorate-General for Financial Stability, Financial Services and Capital Markets Union), usually based on technical advice from one of the ESAs (such as the EBA, ESMA or EIOPA). Once a technical assessment is complete, an equivalence determination will be made by the European Commission, in the form of either an implementing or delegating act:

[2] http://ec.europa.eu/finance/general-policy/global/equivalence/index_en.htm

| Technical Assessment | Committee formed | Commission decision | Final decision | Equivalence application |
|---|---|---|---|---|
| There are no time limits for how long the Commission has to make a decision. | | | | |
| • Carried out by one of the European Supervisory Authorities (such as the EBA, ESMA or EIOPA)<br>• Deals with extent to which the laws and regulation of the third country are equivalent to the EU regime. | • Comprises of representatives from the Member States.<br>• Chaired by a representative of the Commission who will not take part in any committee vote.<br>• Article 51 MiFIR, Article 86 EMIR and Article 50 BMR all provide that this committee will be the European Securities Committee. Article 464 CRR does not specify. | • Once assessment is complete, the committee delivers an opinion on the draft implementing act.<br>• This opinion contains the Commission's decision on third country equivalence.<br>• Opinion is delivered by majority vote. | • If positive equivalence determination it will be in the form of either an implementing or delegating act.<br>• Where an implementing act is adopted, the European Parliament or the Council may at any time indicate to the commission that the implementing act exceeds its implementing powers. The Commission shall then review the act. | • Once a third country framework has been recognised as equivalent, only then can a firm within that third country apply to the relevant European authority to be individually recognised to benefit from that equivalence. |

The relevant implementing or delegating act which confers equivalence upon a third country can be granted either fully or partially, with a time limit and apply to a country's entire framework or some of its authorities only (such as in the case of EU recognition of US CCPs under EMIR[3]).

Once a third country framework has been recognised as equivalent under the relevant implementing or delegating act, only then can a firm within that third country apply to the relevant ESA to be individually recognised to benefit from that equivalence. The timing for this assessment will depend upon the procedure set out in the relevant legislation which enabled equivalence initially (such as EMIR).

**The wider European context**

How important is equivalence for UK access to the EU? Some commentary since the referendum vote has focused on a number of regulatory concepts already available to UK financial services firms, which (it is argued) demonstrate that equivalence is not as crucial to Brexit negotiations as would first appear. This argument has also been deployed in favour of 'downplaying' the importance of passporting rights for UK financial services into the EU and vice versa, once the UK formally leaves the EU.

To analyse the importance of equivalence and the significance of any loss of passporting rights in a 'hard Brexit[4]' scenario, it is first important to understand the wider European context of determining where financial services activities take place.

Essentially: how many financial services activities are actually taking place on a 'cross-border' basis and therefore need authorisation in an EU Member State? If providing a service into a Member State does not require authorisation there, then equivalence (and passporting) are unnecessary.

[3] See footnote 7 in Annex A of Commission equivalence decisions

[4] Although there is no formal definition of what is meant by a 'hard Brexit', most commentators agree that it is shorthand for the UK giving up its tariff-free membership to the European single market and reverting to WTO rules on tariffs in the absence of a specific trade deal between the UK and EU (see https://www.bloomberg.com/news/articles/2016-10-17/what-makes-a-hard-brexit-harder-than-a-soft-one-quicktake-q-a)

*'Characteristic performance'*

Where does a financial services activity take place? If a UK financial services firm can conclude with certainty that a particular service it offers is not 'carried on' in the EU, even if it has European customers, then the concept of equivalence becomes redundant.

In assessing where an activity is carried on, the UK has traditionally tended to favour the so-called 'characteristic performance' test. In order to determine where an activity is carried on, the location of the 'characteristic performance' of the activity (i.e. the essential supply for which payment is due), must be determined.

The Commission produced two helpful papers in 1997 and 2000 examining the location of cross-border services in banking and insurance services[5]. The Commission did not produce an interpretative communication in respect of investment services under MiFID (or its predecessor, the Investment Services Directive), although it is arguable that the principles set out by the Commission in relation to banking services could also apply to investment services[6]. Additionally, in the UK, the SIB (the historic predecessor of the FCA) published draft guidance in 1989[7], which presented an interpretation on characteristic performance in respect of investment services.

These papers, despite being historic, are generally considered to be consistent with the UK's approach to characteristic performance and the scope of cross-border activities.

Broadly speaking, these papers set out a framework for establishing the characteristic performance of various financial services activities as falling into one of the following categories:

(a) deposit-taking activities;

(b) transaction-based activities;

(c) engager-based activities; and

(d) results-based activities.

*Deposit-taking activities*

The Commission's paper on banking services states that 'a bank may have non-resident customers without necessarily pursuing the activities concerned *within the territory* of the Member States where the customers have their domicile' (original emphasis) and it is generally accepted the 'location' of deposit-taking will be where the deposit is, in fact, received (and, by extension, not where the customer is based).

*Transaction-based activities*

According to the draft SIB guidance, activities such as buying or selling investments are 'transaction-based activities' and therefore the relevant question to determine where the activity takes place should be 'is the transaction done in the UK?'. For example, a transaction takes place in the UK if an overseas stockbroker buys from a UK office of a broker. In such circumstances, that overseas stockbroker will need to be authorised (or rely upon an exemption) in the UK, although even this conclusion could be questioned by the advancement of technology since the publication of the draft guidance.

*Engager-based activities*

According to the draft SIB guidance, activities such as managing assets or operating a collective investment scheme denote an activity which is carried on where the person actually is when (s)he is

[5] Commission Interpretative Communication: freedom to provide services and the interest of the general good in the Second Banking Directive (1997) and Commission Interpretative Communication: freedom to provide services and the general good in the insurance sector (2000) (C 43/5)
[6] See FCA Supervision Manual App 3.3.6
[7] Consultative Paper CP 19 Carrying On Investment Business in the United Kingdom, Draft Guidance Release (March 1989)

carrying it on. In other words, to determine the location of where assets are managed from, the characteristic performance test would look at where the manager is physically located. This could mean that, in theory, a UK asset manager managing the assets of non-UK customers would not be carrying on cross-border activities, although it is questionable if such analysis survives the introduction of the territorial scope provisions of European Directives such as MiFID and AIFMD.

*Result-based activities*

Again, according to the draft SIB guidance, the regulated activity of advising on investments denotes an activity which has a 'result' or 'effect' upon another person. Therefore, the view espoused in the draft guidance is that the location of advice will be the location of the customer receiving such advice (although the guidance also states that this will be the location of where the advice is 'given to', which does not preclude the advice being 'given from' another location e.g. a UK firm advising a French customer will arguably be carrying on a regulated activity in both the UK and France).

*Lending*

Although not explicitly set out in the draft SIB guidance or in the Commission papers, the approach taken in legislation, both at European and domestic levels (e.g. in UK consumer credit legislation), is that the characteristic performance of regulated lending activities will be the location of the borrower.

*Limitations of the characteristic performance analysis*

On one view, the characteristic performance test is a useful tool for determining whether a non-UK firm is, in fact, carrying on any regulated activity into the UK. For example, a bank located in Australia dealing with UK customers could argue that, under the characteristic performance analysis, accepting deposits from UK customers should not, in theory, result in that Australian bank doing business in the UK. Indeed, many non-UK firms do rely on such analysis to consider whether regulated activities are taking place in the UK.

Perhaps as a result of this acceptance of the characteristic performance analysis, some commentators have suggested that the concept of passporting is not as important as the UK financial services industry suggests, as a significant number of regulated activities would not ever 'cross the border' if they were provided from the UK (for example, if the activity in question is an 'engager-based activity').

However, there are a number of counter-factuals to challenge an over-reliance on the characteristic performance test.

First, there are limitations to reliance on the Commission interpretative communications. At best, the Commission's views only have the status of guidance and are not binding on the national courts of each Member State (although they may take account of those views when interpreting EU and secondary legislation), as it is ultimately the responsibility of the ECJ to interpret European legislation.

Further, as the FCA notes, '*European Commission communications do not necessarily represent the views taken by all EEA States*[8]'. As a result, there is an inherent limit to the type of financial services firms who can rely upon the characteristic performance test to any degree of benefit. Evidently, it may be useful for a third country firm assessing whether it needs to be authorised in the UK (subject to the non-binding status of the Commission papers). However, it will be of limited value to UK financial services firms attempting to ascertain whether they need authorisation in a Member State in a post-Brexit world, as the Member State in which they want to provide services may not fully subscribe to the view set out in the Commission communications. For example, regulatory authorities in some jurisdictions consider 'reverse solicitation' (discussed further below) to be more relevant than characteristic performance.

Secondly, in respect of investment services and activities, the draft SIB guidance represents a UK-specific view first advocated in 1989 (and again, not necessarily one which is accepted by other Member States) and was never formalised into rules or guidance by the SIB, the FSA or the FCA.

[8] FCA Supervision Manual App 3.3.8

Reliance on the draft SIB guidance in respect of investment activities must also be considered in light of the 'overseas persons exclusion' (discussed further below). If the draft SIB guidance were fully reflective of the UK's position on the location of services, it could be argued that certain elements of the overseas persons exclusion would not be required and that the exclusion itself does not refer to the distinction of engager, transaction or results-based activities (which should be relevant to determining if an overseas person is providing services into the UK).

Further, the draft SIB guidance was intended to provide guidance on the territorial scope of third country firms carrying on business in the UK only. Taken with the other challenges set out above, from a practical perspective, there will therefore be a limit to the certainty with which UK firms looking to provide services into other Member States can rely on the draft SIB guidance.

Thirdly, from a UK perspective, the characteristic performance analysis needs to be considered in conjunction with the provisions of section 418 FSMA, which sets out a number of scenarios whereby a person who would otherwise be carrying on business outside the UK, is considered to be brought 'onshore' and thus requires authorisation under FSMA. Although not inconsistent with the characteristic performance test, it suggests that UK policy objective is to capture certain 'offshore' activities even where a characteristic performance analysis would determine that no UK regulated activities were being carried out.

Finally, from a pan-European perspective, the existence of the passport and certain elements of European legislation, such as the marketing restrictions under AIFMD, suggest that the characteristic performance analysis is not as relevant to the European financial services industry as some would like to suggest. In particular, it is unlikely that a firm, even where it argued that characteristic performance meant that there was no cross-border service taking place, would still be able to directly solicit a customer in Europe for that service without triggering certain regulatory requirements.

Overall, it would appear that the lack of a harmonised approach to the viability of characteristic performance in any contemporary, European-wide guidance or communication has resulted in placing limitations on the characteristic performance test, which would not change in a post-Brexit world.

*<u>'Reverse solicitation'</u>*

A different way of considering the location of financial services, and one adopted by certain Member States, is the concept of 'reverse solicitation'.

Essentially, the concept of reverse solicitation permits a financial services firm to provide cross-border services into a particular Member State where that firm has not actively marketed and clients initiate contact with the firm.

This approach to determining the location of services is also reflected in the UK's 'overseas persons exclusion' by reference to a 'legitimate approach' and is also considered in MiFID II, which permits a third country firm to provide investment services and activities to clients on the exclusive initiative of that client, without requiring authorisation or registration in the EU[9].

The concept of reverse solicitation is also utilised to determine whether marketing of an AIF has taken place under AIFMD. Reverse solicitation, in this context, enables an AIFM to determine if marketing has taken place and, if not, to enable the AIFM to remain out of scope for AIFMD requirements. In particular, an AIFM will not be considered to be marketing if it offers units or shares in an AIF as a result of the 'initiative' of the investor.

*Limitations of the reverse solicitation analysis*

As mentioned above, one limitation on reliance on the reverse solicitation test, is that not all Member States adopt it as the relevant test for determining whether cross-border services have occurred.

[9] Article 42 MiFID II

For example, in AIFMD, there is little consistency in Member States' interpretation of what it means for an investor to 'initiate' the offering of units or shares in an AIF.

Furthermore, a recognition of reverse solicitation in MiFID II does not imply that an overly robust approach to marketing on a cross-border basis will be looked upon favourably by the regulatory authorities in other Member States for investment services more generally; for example, it is unlikely that a UK financial services firm relying upon the reverse solicitation exemption to provide services into another Member State could carry on 'profile raising' marketing and seek to claim that prospective clients had not been solicited.

Additionally, it seems likely that a UK financial services firm seeking to rely upon reverse solicitation in MiFID II could, in reality, be impeded from establishing anything more than an initial relationship with a client that had initiated contact with that firm. Once such a relationship was established, that firm could not subsequently provide that client with other services (unless those additional services had also been expressly sought at the initiative of the client).

*UK's overseas persons exclusion*

Also relevant to financial services firms seeking access to the UK will be the UK's 'overseas persons exclusion'[10]. This exclusion determines that a financial services firm will not require authorisation in the UK for certain types of activities (such as dealing in investments or arranging deals in investments), if it is an overseas person.

Broadly speaking, a financial services firm will be an 'overseas person' if it does not have a permanent place of business in the UK. An overseas person can then carry on the excluded activity where it has resulted from a 'legitimate approach' i.e. the approach has not been solicited by the overseas person (and has been initiated by the client). Similar to the reverse solicitation exemption, it effectively enables a financial services firm which has concluded (perhaps by using the characteristic performance test) that it *is* providing services into the UK, to avoid authorisation if it has no presence in the UK and does not actively solicit UK clients.

*Limitations of the overseas person exclusion*

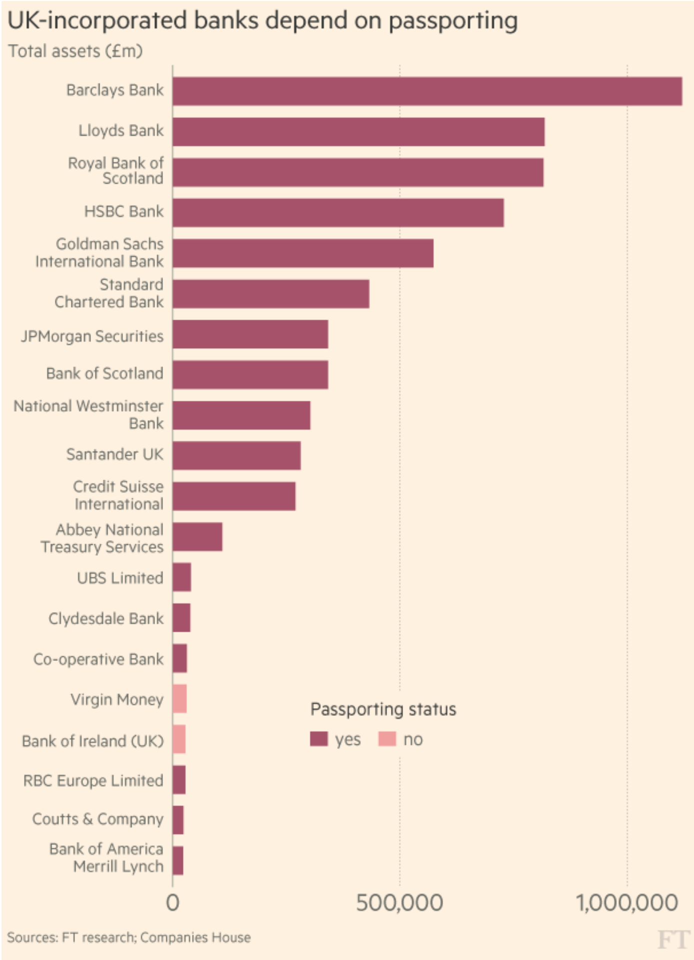
One obvious limitation of the overseas persons exclusion is that it is a UK-specific exclusion and so only benefits non-UK firms seeking access into the UK. For a UK firm to have equivalent benefit from this concept in a post-Brexit world, there would need to be a similar concept enshrined in the local laws of each Member State.

Furthermore, under the UK's overseas persons exclusion, a financial services firm could only benefit from the exclusion if it had no other permanent establishment in the UK. This can prevent firms with branches or, potentially, subsidiaries in the UK from benefiting from the exclusion, if that branch or subsidiary offers similar services to that of the overseas person.

*The European passport*

The limitations on alternative legal concepts to providing cross-border services and the simplicity in approach of the European passport have contributed to its success. Recent data published by the FCA showed that nearly 5500 UK registered companies used passporting to access the EU market, while 8000 companies registered elsewhere in the EU used it to access the UK[11]. Data published by the Financial Times in September 2016 indicated the dependency of UK incorporated banks on the European passport[12]:

[10] The overseas persons exclusion is set out in Article 72, RAO
[11] *Banks fear chill wind of EU 'passport' free*, Financial Times, 21 September 2016
[12] ibid.




The single market 'passport' enables a financial services firm authorised in its 'Home' Member State to exercise its right under a relevant single market Directive to provide services in another Member State, without the need for separate authorisation in the second Member State (known as the 'Host' Member State). These activities can either be provided by establishing a branch in the Host Member State (known as the 'right of establishment') or, alternatively, on a cross-border basis from the Home Member State (known as the services passport).

A financial services firm can passport under one of the following Single Market Directives:

- AIFMD
- CRD IV
- Insurance Mediation Directive
- MiFID
- Mortgage Credit Directive
- Solvency II
- UCITS IV

*From the European passport to European equivalence*

Simon Kirby MP, Economic Secretary to the Treasury, warned of an over-reliance on passporting figures, stating that '*You can look at the numbers of passports…but some of those passports are redundant or unused and the numbers do not demonstrate any kind of volume…Actually getting to a* *position where we* [the Treasury] *can realistically assess the impact* [of losing the passport] *is not quite as straightforward as you might first think…*[13]'.

However, a speech by Anthony Browne, Chief Executive of the British Bankers Association, in October 2016 indicated that some in the banking industry view the passport as being vital:

*'We need to retain the free trade in financial services. The only way to ensure that is for banks based in the UK to retain full access to the single market in financial services…and for European banks to retain full access to the UK's global financial centre, and customers. In other words, we need to retain some version of passporting…*[14]'

In light of these differing views, is it possible that the importance of passporting in a post-Brexit world has been overstated? It is probable that some passports are applied for even where that passport is not required; either because the activities undertaken are not, in fact, cross-border activities or, alternatively, because the firm may initially intend to use the passport or applies for it for convenience or legal certainty.

However, a lack of legal certainty in relying on characteristic performance or reverse solicitation as alternatives to the passport would suggest that losing the use of the European passport will not simply be a case of 're-educating' financial services firms on where cross-border activities are taking place. The argument that some firms apply for a passport for convenience purposes only would suggest that such firms should be unconcerned with its loss post-Brexit; this would not appear to be the case given industry uncertainty since the referendum vote, including a recent statement by Robert Rooney, head of Morgan Stanley's business in Europe that:

"*…(A)lthough there's a lot of noise and emotion around this topic [Brexit], it really isn't terribly complicated. If we are outside the EU and we do not have what would be a stable and long-term assured commitment that we would have access to the single market then we will have to do a lot of things that we do today from London somewhere inside the EU 27 [members]."*[15].

On balance, a 'hard' Brexit scenario, where that results in a loss of the European passport for UK financial services firms (and the UK passport for European financial services firms), would potentially significantly impact on the health of UK financial services. In its starkest form (i.e. one where the UK had no negotiated access to the EU and where the UK's relationship with the EU is determined by WTO obligations), a report on the impact of the UK's exit from the EU by Oliver Wyman estimated that Brexit could cost the UK approximately £18-20bn in revenue and put an estimated 31-35,000 jobs at risk, along with approximately £3-5bn of tax revenues per annum[16].

Even where equivalence can be achieved by the UK, it can only be achieved in certain areas of financial services. For example, there are no equivalence provisions available for deposit-taking and lending activities, which are key for the major European banks. In September 2016, Anthony Browne provided the following example to the House of Lords to demonstrate the effect of a loss of passporting:

"*If a German company was trying to raise €500 million for an investment to build a factory, it might do so by raising a bond with, in addition, a syndicated loan, and then hedge that in respect of foreign exchange payments, currency risk and interest rate risk. Those are three different products…If passporting rights were lost, the company would not be able to come to London for bonds, for a syndicated debt or for hedging foreign exchange or interest rate risk. If we got equivalence… it might be able to come for the bond and to get some hedging, under EMIR, but it would not be able to get the syndicated debt, because there is no provision for lending under any of the existing regulations. So*

[13] Simon Kirby MP, Economic Secretary to the Treasury, *Uncorrected oral evidence: Brexit and Financial Services in the UK*, Select Committee on the European Union, Financial Affairs Sub-Committee, 19 October 2016
[14] Anthony Browne, BBA International Banking Conference, 20 October 2016 (https://www.bba.org.uk/wp-content/uploads/2016/10/20161018-international-banking-conference-speech.pdf)
[15] WSJ City, *Morgan Stanley boss: Jobs will be moved in the case of hard Brexit*, 11 October 2016 (https://city.wsj.com/stories/648c09a9-47d0-4740-9d8a-beb5ac3763a6.html)
[16] *The impact of the UK's exit from the EU on the UK-based financial services sector*, Oliver Wyman, 2016

*banks based in London would only be able to provide a narrower range of services. They would not be able to be the sort of onestop shop that they are at the moment*[17]".

**Achieving equivalence for the UK**

Is equivalence a 'panacea' to the loss of passporting rights? Will the UK easily be able to achieve equivalence on the basis that it is currently an EU Member State? What form will equivalence take for the UK in a post-Brexit world?

These are some of the questions that have been asked following the UK's referendum result. Some commentary has presented equivalence for the UK as a 'default' option for UK financial services after Brexit. As mentioned above, not all European legislation contains equivalence provisions, meaning that the UK will be required to put together a 'patchwork' of available equivalence provisions from various Directives and Regulations. The EU's equivalence regime is relatively new when compared to other jurisdictions such as the US, with some aspects of it (such as the withdrawal process) untested and so the UK is likely to present some unique challenges if it requests an equivalence determination from the EU.

First, the UK will be the first Member State to leave the Union[18] and thus its starting point for achieving regulatory equivalence will be unique. Unlike other third countries, such as the US or Japan, the UK will have, until it formally leaves the EU, implemented all EU legislation into its own regulatory framework. In light of this, surely the UK is already 'equivalent'? Arguably, this should mean that the EU's equivalence determination for the UK in every area of financial services legislation should be relatively painless; the UK currently has identical rules to the rest of the EU.

However, a recent FT article noted that '*One senior EU official said equivalence "is not automatic and is not a right" and was bound to be reconsidered in light of Brexit. Another official noted that…patchy criteria needed to be clarified*'[19]. The UK will face some practical difficulties; for example, it can only formally apply for an equivalence determination from the EU once it 'converts' to a third country i.e. when it formally leaves the EU. Even if UK/EU negotiations include specific provisions on equivalence, from a legal standpoint, the Commission may suspend beginning its formal assessment of equivalence until the UK has left the EU.

Once the determination process has begun, there is little guidance on timeframes for the Commission to reach a decision on assessing equivalence. The inevitable risk of politicisation of equivalence determinations, particularly in the hothouse of the forthcoming Brexit negotiations, means that there is uncertainty on how long a Commission equivalence assessment would take.

Secondly, the concept of equivalence will not be available to all sectors of the financial services industry. For example, the payments sector, mortgage and credit industries have no equivalence provisions in the relevant European legislation. For these sectors of the financial services industry, regulatory equivalence under the current European regime will not provide any solutions.

Thirdly, even under the relevant Directives or Regulations which do offer equivalence provisions, a third country financial services firm does not necessarily have identical 'access' rights into the EU and, in some cases, those access rights may be inadequate for a firm's business model. For example, under MiFID II and MIFIR, an investment firm from an equivalent third country regime will be able to provide investment services into the EU, but will not be able to do so in respect of retail investors. Similarly, the equivalence provisions under CRD IV relate to the recognition of third country prudential exposures, rather than permitting cross-border lending or deposit-taking into the EU.

In light of these issues, the remainder of this paper will consider the Commission's approach to equivalence decisions to date, looking in detail at the equivalence process for banking, investment and clearing services. Having considered the European approach to equivalence, we consider whether

[17] Anthony Browne, Select Committee on the European Union Financial Affairs Sub-Committee, Brexit: financial services (British Bankers' Association, PricewaterhouseCoopers (PwC) and Reuters – Oral evidence (QQ10-17)), (7 September 2016)
[18] Although Greenland voted to leave the EEC in 1985, the UK will the first country to leave the European Union
[19] https://www.ft.com/content/838d084c-a19d-11e6-86d5-4e36b35c3550

approaches taken by other countries could demonstrate some ‘lessons learnt’ which could deal with some of the challenges presented by the European approach.

## Section 4: Examining the evidence: EU Commission decisions on equivalence in financial services

| Area | Legislation | What does equivalence result in? |
|---|---|---|
| **Banking** | CRR | No access rights<br>EU institutions can treat exposures to third country firms as exposures to EU institutions |
| **Clearing Services and Trade Repositories** | EMIR | Access to EU entities |
| **Investment Services** | MiFID II and MIFIR | Access to EU eligible counterparties and per se professional clients (not retail or opted up professional clients) |
| **Benchmarks** | Benchmark Regulation | Ability for EU entities to use third country benchmarks |

**Banking**

*Where are the equivalence provisions?*

The equivalence provisions for banking, specifically around capital rules, are found in the CRR.

*What does the equivalence assessment mean?*

Although there are no equivalence provisions for lending activities for third country banks into the EU, the CRR does provide equivalence provisions for 'EU institutions' (EU credit institutions and EU investment firms) to treat exposures to third country investment firms, credit institutions and exchanges on the same basis as exposures to EU institutions. For EU institutions to benefit from this, the relevant third country must apply prudential and supervisory requirements to the entity concerned which are at least equivalent to those applied in the EU[20].

*How will the Commission determine if a third country is equivalent?*

Although the CRR does not provide further detail on how the Commission should determine if a third country is equivalent, the EBA's guidance to third countries in its regular review of equivalence provides a helpful look at how the EBA will provide its technical advice to the Commission in respect of determining equivalence (the full questionnaire is contained at Annex B). In particular, it states that '*the assessment should be mostly qualitative and outcome-based and thus it should consider the major features of the relevant supervisory and regulatory framework…the equivalence…implies sharing the same objectives as the Union's framework (i.e. ensuring appropriate regulation and supervision, and ultimately financial stability)*[21].

**Clearing Services and Trade Repositories**

*Where are the equivalence provisions?*

[20] Article 107(3) CRR
[21] Questionnaire on the Assessment of the Equivalence with European regulatory and supervisory framework: Guidance to respondents, European Banking Authority

The equivalence provisions for clearing services are found in EMIR.

*What does the equivalence assessment mean?*

A CCP established outside the EU may provide clearing services to EU clearing members where it has been recognised by ESMA.

Once recognised, the CCP is required only to comply with the rules of its home jurisdiction. EU authorities do not apply any direct oversight over third country CCPs.

EMIR also provides that a TR established in a third country that intends to provide services and activities to entities established in the EU must be recognised by ESMA.

Once recognised, the TR is required only to comply with the rules of its home jurisdiction. EU authorities do not apply any direct oversight over third country TRs.

*How will the Commission determine if a third country is equivalent?*

In order for a CCP to be recognised by ESMA, the legal and supervisory regime in the third country must comply with legally binding requirements that are equivalent to the one laid down in EMIR. In addition, CCPs should be subject to effective ongoing supervision and enforcement in the third country and its legal framework should provide for an effective equivalent system for the recognition of CCPs authorised under third country legal regimes.

The main conditions to the recognition of third country CCPs by ESMA are:

- the Commission has adopted a positive equivalence decision with regard to the regulatory framework applicable to CCPs in the third country;
- the CCP is authorised and subject to effective supervision and enforcement in its home country;
- the CCP is established or authorised in a third country that is considered as having equivalent systems for anti-money laundering and combating the financing of terrorism to those of the EU in accordance with the criteria set out in the common understanding between Member States on third country equivalence under the Third Anti-Money Laundering Directive; and
- cooperation arrangements have been established between ESMA and the relevant third country supervisory authorities covering supervisory arrangements and the sharing/notification of information.

In order for a TR to be recognised by ESMA, the Commission must determine that:

- the legal and supervisory regime in the third country in which the TR is established comply with legally binding requirements that are equivalent to the one laid down in EMIR;
- those TRs are subject to effective ongoing supervision and enforcement in the third country; and
- guarantees of professional secrecy exist that are at least equivalent to those of EMIR.

In addition, EMIR requires that the Commission execute agreements with third country regulators ensuring access to data in the recognised TR. ESMA must establish agreements with the relevant third country authorities regarding exchange of information and coordinated supervision.

*Demonstrating equivalence under EMIR: the US*

In providing its technical advice to the Commission, ESMA reiterated that it would follow '*an objective-based approach, where the capability of the regime in the third country to meet the objectives of the EU Regulation is assessed from a holistic perspective*[22]'. However, ESMA's holistic perspective involved a line-by-line analysis of the differences and similarities between the requirements of the third country and those set out in EMIR. Having carried out this line-by-line assessment, ESMA drew its conclusions regarding equivalence on a holistic basis *'taking into account the fundamental objectives that an equivalence assessment under EMIR should look at (i.e. the promotion of financial stability, the protection of EU entities and investors and the prevention of regulatory arbitrage in respect of CCPs)*[23]'.

When ESMA produced its technical advice and considered equivalence between the US and the EU in respect of legally binding requirements which applied to CCPs in the US, it noted that there were some gaps in the requirements and therefore advised the Commission that CCPs looking to be recognised in the EU should effectively 'top up' their internal policies, procedures, rules and methodologies to address those gaps.

It is worth noting that, when the Commission published its implementing act establishing equivalence for the US in respect of EMIR, this recommendation from ESMA regarding 'top up policies' for US CCPs seeking recognition in the EU was dropped; perhaps reflecting the political challenges of seeking to impose additional requirements on US firms.

Arguably, disparity between the ESMA technical advice and the Commission's subsequent implementing act suggest that the Commission was pressured into applying a different tolerance for deviation in its equivalence assessment to that of ESMA when faced with the political realities of attempting to impose the EU's legally binding requirements in their entirety on a powerful jurisdiction such as the US. The lack of concrete guidance within EMIR or by the Commission in respect of its equivalence provisions led to ESMA adopting a relatively strict definition of equivalence; involving a line-by-line comparison of both jurisdictions' requirements and a low tolerance for deviations.

However, this low tolerance was ultimately deemed to be unpalatable for the purposes of the Commission's implementing act; speculating on the reason, one could conclude that ESMA was using an approach to equivalence which was at odds with either the Commission or the US authorities. As Jonathan Hill, former European Commission for Financial Stability, Financial Services and Capital Markets Union commented,'…*Competitive pressures and political reality influence how people think about the equivalence process*…'[24] and, reflecting these pressures and this reality, negotiations for US equivalence under EMIR for CCPs took around three years to finalise.

**Investment Services: MiFID II/MIFIR**

Both MiFID II and MiFIR apply in the EU from 3 January 2018. Given the potential timing of the UK's exit from the EU in March 2019, it is possible that the UK will be among the first wave of third country firms to apply for equivalence under MiFID II in order to enable UK investment firms to provide services.

MiFID II notes that third country investment firms established in the EU do not '*enjoy the freedom to provide services and the right of establishment in Member States other than the one where they are established*'[25]. However, it recognises that it will be for each Member State to determine if an individual third country investment firm can provide services in that country based on whether '*the appropriate level of protection for its retail clients or retail clients who have requested to be treated as professional clients can be achieved*[26]' by establishing a branch in that Member State.

MiFID II, therefore, acknowledges that an individual Member State may conduct a quasi-'equivalence' assessment by determining whether a third country investment firm can deliver comparable investor

[22] Final report: Technical advice on third country regulatory equivalence under EMIR – US, ESMA/2013/1157 (1 September 2013)
[23] *Ibid.*
[24] http://www.telegraph.co.uk/business/2016/06/15/eu-referendum-eurozone-will-make-city-pay-dearly-for-brexit-warn/
[25] Recital 109, MiFID II
[26] *Ibid.*

protection, but does not set out an EU-wide equivalence regime itself. This is set out in MiFID II's corresponding Regulation, MiFIR.

MiFIR sets out an equivalence framework with regard to the authorisation and supervision of investment firms[27].

*What will the equivalence assessment mean?*

If the Commission determines that a third country is equivalent under MiFIR, firms in that third country providing investment services will be able to provide certain services to eligible counterparties and per se professional clients (but not retail clients or opted up professional clients) without requiring those firms to establish a branch in the EU.

Once the Commission has determined that a third country's legal and supervisory framework is equivalent to the EU, investment firms in that third country can submit an application to ESMA to be included on a register of investment firms providing services in the EU. ESMA will consider a complete application within 180 working days and provide a fully reasoned explanation of whether the registration has been granted or refused and maintain a public register of third country firms.

Once a third country investment firm is included on ESMA's register, individual Member States will not be able to impose any additional requirements or, conversely, treat them more favourably than EU investment firms.

ESMA also has the power to withdraw the registration of a third country firm within 30 days if it has '*well founded reasons based on documented evidence*' that the firm is acting in a manner which is clearly prejudicial to investors, the orderly functioning of the markets or breached the rules in its own country.

In addition, under Article 54 of MiFIR, third country firms can continue to provide services in a Member State, where that Member State has previously recognised that firm, for three years after the adoption of an equivalence decision by the Commission.

*How will the Commission determine if a third country is equivalent?*

The Commission will determine that a third country is equivalent under MiFIR if[28]:

- its legal and supervisory framework ensures that its authorised firms comply with legally binding prudential and conduct of business requirements that have equivalent effect to MiFIR and MiFID II; and

- its legal framework provides for 'an effective equivalent system for the recognition of investment firms authorised under third country legal regimes'.

The prudential and conduct of business framework of a third country may be considered to have equivalent effect where the following conditions are fulfilled:

- firms providing investment services or performing investment activities in that third country are subject to authorisation and to effective supervision and enforcement on an ongoing basis;

- firms providing investment services or performing investment activities in that third country are subject to sufficient capital requirements and appropriate requirements applicable to shareholders and members of management bodies;

- firms providing investment services or performing investment activities are subject to appropriate conduct of business rules; and

[27] Articles 46-49, MiFIR
[28] Article 47 MiFIR

- it ensures market transparency and integrity by preventing market abuse in the form of insider dealing and market manipulation.

*A new approach by the Commission to equivalence?*

The recitals to MiFIR explain the background, the aims and objectives of MiFIR and are a useful 'gloss' on the meaning of the operative provisions in the legislation. Here, there is specific reference to the Commission's approach to equivalence that could suggest a new approach to the equivalence assessment.

Recital 41 of MiFIR makes clear that the differentiation in the regulatory frameworks of third countries means that it is *'appropriate to introduce a common regulatory framework at Union level*', ensuring that an assessment of *'effective equivalence*' has been carried out by the Commission in relation to the prudential and business conduct framework of a third country and providing for a '*comparable level of protection to clients in the Union receiving services by third-country firms*'.

In particular, an equivalence decision under MiFIR should have regard to the IOSCO Objectives and Principles of Securities Regulation and its recommendations and that '*[T]he equivalence assessment should be outcome-based; it should assess to what extent the respective third-country regulatory and supervisory framework achieves similar and adequate regulatory effects and to what extent it meets the same objectives as Union law*'.

It states that the Commission should be able to prioritise those third countries according to:

- the materiality of the equivalence finding to EU firms and clients;

- the existence of supervisory and cooperation agreements between the third country and Member States;

- the existence of an effective equivalent system for the recognition of investment firms authorised under foreign regimes; and

- the interest and willingness of the third country to engage in the equivalence assessment process.

In addition, the Commission should monitor any significant changes in the third country's supervisory framework and *'review the equivalence decision where appropriate*'.

**Benchmarks: Benchmark Regulation**

Most of the provisions of the Benchmark Regulation will apply from 1 January 2018. It envisages three parallel regimes relating to the use of benchmarks provided by an administrator located in a third country:

- equivalence;
- recognition; and
- endorsement.

The three parallel regimes are introduced to avoid an adverse impact from the market abruptly ceasing to use an existing third country benchmark until equivalence is granted. The Benchmark Regulation therefore introduces a range of interim measures to help ensure the smooth running of the market in contemplation of a formal equivalence assessment.

*What will the equivalence assessment mean?*

In order for a benchmark or a combination of benchmarks provided by an administrator located in a third country to be used in the EU, the third country benchmark administrator must be registered under the Benchmark Regulation following an equivalence assessment.

Prior to an equivalence decision being taken, third country benchmarks may be used in the EU provided that the administrator obtains prior recognition.

Under the 'recognition' regime, recognition is granted at national level by the Member State's competent authority. In order to gain recognition, the benchmark administrator (among other things) must comply with some of the material requirements of the Benchmark Regulation.

The Benchmark Regulation also introduces an 'endorsement' regime, allowing EU benchmark administrators and other firms to endorse benchmarks provided from a third country.

*How will the Commission determine if a third country is equivalent?*

Regulation 30 sets out the relevant equivalence provisions and states that the Commission may adopt an implementing decision for an equivalent third country if:

- administrators authorised or registered in that third country comply with binding requirements which are equivalent to the requirements in the Benchmark Regulation, in particular taking account of whether its legal framework and supervisory practice ensures compliance with the IOSCO principles for financial benchmarks; and
- there is effective supervision and enforcement on an ongoing basis in that third country.

In addition, ESMA is required to establish cooperation arrangements with the third country regulator which should specify at least:

- the mechanism for the exchange of information between ESMA and the third country regulator, including access to all relevant information regarding the benchmark administrator;
- the mechanism for prompt notification to ESMA where the third country regulator deems that the benchmark administrator is in breach of its conditions of authorisation or other legislation; and
- the procedures for coordinating supervisory activities, including on-site inspections.

*The recognition regime: before equivalence is determined, how will a Member State determine if a third country benchmark administrator should be recognised?*

Recital 45 of the Benchmark Regulation notes that recognition should be granted to administrators complying with the requirements of the Benchmark Regulation and, in order to facilitate this assessment and *'acknowledging the role of the IOSCO principles as a global standard for the provision of benchmarks, the competent authority of the Member State…should be able to grant recognition to administrators on the basis of them applying the IOSCO principles'.*

The Member State should assess the application of the IOSCO principles to the specific administrator and determine whether that application is 'equivalent' to compliance with the various requirements of the Benchmark Regulation, within 90 working days of an application being submitted by that administrator.

It is worth noting that the recitals to the Benchmark Regulation state that there will be a differentiation in the assessment of 'equivalence' between the equivalence regime under Article 30 and the recognition regime under Article 32. Under the recognition regime, 'equivalence' can be determined by reliance on an assessment by an independent external auditor or a certification provided by a third country regulator.

In order to obtain prior recognition and, as part of its application, the third country benchmark administrator must also ensure that it has a legal representative in the relevant Member State, which will '*perform the oversight function relating to the provision of benchmarks….and…shall be accountable to the competent authority of the Member State…*[29]'.

[29] Article 32(3) Benchmark Regulation

*The endorsement regime: before equivalence is determined, how will a Member State determine if a third country benchmark should be endorsed?*

A Member State should take into account whether, in allowing a third country benchmark to be endorsed, compliance with the IOSCO principles would be equivalent to compliance with the Benchmark Regulation (again, with the recitals to the Regulation noting that '*the specificities of the regime of endorsement'* set out in Article 33 will be different to the equivalence regime). Similar to the recognition regime, the Member State will have 90 working days of receipt of an application from an EU administrator to decide whether to authorise the endorsement of the benchmark.

An EU administrator applying for the endorsement of a third country benchmark will have to demonstrate that:

- it has verified and can demonstrate on an ongoing basis that the provision of the benchmark fulfils requirements which are at least as stringent as the requirements of the Benchmark Regulation (again, by taking into account whether the provision of the benchmark complies with IOSCO principles);
- it has the necessary expertise to effectively monitor the activity of the provision of the benchmark in a third country and to manage the associated risks; and
- there is an objective reason to provide the benchmark in a third country and for it to be endorsed in the EU.

If a third country benchmark is endorsed by a Member State, the EU administrator which has endorsed it will be fully responsible for that benchmark.

**A developing European approach?**

A brief summary of recent Commission decisions and the equivalence assessment process set out in this paper indicates that the European approach to equivalence continues to develop over time.

Whilst the equivalence provisions in CRR and EMIR use relatively high level language, the recitals in MiFIR show that more guidance has been provided to the Commission on how to assess equivalence, including a reference to the IOSCO standards and providing for a regular review of equivalence decisions. As noted, MiFIR acknowledges that the equivalence assessment should be '*outcome based*' and consider whether a third country has '*similar and adequate regulatory effects*'.

One could speculate that this development of the European approach to equivalence in recent years, (which more strongly emphasises an outcomes-based equivalence assessment and using international standards as performance benchmarks) is an attempt to avoid a repeat of the politicisation of Commission equivalence assessments, most notably seen in EMIR.

Furthermore, the Benchmark Regulation also introduces two practical regimes for third country firms to deal with the risk that a Commission equivalence decision can take a number of months, or even years; the recognition and endorsement regimes in the Benchmark Regulation offer a quicker route to utilising third country benchmarks (imposing a timeframe of 90 working days to assess an application), enabling Member States to rely upon the application of IOSCO principles and (through a legal representative in the recognition regime and the applicant EU administrator in the endorsement regime) direct accountability to the relevant Member State.

Sections 5 and 6 of this paper consider alternative approaches to equivalence outside Europe and, in Section 6, present a broader concept of equivalence which could assist in the forthcoming negotiations between the UK and EU, and beyond.

## Section 5: Examining the evidence: the international context

**An international approach to equivalence**

This section examines at a high level some other approaches to equivalence in an international context. In particular, we consider the approaches of the CFTC in the US, Singapore and Australia, as well as assessments of equivalence undertaken by international bodies such as IOSCO and the FSB.

*<u>How do other jurisdictions consider equivalence?</u>*

*United States – varying degrees of deference*

In the United States, the CFTC utilises a number of different approaches in its recognition of equivalence (referred to as 'deference').

In respect of intermediaries, the CFTC has provided an exemption under Part 30 of its regulations, enabling foreign brokers to directly solicit US investors without being registered by the CFTC, where those brokers are from a jurisdiction which is determined to have a 'comparable regulatory scheme' to the CFTC's regulatory framework.

At a minimum, the CFTC will consider a jurisdiction to have a comparable regulatory scheme where there are the following features[30], together with an information sharing agreement between the CFTC and that country's regulator:

- Registration, authorisation or other forms of licensing, fitness review or qualification of persons soliciting and accepting customer orders;
- Minimum financial requirements for persons accepting customer funds;
- Protection of customer funds from misapplication;
- Recordkeeping and reporting requirements;
- Minimum sales practice standards, including disclosure of the risks of futures and options transactions and, in particular, the risk of transactions undertaken outside the jurisdiction of domestic law; and
- Supervision, monitoring and enforcement by a regulatory authority for compliance.

The UK has had a longstanding Part 30 exemption for its brokers since 1989, issued to the SIB. This Part 30 exemption has been extended to continue to enable UK brokers to provide brokerage services to US investors on non-US exchanges.

In respect of clearing house organisations, a non-US clearing house looking to clear swaps for a US person will need to seek an exemption from the CFTC as a DCO. Here, the CFTC recognises a form of equivalence for those third countries which have adopted a set of international standards (effectively, without having to perform an assessment of equivalence for that third country, 'equivalence' is inferred from the adoption of common standards between the US and the third country). Having recognised that third country's equivalence, the exempt DCO must consent to the jurisdiction of the US, effectively enabling the CFTC to enforce against the non-US firm. An example of a CFTC Order for an exempt DCO (in this case, in relation to ASX Clear (Futures) Pty Limited) is included at Annex C.

In addition, an MoU is established between the CFTC and third country regulator covering on-site visits to the exempt DCO, event-triggered notifications between regulatory authorities and periodic meetings.

Separately from the concepts of 'comparability' under Part 30 or the adoption of international standards for clearing houses, swaps regulated by the CFTC under the Commodity Exchange Act on

[30] Appendix A to Part 30 – Interpretative Statement With Respect to the Commission's Exemptive Authority Under §30.10 of Its Rules

a cross-border basis into the US are considered under the approach of 'substituted compliance'. In contrast to the European outcomes-based approach to equivalence or the Part 30 'comparable regulatory scheme', the 'substituted compliance' assessment for swaps is considered on a stricter, line-by-line basis.

Finally, in respect of permitting direct access by US persons to non-US exchanges, the CFTC may recognise an exchange as a 'Foreign Board of Trade' under Part 48 of the CFTC Regulations. As part of its recognition, the non-US exchange will need to demonstrate that its regulatory authorities '*provide comprehensive supervision and regulation…that is comparable to the comprehensive supervision and regulation provided by the* [CFTC]*…That is, the regulatory authorities support and enforce regulatory objectives in the oversight of the foreign board of trade…that are substantially equivalent to the regulatory objectives supported and enforced by the* [CFTC]*…*[31]'. Once recognised as a Foreign Board of Trade, the CFTC will defer to the supervision and enforcement of the exchange's home regulator.

As part of its recognition as a Foreign Board of Trade, the CFTC requires a non-US exchange to 'future proof' its recognition by submitting to any new regulations which may be introduced by the CFTC after the date of its recognition (see, for example, paragraph 2 on 'New Regulations' in the CFTC Exemption Order entered into by the London Metal Exchange at Annex C).

The CFTC's approach to equivalence demonstrates a recognition that different areas of financial services can benefit from different supervisory tools once they have been permitted to provide services into the US. For example, in respect of DCOs, the CFTC requires a direct ability to enforce against those firms through its 'consent to jurisdiction' wording while, for foreign exchanges, it is prepared to defer to the exchange's home regulator. This sector-specific approach to equivalence is explored in a European context in Section 6 below.

*Singapore - adequacy*

In Singapore, the Securities and Futures Act sets out common criteria for assessing the 'adequacy' of foreign firms, including trade repositories and clearing facilities.

In order for the Monetary Authority of Singapore (the Singapore regulator) to recognise a foreign firm as being 'adequate', it will consider whether:

- ❖ adequate arrangements exist for cooperation between MAS and the primary financial services regulatory authority responsible for the supervision of that firm; and
- ❖ the firm is, in its home country, subject to requirements and supervision comparable, to an appropriate degree to achieve the MAS' objectives, to the requirements and supervision to which firms are subject under the Securities and Futures Act.

*Australia - recognition*

In Australia, the Australian Securities and Investment Commission set out its principles for cross-border financial regulation to guide ASIC's decision making on unilateral and mutual recognition[32]. The purpose of ASIC's principles are to ensure that it maintains its commitment to protect and promote the interests of Australian investors, the integrity of Australian markets and to manage systemic risks.

ASIC's principles are divided into a set of General Principles and a set of Equivalence Principles.

The General Principles are:

- ❖ ASIC recognises overseas regulatory regimes that are sufficiently equivalent to
- ❖ ASIC gives the fullest possible recognition to sufficiently equivalent

[31] Part 48 CFTC Regulations, §48.7(e)(1)

[32] *Regulatory Guide 54: Principles for cross-border financial regulation* (June 2012), ASIC

the Australian regulatory regime, in relation to the degree of investor protection, market integrity and reduction of systemic risk that they achieve

overseas regulatory regimes.

- ❖ ASIC must have effective cooperation arrangements with the relevant overseas regulatory authorities
- ❖ ASIC must be able to enforce the Australian laws that apply to foreign facilities, services and products
- ❖ Adequate rights and remedies must be practically available to Australian investors who access foreign facilities, services and products in Australia
- ❖ Adequate disclosure must be made of information that Australian investors may reasonably require to make an informed assessment of the consequences of any significant differences between the two regimes

In assessing whether an overseas regulatory regime is equivalent as referred to in the first General Principle, ASIC will consider the following Equivalence Principles:

- ❖ An equivalent regulatory regime is clear, transparent and certain
- ❖ An equivalent regulatory regime is consistent with the IOSCO Objectives and Principles of Securities Regulation
- ❖ An equivalent regulatory regime is adequately enforced in the home jurisdiction
- ❖ An equivalent regulatory regime achieves equivalent outcomes to the Australian regulatory regime

More similar to the European approach to equivalence than the US approach, the Australian principles are a clear set of guiding principles, using international standards as benchmarks as well as an outcomes-based assessment of an overseas regulatory regime. Additionally, the General Principles consider more conduct-focused criteria, such as adequate risk disclosures and direct rights of enforcement for Australian investors.

*Looking towards a globalised approach to equivalence*

*IOSCO*

The ‘patchwork’ nature of the European approach to equivalence assessments and determinations highlights the need for globally harmonised approach to regulatory equivalence. In 2015, IOSCO published its final report[33] on a variety of tools that could be utilised in cross-border regulation and, in particular, considered the need for international standards in equivalence (or ‘recognition’ as it was termed by IOSCO).

The IOSCO report considered international examples of recognition on both a ‘unilateral’ and ‘mutual’ basis. Under unilateral recognition, the cross-border activities of a firm from a recognised foreign jurisdiction is permitted to take place under specific conditions, whereas mutual recognition enables regulators in both jurisdictions to recognise each other in respect of the same cross-border activities. The report noted that some regulators expressed a preference for mutual recognition between countries, as it incentivised and drove an expectation of reciprocity between two countries.

Although not intended to be a model for equivalence on a globalised scale, the IOSCO report sets out a helpful assessment of the steps required to achieve equivalence in the following way:

[33] *IOSCO Task Force on Cross-Border Regulation: Final Report*, FR23/2015, September 2015

***Step 1:*** *Identifying regulatory outcomes*

The domestic regulator should identify a set of regulatory outcomes for the purposes of assessing equivalence. Some common regulatory outcomes identified by regulators were:

- Domestic investor protection;
- Maintenance of local market integrity;
- Reduction of regulatory arbitrage;
- Reduction of systemic risk, crime and misconduct in the domestic financial system; and
- Effective of anti-money laundering and counter-terrorist financing measures implemented in the foreign jurisdiction.

***Step 2:*** *Selecting regulatory outcome measures*

Secondly, the domestic regulator should select relevant regulatory outcome measures. The IOSCO report noted 8 of the most commonly used regulatory outcome measures as:

- General analyses of foreign securities laws, regulations, requirements and standards – determining the clarity and transparency of a foreign regulatory regime;
- Specific analyses on how a foreign regulatory framework considers cross-border activity;
- The level of investor protection;
- The enforcement capability;
- The level of supervisory oversight;
- The legal framework for and implementation of international cooperation;
- Analysis of results from standardised assessment by international organisations (such as FATF, the FSB, IOSCO or IMF) – showing the level of compliance with international principles and standards e.g. the IOSCO Principles and Objectives of Securities Regulation; and
- Membership and status in international organisations, regional communities or groups.

***Step 3:*** *Gathering materials for evaluation*

The domestic regulator should then gather materials for evaluation from, amongst others, the foreign regulator, regulatory and market developments and international organisations.

***Step 4:*** *Evaluation and use of benchmarks*

Finally, the domestic regulator should set benchmarks to determine the extent to which a foreign regulatory framework meets these predetermined regulatory outcomes.

The IOSCO report provides some examples of such benchmarks, noting those that reflect international standards, such as:

- Aspects of domestic regulation that are as strict as internationally-agreed standards, such as the IOSCO Principles and Objectives of Securities Regulation;
- A grading of 'broadly implemented' given by international organisations such as the IMF and World Bank, indicating broad compliance with internationally-agreed principles;
- Status as a Board and/or ordinary member of IOSCO; and

- Membership in a select group of international regulatory groups (such as the OECD, EU or FATF).

The IOSCO report notes that, by using international standards and benchmarks, assessing a foreign regulatory regime may be less burdensome to a domestic regulator, even if it is harder to verify.

Overall, IOSCO emphasises that the overall aim of an equivalence assessment should be on whether a foreign regulatory framework can '*achieve actual regulatory outcomes that are overall substantively similar to those of the domestic regime*'.

*FSB - deference*

In 2014, the FSB published a report[34] on jurisdictions' ability to defer to one another in the context of OTC derivatives and noted the G20 leaders' objective that '*jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes*'.

It is worth noting that the FSB's concept of 'deference' effectively views equivalence as a two-step process; first, a recognition of another country's regulatory regime as achieving similar outcomes and, secondly, a deference or reliance by the home state on that country's regulators.

The FSB Report stated that all jurisdictions which already had authority to defer to a foreign jurisdiction required information sharing or supervisory cooperation arrangements as a condition for granting deference.

The FSB set out examples of standards or criteria used for deference across the globe, noting that many jurisdictions focused on outcomes, international standards and the status of cooperative arrangements:

- Sufficient equivalence and adequate cooperation arrangements (Australia);
- An equivalent regulatory regime and the existence of MoUs (Canada);
- Legally binding requirements that are complied with and equivalent to the host country regulation (the EU);
- An outcomes-based approach taking fully into account international standards (Japan);
- Cooperative arrangements, home requirements and supervision that are comparable to those of the host in the degree to which host country objectives are achieved (Singapore);
- Equivalent regulatory framework (South Africa);
- Entity being adequately regulated and supervised, home regulator not objecting to cross-border activity and granting mutual assistance (Switzerland); and
- Comparable, comprehensive supervision and regulation, including the effectiveness of the supervisory compliance programme administered and the enforcement authority exercised (US).

**Common features of international approaches to equivalence**

Although it is evident that many countries apply a bespoke assessment for determining whether to permit foreign firms into their country, there are some common features which are repeated across the globe.

[34] *Jurisdictions' ability to defer to each other's OTC derivatives market regulatory regimes* (18 September 2014), FSB

In particular, the importance of cooperation arrangements and an adequate home country regulatory framework are mentioned by numerous jurisdictions. However, where another country's regulatory framework is assessed, this is generally on the basis of outcomes, rather than a strict assessment of equivalence on a line-by-line basis. A number of countries also use international standards as appropriate benchmarks for assessing equivalence.

Section 6 of this paper will consider whether these common features of equivalence can be used to help build a bespoke framework for equivalence in the context of the EU-UK negotiations.

## Section 6: Building a bespoke framework for equivalence

**Challenging the European approach to equivalence**

One of the obvious challenges of the European approach has been its patchwork-like framework of equivalence provisions across European legislation. As mentioned above, the current approach to equivalence in Europe would not provide all UK financial services firms with the ability to provide services into Europe, as some areas of European financial services legislation do not contain equivalence provisions, or (for those that do) there are limitations (for example, the lack of equivalence provisions for lending activities under CRD or for investment services for retail clients under MiFID II).

Furthermore, the opacity of the Commission decision-making process for determining equivalence means that third country regulators and firms have little clarity on the timing for a determination or the measures against which a determination will be made. Adding to this complexity is the political nature of equivalence assessments, as noted by Jonathan Hill, in the context of the EMIR equivalence assessment in particular.

Another challenge of the European approach is the 'snapshot in time' risk; this is the risk that the European equivalence process only produces a determination of whether the EU and a third country are equivalent at a particular moment in time. By its very nature, an equivalence determination by the Commission will be 'static'; it will not be able to take into account a potential future divergence of those two regimes. Further, it follows that an equivalence decision carried out by the Commission which is 'outcomes-based' will risk being withdrawn if the intended outcomes of the EU or third country change.

For example, although to date no equivalence determinations under EMIR have been withdrawn, this is a potential risk for third country CCPs, as ESMA continues to publish a series of updated Q&As on practical questions regarding EMIR. In reality, therefore, equivalence for a third country has a 'dynamic' nature, and could require a third country regulator to monitor and consider whether it needs to implement European guidance to avoid the risk of its equivalence status being withdrawn. This risk is also highlighted in the recitals to MiFIR which requires the Commission to monitor significant changes and review its equivalence decisions.

**Building a bespoke regime for UK negotiations**

This paper has considered the existing European approach to equivalence and noted some of its challenges and limitations. It has also examined in brief some alternative approaches to equivalence outside the EU, in the US, Singapore and Australia and by international bodies such as IOSCO and the FSB.

What can we learn from a wider international understanding of equivalence (or deference or adequacy)?

From the US, a sector-by-sector approach to equivalence helps to deal with sector-specific risks and the nature of its players. For example, the Part 30 exemption for non-US brokers provides a 'blanket' exemption for brokers outside the US, based on their country's 'comparable regulatory scheme'. For clearing organisations, which will be relatively few in number in comparison to investment brokers, the US has a direct ability to enforce against such firms, by insisting upon the 'consent to jurisdiction' wording as part of the DCO registration.

In Australia, a clear set of 'general' and 'equivalence' principles means that there is clarity for investors, firms and countries seeking equivalence as to the basis on which the Australian regulator make its determination.

The IOSCO report sets out useful measures for assessing equivalence, as well a 4 step process for building an equivalence framework. The FSB report urges greater clarity and harmonisation from countries in their approach to equivalence and notes some ways in which there is already commonality between countries in their equivalence assessments.

*Do we need a bespoke model for equivalence?*

The purpose of this paper is not to suggest that the European approach to equivalence should be replaced by any one of these models; the EU has developed a supra-national model for equivalence which marks it out as one of more sophisticated jurisdictions for equivalence across the globe.

However, the political ramifications and lack of clear process and guidelines for the equivalence assessment make it difficult to predict how the current European approach to equivalence will work for either the EU or the UK.

The UK and EU will need to negotiate an exit for the UK in less than 2 years from the triggering of Article 50 (assuming that some time will be needed to ratify that negotiation by the remaining 27 Member States). During this time, it is likely that UK and EU negotiators will discuss equivalence and attempt to reach an agreement on how it could apply to the UK once it leaves the EU.

Assuming that Brexit negotiations will be less than 2 years, the timeframe for agreeing an approach to equivalence for the entire UK financial services industry will be less than that taken by the EU in its equivalence determination under EMIR for the US in just one area of financial services. Once the UK does leave the EU, each equivalence determination by the Commission could take months or even years to conclude.

The level of uncertainty following the UK's exit, including whether or not the UK will be able to benefit from any transitional period, suggests that the Brexit negotiations will need to consider whether some form of early or interim equivalence assessment may be appropriate.

Furthermore, the existing equivalence provisions in European legislation do not take a consistent approach in the way in which equivalence is assessed. As discussed above, MiFID II and the Benchmark Regulation refer to international standards, CRR and EMIR do not. The Benchmark Regulation provides for three parallel regimes of equivalence, recognition and endorsement; MiFID II does not take the same approach, but does provide for Member State discretion prior to an equivalence decision being taken.

In our view, the most sensible approach is to look to build upon the existing European model of equivalence to develop some of its existing concepts and provides solutions to others, in a way which will provide clarity to the UK in its negotiations but also seeks to provide the EU with an adequate level of comfort in areas such as enforcement or investor protection. In other words, building a bespoke model of equivalence for the UK, which could be used more widely for other third countries or even by an international body such as IOSCO or the FSB.

The UK has already indicated that some form of bespoke model of equivalence may be the answer; Mark Garnier, the UK's trade minister and government envoy for financial services said '*If we can create a special hybrid version…with a better version of equivalence or a different version of passporting, then that's what we will try to achieve…[W]hat we are not trying to do is fit into an existing box. We are trying to create a new model*'[35].

While creating a bespoke model of equivalence as part of the UK's exit is clearly advantageous for the UK, the EU could also benefit. As discussed above, the procedural and political complexities of the existing equivalence model will place significant stress on the resources of the European institutions, such as the Commission, EBA and ESMA. Building a bespoke model of equivalence could relieve some of this stress by, for example, lightening the burden of political and diplomatic tensions between the EU and the UK by setting clear guidelines of international standards to enable the presumption of equivalence.

Furthermore, it is possible that a bespoke model of equivalence could also include mutual recognition provisions, enabling EU financial services firms to enjoy a greater level of access to the UK than they may have done under the existing model of equivalence. Simply put, if the UK stands to gain more from a bespoke model of equivalence, then it is more likely to accept greater reciprocal benefits for EU financial services firms looking to access the London financial markets.

[35] https://www.bloomberg.com/news/articles/2016-10-26/banks-likely-to-lose-passporting-with-brexit-u-k-official-says

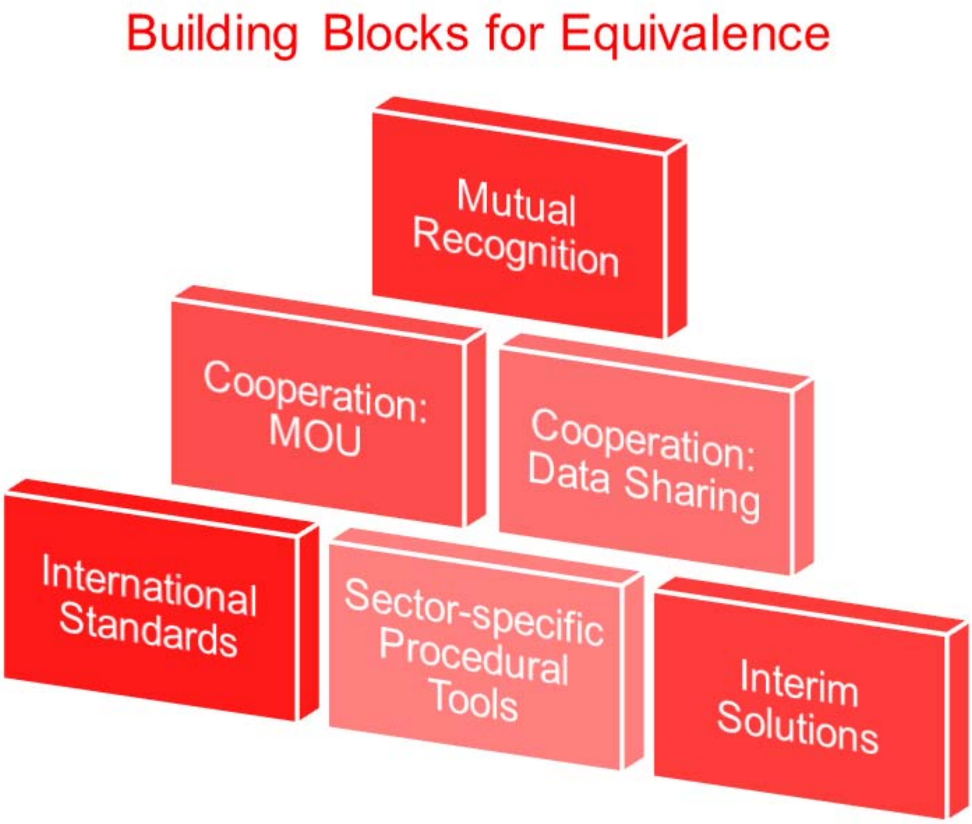
*The 'building blocks' model of equivalence*

One possible approach for a bespoke model of equivalence for the UK is to use the 'building blocks' already utilised in other countries and in international bodies, together with strengthening some of the existing aspects of the European model, to establish a solid foundation for an approach to equivalence.

An essential feature of proposing a bespoke model of equivalence for the UK is the recognition that, to date, the lack of a clear definition on what exactly is meant by 'equivalence' has led to the politicisation and, at times, prevarication by the Commission on determining whether equivalence has been achieved. Therefore, underpinning the building blocks model of equivalence is the following definition of equivalence:

**Equivalence between two regulatory regimes can be determined where there are the following features:**

- **Parity in public policy objectives**
- **Shared regulatory principles**
- **A shared regulatory ethos**
- **Shared intended outcomes**




**Building Block 1: Using International Standards as Equivalence Benchmarks**

The existing European approach to equivalence has high level similarities across its legislation in how the Commission should determine equivalence. It is accepted in the European model that an equivalence assessment should be outcomes-based, assessing how a third country's regulatory framework matches the objectives of the EU, without necessitating a line-by-line analysis of its rules and regulations.

However, as set out in this paper, the reality of the existing European model for equivalence is that political tensions abound, the absence of a consistent framework for benchmarking what these 'outcomes' should be and how a third country should be assessed against them result in an opaque decision-making process by the Commission.

Forming part of a ‘foundation’ layer for the building block model of equivalence should therefore be the use of international standards as equivalence benchmarks. As noted, MiFID II and the Benchmark Regulation already recognise the benefits of using international standards (in both cases, set out by IOSCO) but this model would advocate using international standards as benchmarks in all areas in which equivalence is available.

Indeed, ESMA’s response to the IOSCO’s Task Force on Cross-Border Regulation (appended to this Report at Annex D) noted that ‘*(H)aving granular standards available on time will help reduce the development of differences when an activity becomes subject to regulation across the globe…it should facilitate the second step* [of]*…reliance on foreign regulatory systems when they achieve the same regulatory outcomes*’[36].

As suggested by IOSCO in its Report (referred to in Section 5 above), the Commission could then assess whether the UK’s domestic regime (which, at the time of Brexit negotiations, will be identical to that of the EU) is equivalent to such international standards. This would also allow for any regular reviews conducted by the Commission of the UK’s equivalence to be based on clear benchmarks and would enable the UK to help ‘future proof’ its equivalent status by ensuring that any changes made to its domestic regime are in line with the relevant international standards.

To the extent that the UK deviates from the relevant international standards, the building blocks model would encourage an outcomes-based assessment of those deviations, stipulating that only material deviations which resulted in the UK no longer being ‘broadly compliant’ could result in a withdrawal of equivalence from the EU. For example, a set of IOSCO Principles relating to Equivalence Assessments or supporting guidance to existing IOSCO standards could be useful tools to ensure that an equivalence assessment could only be withdrawn by the EU in the case of a material deviation from the EU regulatory framework.

Undoubtedly, the ability to use international standards as benchmarks in other areas of financial services regulation would require engagement from the relevant international body in areas where such standards are not currently available.

However, the existence of international fora and standard setters, such as IOSCO and FSB, are invaluable sources of knowledge and expertise which could help to form a more harmonised approach to equivalence, not just between the EU and UK, but across the globe. Additionally, the use of global international standards would help ensure that the UK would not be at a competitive disadvantage from the rest of the world in maintaining equivalent standards with Europe.

**Building Block 2: Sector-Specific Procedural Tools**

The second block in the foundation layer is a set of procedural tools made available to the Commission, used in a sector-specific manner.

The procedural tools envisaged here relate to enforcement and oversight of a firm registering for access to the European market once equivalence has been established.


[36] ESMA Comments on the Task Force on Cross-Border Regulation, ESMA/2015/422 (23 February 2016)

The building blocks model envisages that, at a minimum and once equivalence has been established, the UK regulatory authorities (i.e. the BoE, PRA and FCA) should be able to provide supervision and oversight for the majority of firms across the financial services industry who want access to the European market.

This is on the basis that, if the UK is determined to have an equivalent status to the EU, it will be on the basis that the UK's legal and supervisory regime has legally binding requirements which are at least as strict as requirements under relevant European legislation (e.g. MiFID II or EMIR).

While this is a workable approach for the existing European model, it is envisaged that a bespoke UK model will need to take account of the EU's anticipated reluctance to accept a lack of direct enforcement or oversight over certain types of financial services firms.

In particular, there has been political tension around the relocation of euro clearing organisations from London to another Member State following Brexit. Francois Hollande, president of France, said '*The City,* [of London]*, which thanks to the EU, was able to handle clearing operations for the eurozone, will not be able to do them…It can serve as an example for those who seek the end of Europe…It can serve as a lesson*'[37].

The UK handles 75% of euro-denominated derivatives transactions, according to the Bank for International Settlements data on over-the counter trades, with the world's largest clearing house for interest rate swaps, LCH, based in London and majority owned by the London Stock Exchange Group plc[38].

In this context, it is likely that the current European model for equivalence would not provide adequate comfort to the EU that the large clearing organisations seeking to clear euro denominated trades should remain in the UK.

Therefore, it would seem prudent to consider a way of building upon the existing European model of equivalence to provide a range of procedural tools which might provide that comfort to the EU, in a way which would also be workable for UK clearing organisations.

For a sector in the financial services industry where supervision and oversight by UK regulators would be politically sensitive, such as clearing services, the building blocks model proposes the use of more direct form of supervision and oversight by the EU (in likelihood, by the ECB).

Drawing upon the US equivalence model for CCPs, this model uses the concept of 'consent to jurisdiction', which would contractually require UK clearing houses to accept the direct jurisdiction of the ECB and allowing it to directly enforce against the clearing house. As part of this, the ECB would be able to impose additional requirements directly upon UK clearing houses if it felt that the UK regulatory framework was inadequate or posed a risk to Europe in a particular area. The day-to-day functions of ECB supervision could, in addition, be delegated to a relevant competent authority (such as the Bank of England), subject to the ECB's delegation powers.

One of the advantages of introducing this concept for certain UK firms is that, from a political standpoint, this is likely to be a more attractive proposition for the EU for the purposes of UK-EU negotiations.

From the perspective of the EU, it helps to ensure that the ECB has more direct control over UK clearing houses after Brexit. It also avoids the disruption of moving euro clearing to another Member State or the risk that the euro could become less transferable if restrictions were placed on the location of euro clearing.

From the perspective of UK clearing organisations, it is evident that maintaining euro clearing within London would be a significant advantage, avoiding disruption and cost. Additionally, the 'consent to jurisdiction' concept is an established model for achieving equivalence for clearing houses in the US and so should, in theory, be more readily accepted by them if introduced in Europe.

[37] *Why the EU's euro clearing Brexit threat may never happen*, Financial Times (29 June 2016) https://www.ft.com/content/e7b6a752-3dec-11e6-8716-a4a71e8140b0

[38] Data taken from *Banks said to plan for loss of Euro clearing after Brexit,* Bloomberg (21 September 2016)

In order to 'future proof' against the risk of an equivalence determination being withdrawn by the EU, certain firms could also agree to comply with new rules affecting the provision of its services in the EU, similar to the agreement made by the London Metal Exchange in respect of submitting to new CFTC rules as a Foreign Board of Trade in the US discussed above in Section 5.

*Would it be appropriate to use the 'consent to jurisdiction' concept for all UK financial services firms seeking access to Europe through the UK's equivalent status?*

In our view, where there are fewer firms in a particular sector, a European institution such as the ECB or one of the ESAs (such as ESMA) would be able to take more of a direct role in supervising and enforcing that sector. It would be impractical from a resources perspective to require the entirety of UK financial firms accessing the European market to be directly supervised by the ECB or the ESAs. From a political perspective, it would also be unattractive to UK investment firms who could adequately be supervised and regulated by the UK's regulators.

However, for systemically important banks or investment firms, the building blocks model offers a third option; that of supervision and oversight of an international college of supervisors. Made up of both UK and European supervisors, the college of supervisors would follow the EBA's existing model of supervisory colleges, used as '*flexible, coordination structures that bring together regulatory authorities involved in…supervision…colleges are a mechanism for the exchange of information between home and host authorities*[39]*'.*

The use of a supervisory college for systemically important UK firms seeking access to the European market would ensure that the EU had a more involved role in supervising such firms. In contrast to the 'consent to jurisdiction' tool, it would not require a contractual commitment from each firm or enable the ECB to directly enforce against such a firm. It would also ensure a harmonised approach to the supervision of systemically important UK firms which could have a significant impact upon EU investors.

Again, the use of supervisory colleges to coordinate supervisory activities on a cross-border is not new for the EU (or internationally), but building upon this to produce a spectrum of procedural tools which distinguishes between sectors, and between systemically important firms and smaller firms, helps to form another part of the foundation layer of the building blocks model.

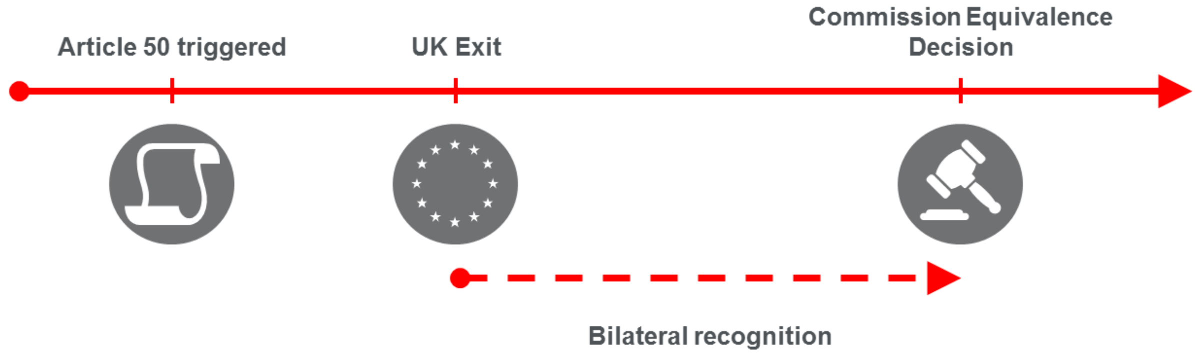
*Arbitration mechanism*

In order to aid the resolution of disagreements between the EU and the UK over the interpretation of an equivalence assessment or determination, a form of arbitration mechanism could be introduced.

For example, this arbitration body could be composed of EU and UK adjudicators (perhaps on a 50:50 basis) and could function similarly to the dispute settlement mechanism set out in CETA to resolve disputes between the EU and Canada or the EFTA Court, which fulfils the judicial function on the interpretation of European legislation for the EFTA states (such as Norway and Switzerland).

[39] EBA website: http://www.eba.europa.eu/supervisory-convergence/supervisory-colleges

**Building Block 3: Interim solutions**




Under the current European approach to equivalence, the UK will only be able to make an application to the Commission regarding equivalence once it formally becomes a third country i.e. when the UK exits the EU, currently envisaged in March 2019.

As discussed above, the timing for a Commission equivalence decision can take a number of years. Prior to an equivalence determination from the Commission, it is currently not clear whether any transitional provisions will be agreed between the UK and EU as part of the Brexit negotiations, to ensure the continued operation of the UK market.

As other commentators have also noted, a transitional agreement between the EU and UK more generally would be beneficial to avoid a ‘cliff edge’ when the UK formally exits the EU. However, specifically in the context of achieving equivalence for the UK, this building block considers whether an interim solution could be introduced to avoid an additional ‘cliff edge’ for UK financial services firms. Once the UK exits the EU in March 2019, UK financial services firms could face a lengthy period of uncertainty whilst awaiting a Commission decision on equivalence.

In building a bespoke model for equivalence for the purposes of the UK’s exit from the EU, the need for an interim solution is important. As at the date of the UK’s exit, the UK will be in a unique position (in contrast to any other third country) in being able to state that it is equivalent to the EU without any equivalence assessment being required; having been one of the Member States will mean that its legal and supervisory framework will, by necessity, be identical to the EU’s.

However, any divergences between the UK and EU from the date of the UK’s exit will have an impact upon the Commission’s equivalence determination, as each divergence will need to be assessed to determine if it impacts upon the regulatory outcomes achieved by the UK.

Where forthcoming European legislation already considers transitional provisions, no additional mechanism would be needed. For example, under Article 54 of MiFIR, third country firms can continue to provide services in a Member State, where that Member State has previously recognised that firm, for three years after the adoption of an equivalence decision by the Commission.

To the extent that relevant European legislation does not contain transitional provisions and prior to a Commission equivalence decision, the third building block in this model would introduce an interim solution based upon the ‘recognition framework’ set out in the forthcoming Benchmark Regulation. As set out in Section 4 of this paper, the Benchmark Regulation introduces the concept of ‘recognition’ as a transitional measure for the use of third country benchmarks prior to a Commission equivalence decision.

Under the Benchmark Regulation, recognition is granted to a third country benchmark administrator on a Member State-by-Member State basis, by relying upon an assessment by an independent external auditor or a certification provided by a third country regulator. The Benchmark Regulation also requires a third country benchmark administrator to have a legal representative in that Member State which will be accountable to that Member State’s regulator for the actions of the benchmark administrator.

Building upon this idea, the interim solution for the building block model of equivalence would introduce the concept of recognition on a bilateral basis (i.e. on a Member State-by-Member State basis) for UK financial services firm seeking to access the European market before a Commission decision on equivalence is taken. A Member State would be able to rely upon a certification by the UK regulators. A Member State could also look to the UK's compliance with any relevant international standards as set out in the first building block of the model. This concept of recognition by a Member State would be subject to excluding those matters reserved to the EU's 'exclusive competence[40]'.

This form of bilateral recognition could also include a requirement to have a legal representative in that Member State for systemically important firms, banks or clearing houses. Again, similar to the procedural tools in the second building block, this would allow each Member State to have appropriate oversight and accountability over UK financial services firms which could have a significant impact upon the EU market. For all other firms, it would be appropriate to require the UK regulators to exercise adequate oversight and to set this out in a memorandum of understanding, discussed further below.

Although this building block considers bilateral recognition as an interim solution prior to a formal Commission equivalence decision, this approach could also, in theory, continue indefinitely in the absence of an equivalence determination by the EU to enable access to UK firms.

**Building Block 4: Cooperation – Memorandum of Understanding**

Under the existing European model, supervisory arrangements for third country firms are generally the subject of a memorandum of understanding or cooperation agreement between the EU and the relevant third country (such as in EMIR or as is envisaged under MiFID II).

The fourth building block of the UK-EU equivalence model would therefore be a comprehensive memorandum of understanding between the UK and EU (including the relevant competent authorities as signatories), ensuring adequate cooperation arrangements. The memorandum of understanding would include an approach to dealing with material deviations in the UK regulatory regime (for example, by requiring the UK regulators to keep the EU informed of such deviations), arrangements for the supervision and oversight of UK firms accessing the European market and (where appropriate) any supervisory colleges.

The memorandum of understanding would also set out the UK and EU's proposed approach to enforcement, ensuring cooperation between both the UK and EU for the purposes of enforcing against a particular firm. This would include, where appropriate, arrangements for direct enforcement by the EU against clearing houses subject to the 'consent to jurisdiction' concept.

Under the building blocks model, a memorandum of understanding would also be prudent for the transitional period, setting out the bilateral recognition concept and ensuring cooperation between the UK and a relevant Member State where enforcement against a 'recognised' UK financial services firm was deemed appropriate.

It is worth noting that IOSCO considered the need for the extension of its Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (the international benchmark for cross-border cooperation established in 2002) to include developments in markets and supervisory and enforcement practices in 2014[41]. If this were developed by IOSCO, it could also prove to be a useful guide for a specific UK-EU memorandum of understanding.

**Building Block 5: Cooperation – Data sharing**

The fifth building block of the UK-EU equivalence model recognises the importance of information sharing for a successful ongoing relationship between the UK and EU once equivalence has been established. Built into the memorandum of understanding, this would cover the sharing of information

[40] Set out in Article 3 TFEU, 'exclusive competence' refers to areas of European market where only the EU can act and not Member States
[41] https://www.iosco.org/library/resolutions/pdf/IOSCORES53.pdf

necessary for the EU to verify that relevant UK financial services firms continued to comply with UK regulatory requirements.

The issue of data sharing between the UK and EU will also need to consider a number of potential challenges arising from existing EU data protection rules. In 2015, the FLMC response to the IOSCO Report identified a number of issues arising from restrictions around data sharing, comprising of three principal concerns:

- the lack of any express safe-harbour for the exchange of information between national regulators pursuant to international agreements;

- a lack of clarity in the application of various exemptions establishing legitimacy for data sharing between firms and regulatory authorities; and

- the likelihood of conflict between restrictions imposed by data protection legislation and firms' obligations to provide information to third country regulators under the terms of their registration in that third country.

The text of the GDPR has changed quite significantly since the draft in circulation at the time the letter prepared by the FLMC was published in 2015.

However, it remains the case that the GDPR in its final form continues to place controls on data transfers with a view to ensuring that the rights of data subjects are protected, which may have an impact upon sharing between market participants and regulators and sharing between regulators themselves.

Among other things, these controls include:

❖ the requirement to ensure that individuals are sufficiently informed about how their personal data will be used (including to whom personal data may be transferred). Certain exceptions to this transparency requirement may apply in some circumstances, but there is no general exemption relating to disclosure between regulators or disclosures to regulators; and

❖ a need for market participants and regulators to ensure that one of the grounds for processing is complied with when making a disclosure. Again, there is no ground dealing specifically with transfers to regulators.

The third key consideration in relation to data sharing relates to the restrictions on the transfers of personal data outside of Europe, for example to overseas regulators.

In the final version of the GDPR, Article 46 does permit the transfer of personal data between public authorities or bodies where '*a legally binding and enforceable instrument between public authorities or bodies'* is in place or, subject to authorisation from a competent supervisory authority, where provisions are inserted into administrative arrangements between public authorities or bodies which include enforceable and effective data subject rights.

However, these provisions do not cover transfers from market participants to overseas regulators, which are often more difficult to justify. This can result in market participants being subject to conflicting requirements.

There is no general exemption for transfers to overseas regulators and the GDPR is clearly intended to restrict transfers to overseas regulators unless appropriate protections are put in place. Indeed, Article 48 provides that any decision of a third country requiring a controller or processor to disclose personal data to them may '*only be recognised or enforceable… if based on an international agreement, such as a mutual legal assistance treaty, in force between the requesting third country and the Union or a Member State'*.

It should be noted that the UK has opted out of this Article 48 citing concerns relating to the integrity of the UK legal system, although it remains to be seen exactly how this opt-out will impact international data transfers to overseas regulators, as market participants will need to rely on another ground to justify any transfers to overseas regulators.

In light of these issues, the likelihood of success for any model of equivalence (not just the building blocks model) will depend, in part, on the ability for UK and EU authorities and, where relevant, UK and EU firms, to share data in a way which does not breach EU or UK data protection rules.

**Building Block 6: Mutual Recognition**

The final building block in this model of equivalence relates to the importance of mutual recognition. Here, this means an acceptance that mutual recognition of equivalent regulatory frameworks, allowing UK firms to access the EU but also permitting EU firms to access the UK, achieves a mutually beneficial goal for both the EU and UK, with a limited amount of disruption for UK and EU firms.

It would appear that the EU recognises the importance of mutual recognition as an important principle of equivalence. A Joint Statement on Mutual Recognition in Securities Markets published by the EU and SEC in 2008 indicated that both authorities would *'intensify work on a possible framework for EU-US mutual recognition for securities…(because)the concept of mutual recognition offers significant promises and means of better protecting investors, fostering capital formation and maintaining fair, orderly and efficient transatlantic securities markets[42]'.*

The IOSCO Report considered an example to demonstrate the tangible benefits of mutual recognition established in Australia and New Zealand for securities offerings. In 2008, these two countries introduced a mutual recognition arrangement premised on the principle of 'substantive compliance' i.e. that each jurisdiction could rely upon an issuer's substantive compliance with the rules of the other jurisdiction.

In 2009, ASIC published a report noting that the mutual recognition scheme had been viewed as a welcome policy development because it:

- reduced firms' costs – particularly, legal and documentation cost savings which could amount to 55-95%
- accelerated the regulatory approval process, which allowed securities offerings to reach the market more quickly

The inclusion of mutual recognition in building a successful model of equivalence is likely to promote a more efficient transition for the UK from a member of the EU to a third country, help reduce costs for both EU and UK financial services firms post-Brexit, help minimise political tensions in the equivalence process and demonstrate the shared regulatory principles of the EU and UK.

How can mutual recognition be achieved? There are two possibilities; where there are no equivalence provisions in an area of European legislation, financial services firms in the EU and UK could agree access to the UK or a particular Member State through the non-legislative avenue of recognition on a regulator-to-regulator basis.

Alternatively, the UK and EU could look to use legislative measures to achieve mutual recognition. In key areas where equivalence is not currently available (such as lending under the CRD/CRR or providing investment services to opted up professional and retail clients under MiFID II), it is possible that amendments could be made to enable access to UK firms. For example, in relation to CRD, it is worth noting that it already recognises the possibility that a third country branch seeking to establish itself in a Member State could have identical criteria applied to it under an EU-wide agreement[43], although (read narrowly) this does not appear to require a Member State to accept a particular third country branch, which would remain at Member State discretion.

[42] https://www.sec.gov/news/press/2008/2008-9.htm
[43] See Article 47 CRD

In persuading the EU to implement such legislative amendments, it would inevitably be made easier if the UK were able to offer similar access to EU branches in the UK. Undoubtedly, the ability to achieve mutual recognition through legislative change in areas where equivalence is not already available would be subject to political appetite to achieve such an outcome.

From a practical perspective, mutual recognition between the UK and EU would also have an impact on a number of the other building blocks in this model, for example, by ensuring that a UK-EU memorandum of understanding includes reciprocal arrangements and adapting data sharing arrangements to ensure UK regulators received adequate data on EU financial services firms accessing the UK.

The danger is that mutual recognition can be used as a political tool in a negotiation; a potential position of threatening to withhold access in one country if equivalence is not permitted by the other. This model is not intended to encourage such positioning; nor to argue that, without mutual recognition, unilateral equivalence will not succeed. Rather, the inclusion of mutual recognition in the building blocks of equivalence attempts to highlight the potential benefits to both sides in building upon a foundation of shared regulatory principles and, to date, a harmonised approach to regulation, which would allow the EU and UK to continue to trade successfully with one another, even once the UK has left the EU.

*How might EU firms be treated in the UK post-Brexit?*

As noted above, data released by the FCA estimated that 8000 companies registered in the EU currently use a passport to access the UK. How might such firms expect the UK financial services landscape to look post-Brexit?

To date, the UK Government has not provided any official details on how it intends to supervise EU firms looking to continue to provide services into the UK and so this can only be, at this stage, a speculative exercise. However, it is useful to look at how the UK regulators have supervised non-EU firms to date as an indication of how they might approach the supervision of EU firms post-Brexit.

Generally speaking, if a firm outside the EU wishes to operate in the UK, the UK regulators will require that firm to establish a subsidiary in the UK. For the PRA, the prudential regulator, this is to ensure that it is able to have adequate control from a prudential perspective over that firm, including its potential impact on UK financial stability.

In certain circumstances, the UK regulators will also consider an application from a firm outside the EU that wishes to establish a UK branch (and avoid setting up a separate subsidiary). In March 2016, the PRA published an updated paper on its approach to banking supervision and stated that, in relation to UK branches of firms outside the EU, '*the PRA will, as a first step, form a judgment on the adequacy or equivalence of the home regulator and its regulatory regime…the PRA may also have regard to the opinion of an overseas authority…In considering how much weight to attach to such opinions, the PRA must have regard to the nature and scope of the supervision exercised by the overseas regulator*[44]*'.*

The similarities between the PRA's approach to non-EU branches and the European equivalence regime are evident; the PRA will consider whether a country's regulatory regime is adequate or equivalent and will consider the extent of supervision exercised by its regulator. In addition, the PRA stated that, for existing UK branches of non-EU firms where its home regulatory regime is not considered to be equivalent, the PRA's supervisory work would be aimed at *'mitigating the risks of non-equivalence in the relevant areas*'.

Although this approach may change in relation to how EU firms are supervised in the UK post-Brexit, it is possible that the PRA (and FCA) would look to align its approach with that for non-EU firms. This would mean that, for an EU firm looking to establish a branch in the UK, without having to set up a subsidiary, UK regulators would need to be comfortable that the EU's regulatory regime was equivalent to the UK's.

[44] The PRA's approach to banking supervision (March 2016)
http://www.bankofengland.co.uk/publications/Documents/praapproach/bankingappr1603.pdf

This further demonstrates the benefits of mutual recognition, as without the UK recognising the EU as equivalent, EU firms could be treated less favourably than non-EU firms in a post-Brexit world by being unable to set up branches in the UK.

If European banks were forced to convert their existing branches in the UK into subsidiaries, a report by Boston Consulting Group cited in the Financial Times claimed that this could amount to €30-40 billion[45]. The Financial Times also reported in July 2016 that the Bank of England had confidentially informed at least one major EU bank that it would not be forced to establish a separately capitalised UK subsidiary post-Brexit, although this has not been confirmed by the UK regulators[46].

The exact future for EU financial services firms in the UK remains, at this point, to be determined.

The remainder of this paper focuses on the UK and considers what the overall financial services landscape may look like in the UK in a post-Brexit world. It considers whether UK financial services firm can look to alternative structures for accessing the European market.

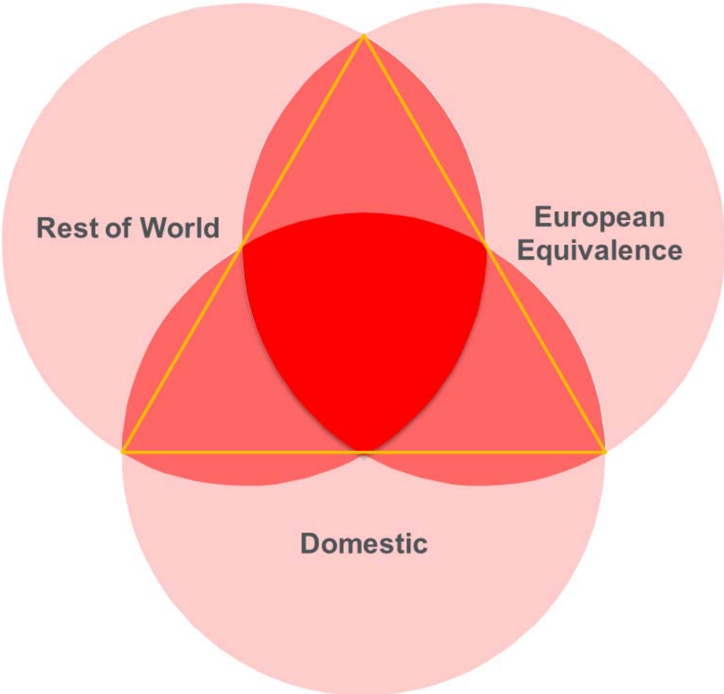
[45] 'European banks face €30bn-€40bn capital bill after Brexit' (15 July 2016), Financial Times https://www.ft.com/content/61ef4104-49c9-11e6-8d68-72e9211e86ab

[46] 'BoE reassures EU banks on post-Brexit restructuring' (31 July 2016), Financial Times https://www.ft.com/content/f4d23f02-55a0-11e6-befd-2fc0c26b3c60

## Section 7: Related equivalence issues

**The UK financial services industry post-Brexit**

*The triangulation framework*




The UK's relationship with the EU post-Brexit will be just one aspect of its financial services industry. As referred to earlier in this paper, the UK will also be simultaneously negotiating a series of trade agreements with countries outside the EU that it currently benefits from as a result of being a Member State.

Recent events in the United States have indicated that there may be a trend of regulatory reform in financial services in the US; during his presidential campaign, President-Elect Donald Trump promised to 'dismantle' the Dodd-Frank Act and other bank reform legislation. Although it is not yet clear to what extent this 'dismantling' will take, it is possible that the US will face a period of reform in its financial services industry.

Coupled with increasing harmonisation and regulation in the EU, what will this mean for the UK? On one view and, as some commentary suggests, it could signal a shift of financial services from Europe to New York, if financial institutions find it easier and cheaper to do business there.

However, this could also present an opportunity for the UK.

It is possible that the UK financial services industry could benefit from this divergent approach by becoming a 'triangulation' hub. Effectively, the UK could become a hub for three types of financial services firms; those who wish to access the European markets, those who wish to access the US and the rest of the world and those who only wish to carry on UK domestic business. It assumes the benefits of the UK's status as an equivalent third country with the EU but also notes that the UK is geographically well placed between Europe and the US to establish a separate regulatory hub for US marketplace activity and also develop its own domestic regulatory regime for those firms wanting to maintain a wholly domestic business in the UK.

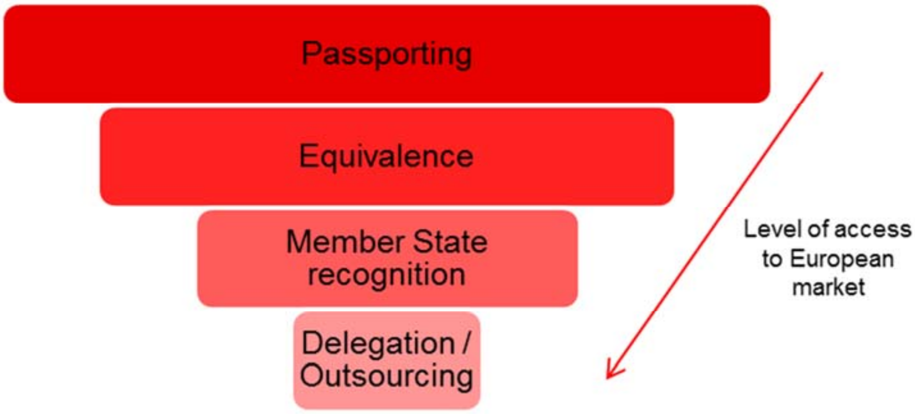
*Equivalence determinations across the globe: UK firms*

Alongside its Brexit negotiations and the parallel negotiation of a series of trade agreements with third countries that it previously benefitted from as a member of the EU, the UK may also need to simultaneously assess whether it needs to negotiate equivalence determinations with non-EU countries to avoid a 'cliff edge' once the UK leaves the EU.

As a Member State, the UK will have had the benefit of equivalence determinations in non-EU countries where the EU is recognised as an equivalent regulatory regime. It is possible that, in those non-EU countries, a major regulatory change such as Brexit could trigger a review of that equivalence determination and consideration of whether UK firms should continue to benefit from that equivalence determination. Where this is the case, UK negotiators will need to convince those countries that the UK should continue to be considered equivalent, even after it leaves the EU.

In achieving this, it would undoubtedly streamline the process if the UK were able to indicate that it would be seeking equivalence with the EU and a form of 'bilateral recognition' (i.e. a recognition by Member States of the UK's equivalence pending a formal equivalence determination by the Commission) in the UK and EU's transitional measures.

*'Cascading' European access: from passporting to delegation and outsourcing*




As explored in this paper, the European passport offers a financial services firm liberal and wide-ranging access to the European market, in comparison to which, the concept of equivalence offers a narrower (but still pan-European) scope of access.

In the event that equivalence cannot be achieved or agreed upon between the EU and UK, the various options for the UK financial services industry can be seen as a 'cascade' of narrowing access to the European market.

In the absence of equivalence and the European passport, what form of access could UK financial services firms seek to achieve?

*Member State recognition*

It is possible that a UK financial services firm could seek access to an individual Member State (as opposed to access to the EU as a single market), where that Member State permits the firm to provide services. Similar to the UK's approach to branches of third country firms or a private placement regime, this would be on a firm-specific basis, subject to the ability of the Member State to make such a determination under European legislation (for example, where the EU did not have 'exclusive competence' to decide such a matter) and the political appetite for that Member State to permit access to UK financial services firms.

However, if this opportunity for Member State recognition could not be used by a UK financial services firm (for example, if the EU had exclusive competence in a particular area), but cross-border activity still took place, that UK firm would need to establish an onshore entity in the EU.

*Delegation*

In this scenario, some commentators have suggested that a UK firm could look to delegate some aspects of its services to an EU affiliate as a means of accessing the European market. For example, a UK firm could use an affiliate in Dublin (which holds a European passport) to provide services to European clients by delegating its services to the Dublin affiliate. Conversely, an EU firm could access clients in the UK by delegating its services to a UK firm, without requiring authorisation in the UK itself.

In relation to the provision of investment services in this ‘delegation’ model, it may be possible for a UK financial services firm to rely upon an existing exemption in MiFID regarding the provision of intra-group services. Under MiFID, a firm exclusively providing investment services to another part of its group will be exempt from the requirement to be authorised in the EU. This could mean that, if a UK financial services firm were able to rely upon that exemption, it could provide investment services to another entity in its group (e.g. a European affiliate) on a cross-border basis into Europe. Arguably, that European affiliate could then provide those investment services to European clients.

*Outsourcing*

A similar concept is considered in relation to how far a UK financial services firm could, simply, outsource its activities to an entity onshore in the EU. The use of outsourcing is an established model in the European financial services industry and many firms outsource back and mid office activities to entities located in other jurisdictions. In addition, ESMA has previously accepted that a firm providing CFDs to retail clients may outsource certain client facing functions, such as website design, financial promotions or client onboarding processes, to third parties in other jurisdictions, subject to effective oversight by that firm[47]. It is possible that this could continue in some form to enable limited access to the EU for UK firms.

However, there are some challenges to the delegation and outsourcing models, notably that the EU (and the UK) are unlikely to tolerate a model which encourages regulatory arbitrage in any form; arguably, if these approaches were workable on a widespread scale, the need for passporting or equivalence provisions would be reduced as third country firms could simply delegate or outsource their services to EU firms.

Further, it is unlikely that a UK firm could outsource any significant client-facing activities without triggering a need for authorisation in the EU. Even where a UK firm merely had a ‘brass plate’ establishment in a Member State (i.e. an establishment through which a UK firm routed all of its activities into the EU), it would be likely to be brought ‘onshore’ into the EU where that firm dealt directly with European clients.

Although this paper has primarily focused on the concept of regulatory equivalence, this section has also, at a high level, considered the range of opportunities available to the UK in the post-Brexit world, together with an assessment of the limitations and challenges of each such opportunity.

[47] https://www.esma.europa.eu/sites/default/files/library/2016-904_qa_on_cfds_other_speculative_products.pdf

## Section 8: Observations, recommendations and conclusions

Sir Charles Bean, Professor of Economics at the London School of Economics has noted that '*…in practice, proving equivalence and maintaining it is quite challenging*[48]'. This paper has examined some of the ways in which proving and maintaining equivalence will, indeed, be a challenge for the UK.

First, the patchwork nature of equivalence provisions means that, for the UK financial services industry, the current European model of equivalence will not provide a solution which will replace the benefits of passporting in their entirety. Gaps in equivalence provisions will mean that, for example, UK banks will not be able to provide lending or deposit-taking services to European clients on a cross-border basis, as there are no such equivalence provisions in CRD IV.

Secondly, the risk of politicisation of the equivalence process in Europe will mean that the benchmarks against which the UK will be assessed and the timing for an equivalence decision remain unclear. In the heightened political atmosphere of the Brexit negotiations, such tensions are likely to be increased and it is possible that the Commission's determination of UK equivalence could become more of a political negotiating position than a legal analysis of the two regulatory regimes.

Thirdly, this paper has examined some other approaches to equivalence across the globe. The divergence of approach in other countries in relation to equivalence, or similar concepts, highlights the lack of an internationally agreed definition of what exactly is meant by concluding that two regulatory regimes are 'equivalent'.

Finally, we note that the heightened political atmosphere around Brexit has resulted in an emotive lexicon; terms such as 'passporting' and 'equivalence' may now have political implications that could, at times, impede a neutral discussion of these concepts. It is possible that, for the purposes of the Brexit negotiations, a new lexicon to describe European-UK access (for example, a 'relationship framework') may be helpful.

**Recommendations**

There are some common features in equivalence assessments which can be identified across the globe, both in the EU and beyond. For example, many countries rely upon cooperation arrangements, an assessment of comparable regulatory frameworks and data sharing arrangements to determine equivalence.

Building upon some of these common features and also introducing specific features in equivalence models established elsewhere than in the EU, this paper has suggested a bespoke model of equivalence which could be used by UK negotiators in the Brexit negotiations. Focusing on sector-specific tools, interim solutions and international standards, this bespoke model seeks to suggest a forward-looking path to UK-EU relations which could, potentially, benefit both sides.

In particular, this paper makes the following recommendations in relation to UK/EU negotiations on equivalence:

- There is a need for a clear, unambiguous definition of equivalence, which is currently lacking in European legislation
- Linked to this, there is a need for clear, definitive benchmarks for the assessment of equivalence determinations by the Commission, which could draw upon international standards in order to provide a 'dynamic' version of equivalence which mitigates the risk of equivalence being unexpectedly withdrawn
- Building upon the current European approach to equivalence, it is pragmatic and mutually beneficial to both the EU and UK to utilise existing concepts and established precedents to

[48] Sir Charles Bean, evidence to the Select Committee on the European Union, Financial Affairs Sub-Committee (7 September 2016)

augment European equivalence through using sector-specific procedural tools and interim solutions as described in the building blocks model

- Negotiating the UK's exit from the EU could benefit from a less politically charged debate by replacing the emotive terms of 'passporting' and 'equivalence' with a more politically neutral term, such as by negotiating the 'relationship framework' between the UK and EU.

It will also be important for the UK to consider some of the issues related to equivalence, such as the importance of parallel negotiations with other non-EU countries to avoid a 'cliff edge' once the UK leaves the EU.

It is intended that this paper may serve as a starting point for further, more detailed, discussions on equivalence, focusing on a pragmatic and anti-protectionist way of building UK and EU relations for the future.

## Annex A: Equivalence decisions taken by the Commission (as at 19 September 2016)

| EQUIVALENCE DECISIONS TAKEN BY THE EUROPEAN COMMISSION (as at 19/09/2016) | | Abu Dhabi | Argentina | Australia | Bermuda | Brasil | Canada | Caymans | Chile | China | Dubai | Egypt | Faroe Islands | Greenland | Guernsey | Hong Kong | India | Indonesia | Isle of Man | Israel | Japan | Jersey | (South) Korea | Malaysia | Mauritius | Mexico | Monaco | N. Zealand | Russia | Saudi Arabia | Singapore | S. Africa | Switzerland | Thailand | Taiwan | Turkey | UAE | US |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Equivalence of prospectuses: Art. 20(3) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| PROSPECTUS | 3rd country GAAP with IFRS: Art. 35 of Regulation 809/2004 | | | | | | Y | | | Y | | | | | | | | | | | Y | | Y | | | | | | | | | | | | | | | Y |
| | 3rd country GAAP with IFRS: Art. 23(4) Sub-para 3 | | | | | | Y | | | Y | | | | | | | | | | | Y | | Y | | | | | | | | | | | | | | | Y |
| TRANSPARENCY DIRECTIVE | general transparency requirements: Art. 23(4) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| ACCOUNTING DIRECTIVE | country-by-country reporting: Art. 46 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| CREDIT RATING AGENCIES | Equivalence - Article 5(6) | | Y | Y | | Y | Y | | | | | | | | | Y | | | | | Y | | | | | Y | | | | | Y | | | | | | | Y |
| | Adequacy of audit framework: Article 47(3) | | | Y | | Y | Y | | | | Y | | | | Y | | | Y | Y | | Y | Y | Y | Y | | | | | | | | Y | Y | Y | Y | | | Y |
| | Equivalence of audit framework: Art.46(2) | Y | | Y | | Y | Y | | | Y | Y | | | | Y | | | Y | Y | | Y | Y | Y | Y | Y | | | Y | | | Y | Y | Y | Y | Y | Y | | Y |
| STATUTORY AUDIT | Equivalence- Article 46 (2): transitional period | | | | Y | | | Y | | | | Y | | | | | | | | | | | | | | | | | Y | | | | | | | | | |
| | central bank exemption: Art. 1(6) | | | | | | | | | | | | | | | | | | | | Y | | | | | | | | | | | | | | | | | Y |
| | regulated markets: Art. 2a | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | Y |
| | transaction requirements: Art. 13 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | CCPs: Art. 25(6) | | | Y | | | Y | | | | | | | | | Y | | | | | Y | | Y | | | Y | | | | | Y | Y | Y | | | | | Y |
| EMIR | trade repositories: Art. 75 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| CSDR | CSDs: Art. 25(9) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | central bank exemption: Art. 2(4) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | trade repositories: Art. 19 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| SFTR | transaction requirements: Art. 21 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Requirements for benchmark administrators: Art. 30(2) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| BENCHMARKS | Specific administrators or benchmarks: Art. 30(3) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| SHORT SELLING | Requirements for markets: Art. 17(2) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Exemption for monetary and public debt management activities: Art 6(5) | | | Y | | Y | Y | | | Y | | | | | | Y | Y | | | | Y | | Y | | | Y | | | | | Y | | Y | | | Y | | Y |
| MAR | Exemption for climate policy activities: Art. 6(6) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | central bank exemption: Art. 1(9) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | trading venues for the purposes of trading obligation for derivatives and shares: Art. 23 and 28 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | derivatives: trade execution and clearing obligations: Art. 33 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | trading venues for the purposes of clearing access: Art. 38 (1) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | trading venues and CCPs - access to benchmarks and licences for the purposes of clearing and trading obligation: Art. 38(2)-(3) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | investment firms providing investment services to EU professional clients and eligible counterparties: Art. 47 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| MiFIR / MIFID2 | regulated markets for the purposes of easier distribution in the EU of certain financial instruments traded there: Art. 25(4) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | credit institutions for the purposes of Article 107(4) | | | Y | | Y | Y | | | Y | | | | | Y | Y | Y | | Y | | Y | Y | | | | Y | Y | | | Y | Y | Y | Y | | | | | Y |
| | investment firms for the purposes of Article 107(4) | | | Y | | Y | Y | | | Y | | | | | | Y | | Y | | | Y | | Y | | | Y | | | | Y | Y | Y | | | | | | Y |
| | exchanges for the purposes of Article 107(4) | | | Y | | Y | Y | | | Y | | | | | | | Y | Y | | | Y | | Y | | | Y | | | | Y | Y | Y | | | | | | Y |
| | exposures to central governments, central banks, regional governments, local authorities and public sector entities for the purposes of Articles 114, 115, 116 | | | Y | | Y | Y | | | Y | | | | | Y | Y | Y | | Y | | Y | Y | | | | Y | Y | | | Y | Y | Y | Y | | | | | Y |
| | credit institutions for the purposes Article 142 | | | Y | | Y | Y | | | Y | | | | | Y | Y | Y | | Y | | Y | Y | | | | Y | Y | | | Y | Y | Y | Y | | | | | Y |
| CRR | investment firms for the purposes Article 142 | | | Y | | Y | Y | | | Y | | | | | | Y | | Y | | | Y | | Y | | | Y | | | | Y | Y | Y | | | | | | Y |
| | for third-country reinsurers in the EU: equivalent treatment of their activities and of EU reinsurers' activities: Art. 172 | | | | Y | | | | | | | | | | | | | | | | Y | | | | | | | | | | | | Y | | | | | |
| | for EU insurers in third countries: equivalence of third-country solvency rules for calculation of capital requirements and own funds: Art. 227 | | | Y | Y | Y | Y | | | | | | | | | | | | | | Y | | | | | Y | | | | | | | Y | | | | | Y |
| SOLVENCY 2 | for third-country insurers in the EU: equivalence of group supervision exercised by the third-country supervisory authorities: Art. 260 | | | | Y | | | | | | | | | | | | | | | | | | | | | | | | | | | | Y | | | | | |

***Notes:***

**1. In view of possible on-going dialogues with third country authorities only information on completed equivalence assessments resulting in a decision is published in this table (relevant entries marked with "Y")**

**2. Does not include ESMA assessments for CRAR endorsement purposes**

**3. Exemption under Art. 6(5) MAR for China, India and Singapore concerns only monetary activities.**

**4. Includes provisional (time-limited) and partial equivalence decisions**

**5. "Dubai" here stands for Dubai International Financial Center**

**6. CRR equivalence of Japan's investment firms' regime is limited to Type I Financial Instruments Business Operators**

**7. EMIR equivalence of the US CCP regime is limited to the framework of the U.S. Commodity Futures Trading Commission. EMIR equivalence of the Japanese CCP regime does not cover commodity derivatives.**

## Annex B: EBA questionnaire on assessment of equivalence in CRR

# Questionnaire on the Assessment of the Equivalence with European regulatory and supervisory framework

## Guidance to respondents

### Background

The Capital Requirements Regulation (CRR, Regulation (EU) No 575/2013) foresees that under well-defined conditions, certain categories of exposures to entities located in third countries (countries outside the European Union (EU)) ), including central governments, can benefit from the same, more favorable treatment applied to EU Countries exposures in terms of capital requirements. Such a preferential treatment is only available where the European Commission adopts an Implementing Decision determining that a third country's prudential supervisory and regulatory requirements are at least equivalent to those applied in the EU.

In the context of this process, the European Banking Authority (EBA) assists the European Commission in carrying out its mandate to regularly review the equivalence of third countries.

The aim of the equivalence assessment process is to assess whether third countries and territories apply regulatory and supervisory arrangements that are equivalent to the EU regulatory and supervisory framework applied in the relevant areas. Such a framework was introduced in 2013, when the EU adopted a legislative package to strengthen the regulation of the banking sector with the aim of creating a sounder and safer financial system. The building blocks are given by the CRR and the Capital Requirements Directive (CRD):

- The CRR contains the detailed prudential requirements for credit institutions and investment firms in terms of capital requirements, risk definition and measurement for credit, market and operational risk , liquidity and leverage;
- The CRD deals with the procedures and processes from the supervisory side to ensure effective monitoring of risk governance and practices and envisages specific requirements on corporate governance arrangements and rules aimed at increasing the effectiveness of risk oversight.

Ultimately, for those third countries which are recognised as equivalent, EU banks can apply preferential risk weights to relevant exposures to entities located in those countries.

## Questionnaire

1. The purpose of this questionnaire is to facilitate collection of data and guide the assessment of the other jurisdictions' equivalence with the EU prudential supervision and regulatory requirements specified in the CRR and the CRD. The questions included in the questionnaire are divided into thematic sections presented within two separate parts: "Part I - Prudential supervision" and "Part II - Prudential regulatory requirements". The questions are accompanied with legislative references to the appropriate CRD/CRR provisions, and in most cases, also with a brief explanation of the EU rules in a specific area. This explanation is added to the questionnaire in order to guide the interpretation of the CRR/CRD. It should be noted, however, that the brief explanations do not contain assessment criteria, and jurisdictions are not assessed against the explanations, examples and definitions that they contain.

2. The assessment should be mostly qualitative and outcome-based, and thus it should consider the major features of the relevant supervisory and regulatory framework. Along these lines, the equivalence of the third country's regulatory and supervisory framework implies sharing the same objectives as the Union's framework (i.e. ensuring appropriate regulation and supervision, and ultimately financial stability).

3. Since the assessment is aimed at evaluating national regulations, the addressed national supervisory authority should communicate with other relevant authorities within its jurisdiction and if necessary involve them in the evaluation, in order to achieve a consistent review of the national regulatory framework.

4. Domestic regulations are assessed for their compliance with the EU requirements according to the materiality of any deviations from the EU framework.

5. All sections of the questionnaire should be completed in English. References to domestic regulations and specific regulatory texts that implement the requirements equivalent to the EU provisions should be as detailed as possible and links or copies of such legal or regulatory texts should be provided (preferably in English). Additional sheets and associated documents can be appended to the questionnaire to help provide further explanation and background information to the assessment team.

6. The questionnaire is aimed at assessing equivalence with respect to the provisions of the Capital Requirements Regulations (CRR) and the Capital Requirements Directive (CRD). Besides the relevant articles of the CRR or CRD which are stated in the questionnaire for ease of reference (and since the CRR/CRD are de facto the implementation of the Basel III framework in the EU that incorporate previous Basel II provisions) we would like to provide you with Annex II which also quotes for the majority of legal references the corresponding paragraph of the relevant Basel II and/or Basel III framework. However, it must be clear that the EBA's mandate by the European Commission is to assess equivalence only against the EU CRR and CRD.

## Definitions for the Questionnaire

For a proper interpretation and understanding of the CRR/CRD provisions, while answering all questions included in the questionnaire, it is always necessary to refer to definitions of specific terms used in these legal acts (especially to the definitions provided in Article 4 of the CRR and Article 3 of the CRD). Nevertheless, with the aim of facilitating the process of answering the questions, the key terms which are most frequently used within the questionnaire are defined below (in a simplified way):

- **“credit institution”** means an undertaking the business of which is to take deposits or other repayable funds from the public and grant credits for its own account;
- **“investment firm”** means a legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis;
- **“institution”** means a credit institution or investment firm;
- **“Member State”** means a country that belongs to the European Union;
- **“competent authority”** means a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned;
- “**prudential regulation”** mean a set of rules concerning: (i) access to the activity of credit institutions and investment firms (i.e. conditions for their authorisation); (ii) supervisory powers and tools for the prudential supervision of institutions by competent authorities; (iii) the prudential supervision of institutions by competent authorities; (iv) publication requirements for competent authorities in the field of prudential regulation and supervision of institutions; (v) requirements imposed on institutions, which cover: (a) own funds requirements relating to entirely quantifiable, uniform and standardised elements of credit risk, market risk, operational risk and settlement risk; (b) liquidity requirements relating to entirely quantifiable, uniform and standardised elements of liquidity risk; (c) requirements limiting large exposures; (d) reporting requirements related to own funds requirements and to leverage; (e) public disclosure requirements.

## List of documents relevant to the assessment

1. Capital Requirements Regulation (CRR; Regulation (EU) No 575/2013) http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1426611327950&uri=CELEX:32013R0575

2. Capital Requirements Directive (CRD; 2013/36/EU) http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013L0036

## Disclaimer

The publication of the questionnaire allows third countries to prepare themselves for the assessment of its jurisdiction's equivalence with the EU prudential supervision and regulatory requirements specified in CRR and CRD. The questionnaire covers all areas relevant for the assessment. Nevertheless changes to the questionnaire might occur in the future. The basis for the actual assessment will only be the version which is send to the selected country at the point in time when the country is included in a formal assessment.

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| Country | |
| Supervisory authority | |
| Contact person | |
| Date | |

## Part I – Prudential Supervision

| **1) General questions** | |
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| GENERAL PRINCIPLE | Since credit institutions and investment firms are a key element for the efficient functioning of the economy, the EU requires that such institutions must comply on an on-going basis with specific prudential requirements regarding (among others) own funds (capital), liquidity and leverage as well as on internal governance arrangements. The EU institutions' compliance with those rules and regulations is verified by competent authorities. |
| **1.1** | **Please explain which authorities are responsible in your jurisdiction for prudential regulation and supervision and briefly describe their respective responsibilities.** |
| **1.2** | **Please explain which types of institutions are subject to prudential regulation in your jurisdiction.** |
| *Brief Explanation* | *The CRD and the CRR set out prudential requirements applicable for :*<br>• *<u>Credit institutions</u>: undertakings of which the business is to take deposits or other repayable funds from the public and grant credits for their own account, and*<br>• *<u>Investment firms</u>: legal persons whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis.*<br>*In line with the terminology adopted in the CRD/CRR, within the questionnaire, the word "institutions" is meant to include credit institutions and investment firms.* |
| **1.3** | **Please describe the legal framework in your jurisdiction for conducting banking activities (providing a list of relevant laws and regulations, with the respective issuance date). Are these laws and regulations legally binding and enforceable for all institutions or only for specific types of institutions (e.g. only for systemically important banks, specialised banks)?** |
| **1.4** | **Are the laws and regulations supplemented by additional guidance, for example, interpretative notes issued by the relevant supervisor(s)? What is the legal status of the additional supervisory guidance and the consequences of institutions not meeting the guidance?** |
| **1.5** | **Are the laws, regulations and the additional guidance available in English? If yes, please provide a link or send relevant documents in pdf format.** |

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| **1.6** | Please describe **the main features of your country's financial sector and its prudential, supervision systems** (e.g. size, number and type of institutions under prudential supervision). Please provide details concerning their main activities – and whether they are integrated in international groups or if they are domestic or are of relevance to foreign investors in the banking system. |
| *Brief Explanation* | *Please attach **relevant documents supporting this description** (e.g. public reports from your supervisory authority, from international organisations such as the International Monetary Fund (IMF) or the World Bank); these can be documents in your native language, but preferably in English.* |
| **1.7** | **Has the Basel III International Regulatory Framework for Banks and associated supplementary standards (for example, the Basel Committee on Banking Supervision (BCBS) Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools) for financial institutions been implemented in your country? If not, is there a defined timeframe for its implementation?** |
| **1.8** | **In case the Basel III framework has not been implemented, has your jurisdiction adopted the Basel II regulatory framework?** |
| **1.9** | **If applicable, please describe all "phase-in" provisions, divided by matters, applicable in your jurisdiction with regard to the implementation of Basel III.** |
| *Brief Explanation* | *The implementation of some CRR/CRD rules is progressive, i.e. it follows a transition period or "phasing-in" before the full application of the new requirements. For instance, a number of deductions from own funds within the CRR are introduced progressively, while Article 160 of the CRD includes "phase-in" rules with regard to the amount of the capital conservation buffer.* |
| **1.10** | **If applicable, please describe all "phasing-out" or grandfathering provisions, divided by matters, applicable in your jurisdiction with regard to the implementation of Basel III.** |
| *Brief Explanation* | *There are also grandfathering provisions that apply to certain matters (for example, to capital instruments issued before the CRD/CRR/Basel III) that were present before the implementation of the new requirements and do not meet the new regulatory exigencies, thus ensuring a smooth "phase-out".* |
| **2) Competencies of supervisory authorities** | |
| GENERAL PRINCIPLE | The EU framework applicable to institutions requires Member States to designate supervisory authorities in order to carry out all supervisory functions provided for in EU law. In order to effectively fulfil their duties, these 'competent authorities' shall be equipped with a range of powers. |
| **2.1** | **Which rights and powers do supervisory authorities within your jurisdiction have?** |
| *Brief Explanation* | *One of the key features of the CRD is the empowerment of competent authorities with specific tasks and duties, which they can exercise with legal force . In particular, Member States must guarantee that competent authorities have the expertise, the resources, the operational capacity and the powers and independence to carry out their duties relating to prudential supervision and have also adequate power to carry out investigation and raise appropriate penalties. If* |

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| | *institutions are subject to supervision by more than one competent authority, Member States should take appropriate measures to organize coordination and cooperation between such competent authorities.* |
| *Legislative reference* | Powers of competent authorities and coordination with other Member States are defined in Article 4-5 of the CRD. |
| **2.2** | **What are the requirements in place within your jurisdiction:**<br>- **for the granting of authorisation for credit institutions to run their activities?**<br>- **for the withdrawal of an authorisation that was granted to a credit institution?** |
| *Brief Explanation* | *The CRD provides requirements for the access to the activity of credit institutions and investment firms (including the provisions on the initial required capital, programme of operations and structural organisation, suitability of shareholders, and other conditions for granting and withdrawing the authorization by the competent authorities and disclosure of such decisions). Please note that institutions cannot accept deposits before the authorization has been granted.* |
| *Legislative reference* | Provisions about the requirements for the access to the activity of institutions are laid down in Article 8-21 of the CRD. |
| **2.3** | **What are the requirements for the initial capital of credit institutions and investment firms implemented in your jurisdiction?** |
| *Brief Explanation* | *EU legislation requires for credit institutions to hold a minimum initial capital or separate own funds prior to receiving authorisation to commence their activities.*<br>*The requirements envisaged by the EU legislation follow the key principle that the initial capital should give the investment firm a stable basis to fund the core business without taking excessive risk, and should show adequate commitment from the investors. The CRD envisages different requirements for investment firms depending on the scope of investment activities run by these firms.* |
| *Legislative reference* | The rules on initial capital are detailed in Article 12 of the CRD for credit institutions and Article 28-32 of the CRD for investment firms. |
| **2.4.** | **What are the requirements concerning the qualification of credit institutions' shareholders or members applicable in your jurisdiction?** |
| *Brief Explanation* | *Identification and suitability of shareholders and members of credit institutions play an important role with respect to their authorization. In particular, such rules aim at ensuring prudent and efficient management of the institutions, avoiding malpractice and conflict of interest. Moreover, the authorization can be refused if the laws or regulation of a third country governing an entity, with which the credit institution has links, prevent an effective supervision or if there are difficulties in enforcement of such laws.* |
| *Legislative reference* | Shareholders and members' requirements are defined in Article 14 of the CRD. |
| **2.5** | **Does your jurisdiction require that acquisitions or increases of qualifying or significant holdings in credit institutions be subject to notification and prudential assessment?**<br>- **If so, how is a qualifying or significant holding defined?**<br>- **Within this context, are there specific provisions concerning cross-** |

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| | **border cooperation between supervisory authorities? If so, please provide a brief outline of such provisions, including the arrangements regarding confidentiality.** |
| *Brief Explanation* | *The EU framework envisages specific rules about the acquisition of "qualifying holding" in a credit institution (i.e. acquiring participations in the credit institution as a result of which the percentage of voting rights or capital held in this institution would exceed any of the thresholds defined in the CRD (e.g. 20%, 30%, 50%). Specific criteria are also set out in order to properly assess the suitability of the proposed acquirer and the financial soundness of the proposed acquisition. Furthermore, specific information and disclosure requirements are envisaged in the CRD.* |
| *Legislative reference* | Provisions of notification and assessment of a proposed acquisition, as well as the concept of qualifying holding are laid down in Article 22-27 of the CRD. Cooperation between competent authorities is specified in Article 24 of the CRD. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **3) Prudential Supervision** | |
| GENERAL PRINCIPLE | The EU rules require auditors and accountants of institutions to inform the competent authority in case of breaches of law within their area of expertise. Moreover, according to the CRD, the competent authority has the right to impose administrative penalties, and/or supervisory measures, on institutions which do not comply with requirements applicable to them. |
| **3.1** | **What is the level of prudential supervision performed in your jurisdiction (e.g. on an individual institution level or a consolidated level or a combination of both)?**<br>**Where the supervision is performed on a consolidated basis, please explain the rules applicable for the determination of the scope / perimeter of regulatory consolidation.** |
| *Brief Explanation* | *This section aims at understanding which types of institutions fall under the scope of prudential supervision in your jurisdiction and whether prudential supervision is performed on an individual institution level or a consolidated level or a combination of both.*<br>*With regard to the level of consolidation, note that within the CRR both levels are supervised (i.e. individual and consolidated); supervision at only one level should be carefully explained.* |
| *Legislative reference* | Please refer to Article 1 of the CRR for the scope of the regulation and to Article 6-9 of the CRR and Article 11-19 of the CRR for the level of supervision on a consolidated basis. |
| **3.2** | **Is there a legal obligation in your jurisdiction for persons responsible for legal control of annual and consolidated accounts to inform the supervisory authorities about their findings related to any material breaches of law or regulation?** |

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| *Brief Explanation* | *In the EU framework external auditors (and similar functions) are obliged to inform supervisors about identified material breaches of the law, regulation or administrative provisions specifying conditions for authorisation or carrying out activities of institutions.* |
| *Legislative reference* | Article 63 of the CRD (control of consolidated accounts). |
| **3.3** | **Are the supervisory authorities in your jurisdiction legally in a position to impose administrative penalties or other administrative measures on institutions? If so, under which conditions?** |
| *Brief Explanation* | *Member States must set out rules on administrative penalties and other administrative measures following breaches of provisions of both the CRD and CRR.* |
| *Legislative reference* | See Articles 64-65 of the CRD (supervisory powers). |
| **3.4** | **Are supervisory authorities in your jurisdiction empowered to impose an equivalent set of administrative powers and other administrative measures towards institutions as the ones specified in the CRD?** |
| *Brief Explanation* | *In EU legislation, supervisors are allowed to impose administrative penalties and other administrative measures in various circumstances ranging from reporting of incomplete or inaccurate information to breach of limits. Moreover, supervisors are required to have in place appropriate mechanisms to encourage reporting of potential or actual breaches of law and institutions are required to have in place appropriate procedures for their employees to report breaches internally.* |
| *Legislative reference* | Article 66 and 67 of the CRD specify the administrative penalties and other administrative measures, and the circumstances where such administrative penalties or other administrative measures can be imposed. The need for establishing an appropriate system of reporting breaches is set out in Article 71 of the CRD. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **4) Supervisory Review Process** | |
| GENERAL PRINCIPLE | The European supervisors are required to perform an independent evaluation of the institutions' risk situation, since the supervisor might evaluate the risks of the institution differently than the institution itself. Following such independent evaluation of risks, the competent authority is empowered to impose additional capital or other requirements in order to cover any potential additional risk not covered by the institution following its internal evaluation of risks. |
| **4.1** | **Does your legislation include the need for institutions to carry out their own Internal Capital Adequacy Assessment Process (ICAAP)?** |
| *Brief Explanation* | *The ICAAP is at the core of the "Pillar II" approach, and requires that institutions undertake a regular assessment of the amounts, types and distribution of capital* |

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| | *that they consider adequate to cover the risks to which they are exposed.*<br>*Such an assessment should cover the major sources of risks to the institutions' ability to meet their liabilities as they fall due, as well as incorporate stress testing and scenario analysis. The ICAAP, and the corresponding internal processes, should be proportionate to the nature, scale and complexity of the institution.*<br>*The ICAAP complements the CRR capital requirements for the institutions in terms of risk management and risk measurement:*<br>*<u>Management</u> – Development of sound risk management processes, including measurement approaches, enhancing the link between an institution's risk profile, its risk management systems, and its capital.*<br>*<u>Measurement</u> - At transaction level institutions rely on Pillar I estimates if based on the standard approach, or on managerial estimates if the advanced approach is used. For the portfolio view, bank must develop internal credit portfolio models (CPM) that fully capture all the sources of credit risk, including concentration effects.* |
| *Legislative reference* | The provisions on ICAAP are set out in Article 73 of the CRD. |
| **4.2** | **Are the provisions for the governance arrangements, including clear organisational structure, consistent lines of responsibility, effective processes to identify, manage, monitor and report risks, adequate internal control mechanisms and sound remuneration policies (also including a potential bonus cap) and practices within credit institutions implemented in an equivalent way in your jurisdiction? Specifically, are the requirements for the governance arrangements and for the existence of an independent risk management function equivalent?** |
| *Brief Explanation* | *In order to assess the internal approach to governance and risk measurement chosen by the institution, the review process performed by competent authorities should be a thorough and pervasive procedure. It should cover many areas of the institution, including governance arrangements such as remuneration policies, capital and liquidity adequacy and the treatment of different risks (internal approaches to calculate own funds, credit and counterparty risk, concentration risk, securitisation risk, liquidity risk, market risk and operational risk). Such a process is necessary for all institutions, regardless of their size or their systemic importance.*<br>*The EU rules also establish that the institutions shall set up an appropriate independent risk management function with dedicated committee to monitor and address the risk strategy and the risk appetite of the institution.* |
| *Legislative reference* | Governance arrangements and remuneration policies are covered in Articles 74, 75, 92, 94 and 95 of the CRD and in Articles 88, 91 and 96 of the CRD, while the treatment of risks is laid down in Articles 77-87 of the CRD. Particular attention should be paid to Article 76 of the CRD, where it is stated that Member states should ensure that the management body of institutions devote sufficient time to the consideration of risk issues and should be actively involved in the management of all material risks. In addition, this article requires institutions to have an independent risk management function with sufficient authority, statute, resources and access to the management body. |

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| **4.3** | **Are the requirements for the Supervisory Review and Evaluation Process (SREP) implemented in an equivalent way within your jurisdiction?** |
| *Brief Explanation* | *Competent authorities shall review arrangements and processes implemented by the institutions and evaluate the risks to which such institutions are exposed, together with the risks posed to the financial system and its stability. Following such assessment, the competent authorities are authorised to undertake supervisory measures and use their supervisory powers to minimise or reduce identified risks.* |
| *Legislative reference* | The SREP provisions are defined in Article97-107 and 110 of the CRD. |
| **4.4** | **Is an ongoing review of internal approaches equivalently established?** |
| *Brief Explanation* | *While internal models should provide a better and more accurate assessment of the risks of institutions, they can give rise to concerns regarding their use for regulatory capital purposes and in the consistency of Risk Weighted Assets (RWAs) calculations. These concerns are stemming from the large variety in RWA results for similar portfolios and reservations about certain risk models' ability to capture tail risks. As a result, regulators and supervisors have questioned the reliability of capital adequacy measures based on the internal models based framework, as well as the potential creation of level-playing field issues. This is why the EU framework envisages a continuous monitoring and review of the internal models.* |
| *Legislative reference* | Ongoing review of internal models is defined by Article101 of the CRD. |
| **4.5** | **Is your supervisory authority empowered to levy higher capital and/or liquidity requirements for risks not covered or for capital/liquidity not being adequate with respect to risks faced?** |
| *Brief Explanation* | *Like elsewhere in the EU legislation, empowerment and enforceability are the cornerstone of the supervision: indeed, only if the supervisor has tools to require adequate capital levels and other requirements, the SREP process can be successful.* |
| *Legislative reference* | CRD Article104 (supervisory powers and own funds) and Article105 (liquidity). |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **5) Professional secrecy and international cooperation** | |
| GENERAL PRINCIPLE | In the EU, all persons working for or who have worked for competent authorities and auditors or persons acting on behalf of competent authorities are subject to professional secrecy requirements. Competent authorities in the EU may conclude cooperation agreements with non-EU supervisory authorities, providing for information sharing, where the information disclosed is subject to a guarantee that professional secrecy requirements are at least equivalent to the EU rules. |

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| **5.1** | **Are all persons working for or who have worked for the supervisory authorities in your jurisdiction and auditors or experts acting on behalf of these authorities subject to professional secrecy requirements? If so, please provide a brief description of the professional secrecy regime.** |
| *Brief Explanation* | *According to the EU rules, the professional secrecy obligation applies to confidential information received in the course of the work for, or on behalf of the competent authority. Such confidential information should only be used in the course of the supervisory duties. Strict conditions are imposed on the exchange of confidential information between authorities.* |
| *Legislative reference* | Relevant provisions with regards to professional secrecy are laid down in Article53 (professional secrecy obligation), and 54, 56, 57, 58, 59, 60, and 61 (use of confidential information) of the CRD. |
| **5.2** | **Which kind of options and obligations does your supervisory authority have in the area of international cooperation?** |
| *Brief Explanation* | *For European supervisors, cooperation with the EU, as well as with third countries is an important aspect of their work. European supervisors have different tools for cooperation. They are commonly involved in international supervisory colleges; and they have agreements of information sharing and cooperation (Memoranda of Understanding). Depending on the style and level of cooperation it is important to assess the level of equivalence first, for example in the area of "Professional Secrecy and Confidentiality" or more general in "Regulation and Supervision".* |
| *Legislative reference* | See Article55, 125, and 116 (6) of the CRD. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |

## Part II - Prudential regulatory requirements

| **6) Own Funds** | |
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| GENERAL PRINCIPLE | The EU regulation intends to cover different risks faced by institutions with their own funds, encompassing capital instruments which can be classified according to their loss absorption capacity as: Common Equity Tier 1 (CET1 – the highest quality capital), Additional Tier 1 capital instruments (AT1) and Tier 2 capital instruments .<br>Total amount of own funds qualifying to cover the different risks is calculated as Total Capital= CET1+AT1+Tier 2.<br>The CRR also establishes a predefined minimum amount and composition in terms of quality of the own funds, whereas lower quality requirements can be fulfilled with higher quality capital (the Tier 1 requirement can be met with CET1 fully or with CET1 and up to 1.5% AT1; and the Total own funds requirement can be met with Tier 1 fully or with Tier 1 and up to 2.0% Tier 2).<br>The overall principles on classification of own funds items into CET1, AT1 or Tier 2 are the loss absorbency and the availability of capital in cases of severe distress. For example, only capital instruments that are permanently available for absorbing losses of the institution would qualify as the CET1 – the highest quality capital. |
| **6.1** | **What are the minimum requirements with regards to regulatory capital ratios (corresponding to CET1, Tier 1, Total Capital) applicable in your jurisdiction? Does your legislation envisage other measures than capital requirements to ensure sufficient coverage of all risks at all time?** |
| *Brief Explanation* | *The own funds requirements are presented below (as a percentage of the total risk exposure amount, composed of RWAs and the exposure measures for market risk, operational risk and other relevant risks under the CRR):*<br>*• CET 1 capital ratio of 4.5%;*<br>*• Tier 1 capital ratio of 6%, (composed of CET1 and AT1);*<br>*• Total Capital ratio of 8%, (composed of CET1, AT1 and Tier 2).*<br>*Tier 1 capital allows financial institutions to continue their activities (going-concern) and help prevent insolvency. However, Tier 2 capital instruments aim at ensuring that depositors and senior creditors can be repaid in case the institution fails (gone-concern).* |
| *Legislative reference* | The general provisions in terms of eligible capital are defined in Article 25, 71 and 72 of the CRR, while quantitative requirements are defined in Article 92 of the CRR. |
| **6.2** | **What are the requirements and eligibility conditions for CET1 items applicable in your jurisdiction?** |
| *Brief Explanation* | *CET1 items should consist only of CET1 instruments, share premium accounts related to those instruments, retained earnings, Accumulated Other Comprehensive Income (AOCI), and other reserves and funds for general banking risk.*<br>*The eligibility conditions to qualify as CET1 capital are the key features that ensure the highest quality type of capital. Some of the most important provisions are that, in order to qualify as CET1, capital instruments must be issued directly* |

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| | *by the institution; they must be perpetual (i.e. have no maturity date); they must not bear any obligation for the institutions to make distributions to their owners; and must not be reduced or repaid, except in well-defined cases. The CET1 instruments rank below all other claims in the event of insolvency or liquidation of the institution (i.e. they are junior to all other claims).* |
| *Legislative reference* | Article26 of the CRR defines the items that can be computed in CET1, while Article 28 of the CRR defines the respective qualifying conditions. The respective provisions for mutual and cooperative societies are laid down in Article 27 and 29 of the CRR. Instruments subscribed by public authorities in emergency situations that may qualify as CET1 are defined in Article 31 of the CRR. |
| **6.3** | **If accounting is based on IFRS (or another accounting system that is influenced by Fair Value measurement) in your jurisdiction, please specify whether prudential filters on securitized assets, cash flow hedge and additional value adjustment are applied to CET1 capital.** |
| *Brief Explanation* | *Prudential filters refer to a number of items which under the IFRS may be classified as Equity (for accounting purposes), however cannot be recognised in the prudential own funds at regulatory level due to the uncertainty of their realisation. The prudential filters aim to exclude from CET1 any change in equity stemming from the following items:*<br>• *securitised assets*<br>• *cash flow hedges and changes in the value of own liabilities that result from changes in the credit standing of the institution*<br>• *unrealised gains and losses measured at fair value*<br>*Furthermore, the CRR prescribes additional value adjustments which may lead to a downward adjustment of accounting values for prudential purposes.* |
| *Legislative reference* | Provisions for prudential filters are in Article 32-35 of the CRR |
| **6.4** | **What are the principles applicable to deductions from CET1 capital in your jurisdiction? What are the categories of items that are deducted from CET 1 capital?**<br>**Please describe any differences to the categories of items referred to under the CRR. If you have identified such differences, please provide information regarding the rationale for the treatment chosen in your jurisdiction.** |
| *Brief Explanation* | *With regard to deductions from CET1 capital, both the CRR and the Basel III framework establish as a guiding principle those items which realisation has not yet occurred or might occur only in the future (with a certain degree of uncertainty) cannot be considered fully loss absorbent and thus must be removed from the highest quality capital. Amongst others, the following main elements are deducted from CET1:*<br>• *Goodwill and intangible assets*<br>• *Deferred Tax Assets (DTA)*<br>- *tax losses carried forward will be deducted from CET1*<br>- *DTA depending on future profitability: deduction for the portion > 10% CET1*<br>- *DTA not depending on future profitability, i.e. DTA that can be translated into tax claims in case the bank incurs a loss, will be risk-weighted at 100%* |

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| | • *Defined benefit pension fund assets: the revised IAS 19 implies that actuarial gains/losses will be accounted in other comprehensive income (OCI), hence impacting CET1. Additionally, the amount of the defined pension fund assets shall the deducted from CET1.*<br>• *Shortfall: 100% of the shortfall of the stock of Loan Loss Provision with respect to Expected Losses under the IRB approach will be deducted fromCET1.*<br>• *Securitisations: the 100% of exposures towards securitisations not rated or rated below a BB-rating (or equivalent) should be deducted from CET1.*<br>*In addition, the CRR and the Basel III framework prevent double gearing of Own Funds and therefore deduct both significant and non-significant investments in financial institutions:*<br>• *Significant (i.e. share >10%) investments in non-consolidated financial institutions (including insurance companies) will be deducted for the portion exceeding 10% of CET1*<br>• *15% threshold for non-deduction: If the sum of DTA depending on future profitability and significant investments in financial institutions exceeds the 15% of CET1 capital, the excess will be deducted from CET1. The amount not deducted from CET1 (i.e. the portion below 15%) will be risk-weighted at 250%* |
| *Legislative reference* | Provisions for deductions from CET1 Capital can be found in Article 36-47 of the CRR |
| **6.5** | **What are the eligibility criteria and deductions for AT1 capital instruments applicable in your jurisdiction?** |
| *Brief Explanation* | *AT1 items consist of AT1 capital instruments (whose eligibility criteria are defined in Article 52) and premium accounts related to those instruments.*<br>*AT1 instruments are perpetual and the provisions governing them do not include any incentive to redeem them; they rank below Tier 2 instruments in the event of liquidation or insolvency; they may be called, redeemed or repurchased only after meeting the conditions laid down in Article 52 of the CRR. Moreover, upon occurrence of a trigger event, the principal amount shall be written down on a permanent or temporary basis or the instruments converted to CET1 instruments.*<br>*The institution has full discretion to cancel the distributions for an unlimited period and on a non-cumulative basis; and this cancellation of distributions does not constitute an event of default.*<br>*Among deductions, the most important are the ones related to holdings of AT1 instruments issued by other entities in which the institutions itself has a share. Like provisions for CET1, such deductions from AT1 aim at preventing excessive "double-gearing", i.e. an artificial inflation of capital via reciprocal investments.* |
| *Legislative reference* | Provisions for AT1 capital are stated in Article 51-55 and 61 of the CRR, while deductions are detailed in Article 56-60 of the CRR. Please note that AT1 instrument usually cannot be called or redeemed before 5 years; however, Article 77-78 of the CRR details when supervisory permission may allow an instruction to call or redeem such instruments before that term. |
| **6.6** | **What are the eligibility criteria and deductions for Tier 2 capital instruments applicable in your jurisdiction?** |
| *Brief Explanation* | *Tier 2 items consist of Tier 2 and subordinated loans (whose eligibility criteria are defined in Article 63 of the CRR) and share premium accounts related to those* |

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| | *instruments. The CRR also introduced harmonized eligibility criteria.*<br>*The <u>most important</u> ones are the following:*<br>*a) the claim on the principal amount of the instruments is wholly subordinated to claims of all non-subordinated creditors;*<br>*b) The instruments are not secured and are not subject to any arrangement that otherwise enhances the seniority of the claims;*<br>*c) they have an original maturity of at least five years;*<br>*d) their provisions do not include any incentive for them to be redeemed by the institution itself.*<br>*Tier 2 capital ensures loss absorption in liquidation (gone-concern).*<br>*Deductions are particularly relevant in terms of cross-holdings, as well as significant and non-significant investment in financial institutions.* |
| *Legislative reference* | Provisions for Tier 2 capital are stated in Article 62-65 and 71 of the CRR, while deductions are detailed in Article 66-70 of the CRR. |
| **6.7** | **What are the rules that discipline any potential reduction of own funds applicable in your jurisdiction?** |
| *Brief Explanation* | *To reduce capital instruments (call, repurchase, and redemption), institutions must ask for permission to the competent authority, respect the timing for reductions of own funds, and ensure an adequate level of capital after the reduction (which implies the replacement of the instrument by another one of equal or higher quality where necessary, or the demonstration that the institution still meets the quantitative requirement for own funds).*<br>*Additionally, the sustainability of any replacement should be considered in terms of income capacity of the institution.* |
| *Legislative reference* | See Article77-78 CRR on the permission to reduce own funds. |
| **6.8** | **Are requirements concerning minority interest and holdings outside the financial sector equivalently implemented?** |
| *Brief Explanation* | *Under the CRR, 'minority interest' means the amount of CET1 capital of a subsidiary of an institution that is attributable to natural or legal persons other than those included in the prudential scope of consolidation of the institution.*<br>*Minority interests in excess of minimum capital requirements, <u>including national systemic buffers</u>, of each subsidiary cannot be counted within the group capital, according to the so-called "corresponding approach" (i.e. excess CET1 cannot be counted in CET1 capital, excess AT1 cannot be counted in AT1 and excess Tier 2 cannot be counted in Tier 2).*<br>*The prudential rationale behind this requirement is that while minority interest supports the risks taken by the subsidiary, it is not necessarily available to back the risks taken by the group. Therefore, excess capital above the minimum requirement of the subsidiary can be included in the group capital only in proportion to the minority share.*<br>*Please note that the relevant level of CET1 capital to be employed to calculate minority interests also includes the new capital conservation buffer, countercyclical buffer and any systemic risk buffer that might be imposed by the competent authority.* |

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| *Legislative reference* | "Minority interest" is defined in Article 4 (120) of the CRR and the relative provisions are laid down in Article 81-84 of CRR |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **7) Capital Requirements - General Requirements, Valuation and Reporting** | |
| GENERAL PRINCIPLE | The EU capital requirements regulation sets the minimum capital requirement as a ratio of RWAs. The total risk exposure amount, composed of RWA (credit risk), and the exposure measures for Market Risk, Operational Risk and other relevant risks ratio need to be fulfilled with high quality loss absorbing capital. The capital requirement should ensure either the going-concern (i.e. business as usual and recovery phase) of the institution or allow an organized winding down, if necessary ("gone concern"). The total risk exposure amount is defined as the sum of the different risk categories; for each risk category, institutions can choose (within the limitations established by the CRR) an approach to calculate the risks. |
| **7.1** | **How do you determine the current risk an institution has to bear? For which kind of risk categories do you require the institutions to hold capital?** |
| *Legislative reference* | The types of risk covered by the EU framework are specified in Article 92(3) of the CRR |
| **7.2** | **Are supervised institutions subject to prudential reporting requirements? What is the content of the prudential reporting? What is the reporting frequency?**<br>**Is there a common reporting format and obligation?** |
| *Brief Explanation* | *A clear and transparent reporting is a prerequisite for allowing efficient and consistent supervision activity. While it should be expected that reporting obligations are not completely aligned (especially in terms of frequency), the overall objective should be comparable.* |
| *Legislative reference* | The provisions concerning the calculation and reporting requirements are laid down in Article 99-101 of the CRR. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction** |
| **8) Capital Requirements for Credit Risk** | |

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| GENERAL PRINCIPLE | Credit risk can be defined as the potential that an institution's borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The credit risk typically resides in assets in institutions' banking book (loans and debt instruments held to maturity) but it can also arise in the trading book as a counterparty credit risk.<br><br>The EU regulation requires institutions to classify all exposures to their obligors into exposure classes and differentiate them on the basis of the obligor's ability to meet its obligations. The risk-weighted exposure amounts are based on the exposure value and risk weights (assigned on the basis of exposures' classification and their credit quality). Depending on the sophistication of the approach applied the risk weight can be assigned following the standardised CRR rules (Standardised Approach) or it can be determined by the institution on the basis of statistical methods (Internal Ratings-Based Approach – IRB Approach) used to estimate the Probability of Default (PD), Loss Given Default (LGD), Exposure at Default (EAD) and calculate Maturity of exposure [M]. |
| **8.1** | **Please specify which approaches for measuring credit risk for the purpose of calculating Pillar 1 capital requirements are applied in your jurisdiction?** |
| *Brief Explanation* | *The CRR sets out detailed requirements for two alternative approaches to measure institutions' exposure to credit risk: the Standardised Approach and the Internal Ratings-Based Approach (the IRB Approach). For each of these approaches, the CRR also specifies detailed requirements and sets out conditions for using credit risk mitigation techniques, and provides rules for treatment of securitised exposures and applying conversion factor/percentage for off-balance sheet exposures.* |
| *Legislative reference* | For general principles for credit risk refer to Article 107-110 of the CRR. |
| **8.2** | **Please describe the rules implementing the Standardised Approach for calculating capital requirements for credit risk in your jurisdiction.** |
| *Brief Explanation* | *The CRR sets out detailed rules for the Standardised Approach for calculating capital requirements for credit risk by specifying inter alia:*<br>*a. Exposure classes (the CRR specifies seventeen exposure classes including exposures to central governments or central banks; exposures to public sector entities, exposures to corporations; retail exposures, items representing securitisation positions, exposures secured by mortgages on immovable property etc.)*<br>*b. Risk weights applicable for each exposure class (which may depend in particular on external ratings assigned by a recognised external credit assessment institutions(ECAIs)*<br>*c. Rules for establishing exposure value (in particular taking into account net exposure after specific credit risk adjustments and using percentages for off-balance sheet exposures);*<br>*d. Rules for using external ratings assigned by ECAIs (recognition of ECAIs, mapping of ECAIs' credit assessment into credit quality steps and use of ECAIs' credit assessment for the determination of risk weights);* |

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| | *e. Definition of default.*<br>*<u>Please ensure that your description covers all items mentioned above.</u>* |
| *Legislative reference* | The provisions for the Standardized Approach for credit risk are laid down in Art 111-141 CRR. References to specific areas are as follows:<br>- Exposure classes: Article 112 of the CRR;<br>- Risk weights: Article 113-134 of the CRR;<br>- Exposure value: Article 111 of the CRR;<br>- External ratings (ECAIs): Article 135-138 of the CRR;<br>- Definition of default: Article 127 and 178 of the CRR. |
| **8.3** | **Please describe the rules implementing the IRB Approach for calculating capital requirements for credit risk in your jurisdiction.** |
| *Brief Explanation* | *The CRR sets out detailed rules for using the IRB Approach for calculating capital requirements for credit risk. Based on the complexity, the CRR distinguishes between: (i) the Foundation IRB (F-IRB) Approach under which institutions estimate only PD and use supervisory estimates for the remaining risk components; and (ii) the Advanced IRB (A-IRB) Approach under which the institutions estimate all risk components (i.e. PD, LGD, EAD and M).*<br>*The key requirements for the IRB Approach specified in the CRR are as follows:*<br>*a. Exposure classes (seven risk classes including: exposures to central governments and central banks; exposures to on institutions; exposures to corporates; retail exposures; equity exposures; items representing securitisation positions; other non-credit obligation assets)*<br>*b. Calculation of risk weighted exposure amounts*<br>*c. Expected loss amounts (EL = PD × LGD × EAD)*<br>*d. Rules for use of risk components:*<br>*i. Probability of Default [PD]*<br>*ii. Loss Given Default [LGD]*<br>*iii. Exposure at Default [EAD]*<br>*iv. Maturity of exposure [M]*<br>*e. Requirements for the IRB models:*<br>*i. Structure of rating systems, rating assignment process, data maintenance and documentation*<br>*ii. Estimation of risk parameters (including rules on models' development, risk quantification, validation)*<br>*iii. Requirements for internal governance (including the role of credit risk control unit and internal audit)*<br>*iv. Conditions for supervisory permission for the IRB models (including use test, permanent partial use, roll out plans)*<br>*f. Definition of default*<br>*<u>Please ensure that your description covers all items mentioned above.</u>* |
| *Legislative reference* | The provisions for the IRB Approach for credit risk are laid down in Article 142-191 of the CRR. More detailed references are as follows:<br>- Exposure classes: Article147of the CRR<br>- Calculation of risk weighted exposure amounts: Article 151-157 of the CRR, Expected loss amounts: Article 158-159 of the CRR<br>- Risk components [PD, LGD, EAD, M]: Article 160-168 of the CRR |

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| | - Requirements for the IRB models: Article 142-150, 169-191 of the CRR<br>- Definition of default: Article 178 of the CRR |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **9) Credit Risk Mitigation** | |
| GENERAL PRINCIPLE | Credit risk mitigation (CRM) techniques allow institutions to reduce credit risk originating from exposures they hold. The CRR distinguishes two types of the CRM techniques: (i) 'funded credit protection' where the reduction of the credit risk on the exposure derives from the rights that institution has towards the asset provided as collateral, in the event of default of the counterparty or on the occurrence of other specified credit events relating to the counterparty; and (ii) 'unfunded credit protection' where the reduction of the credit risk on the exposure derives from the obligation of a third party to pay an amount in the event of the default of the borrower or the occurrence of other specified credit events. According to the CRR, upon meeting specific requirements for the CRM, institutions are allowed to recognise the effects of the CRM in the calculation of the minimum capital requirements for credit risk. |
| **9.1** | **What credit risk mitigation (CRM) techniques in your jurisdiction are recognised for the purpose of calculating capital requirements for credit risk? What are the general principles for eligibility of the CRM techniques for their recognition in calculating capital requirements for credit risk?** |
| *Brief Explanation* | *The CRR specifies the general principles for eligibility of CRM techniques which include inter alia the following requirements:*<br>a. *credit protection arrangements must be legally effective and enforceable in all relevant jurisdictions (these should be confirmed by legal opinions);*<br>b. *funded credit protection can be recognised if assets relied upon for protection (i) are included in the list of eligible assets (specified for this purpose in the CRR), and (ii) are sufficiently liquid, their value over time is sufficiently stable and not highly correlated with the credit quality of the obligor;*<br>c. *unfunded credit protection can be recognised where (i) it takes form of the eligible protection agreements (e.g. guarantee; credit derivatives); and (ii) the protection provider is eligible (i.e. included in the list of eligible protection providers specified in the CRR);*<br>d. *institution has adequate risk management processes to control the risks stemming from its CRM practices.*<br><ins>*Please ensure that your description covers all items mentioned above.*</ins> |
| *Legislative reference* | The general provisions for CRM are specified in Article 192 and 194 of the CRR. |
| **9.2** | **Please describe in detail the rules applicable in your jurisdiction for 'funded credit protection'.** |

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| *Brief Explanation* | *With regard to the funded credit protection the CRR provides specific rules for:*<br>*a. Eligible forms of CRM techniques (e.g. on-balance sheet netting, master netting agreements, legal agreements empowering a lending institution to liquidate or retain an asset from which the protection derives, life insurance policies pledged);*<br>*b. Eligibility of collateral (e.g. cash, debt securities, equities and convertible bonds issued by eligible entities, physical collateral);*<br>*c. Detailed requirements for eligible forms of funded credit protection and assets eligible as collaterals.*<br>*It should be noted that the CRR provides different requirements for institutions using the Standardised Approach or the IRB Approach (i.e. there is a broader scope of the eligible collaterals under the IRB Approach). <u>Please ensure that your description covers all items mentioned above.</u>* |
| *Legislative reference* | Requirements for funded credit protection are specified in Article 195-200, 205-212 of the CRR |
| **9.3** | **Please describe the rules applicable in your jurisdiction for 'unfunded credit protection'.** |
| *Brief Explanation* | *With regard to unfunded credit protection the CRR provides specific rules for:*<br>*a. Eligible forms of CRM techniques (e.g. guarantees, counter-guarantees, credit derivatives, credit linked notes);*<br>*b. Eligibility of protection providers;*<br>*c. Eligible types of credit derivatives;*<br>*d. Detailed requirements for each eligible form of unfunded CRM (e.g. the credit protection must be direct, clearly defined, incontrovertible, do not include clauses outside of direct control of the lender).*<br>*The CRR defines strict rules for unfunded credit protection and recognises guarantees, credit derivatives and credit linked notes to the extent of their cash funding. On the other hand, insurance remains outside the scope of the CRM regime. Furthermore, only certain entities can provide unfunded protection, these include sovereign entities, regional governments and local authorities, public sector entities (PSEs), banks (including multilateral development banks), certain international organisations, central counterparties and investment firms, and corporations with good external ratings. In addition, it should be noted that the CRR provides different requirements for institutions using the Standardised Approach or the IRB Approach.*<br>*<u>Please ensure that your detailed description covers all items mentioned above</u>.* |
| *Legislative reference* | Requirements for unfunded credit protection are specified in Article201-204 and 213-217 of the CRR |
| **9.4** | **Please describe the rules applicable in your jurisdiction for recognising the effects of CRM in the calculation of capital requirements for credit risk.** |
| *Brief Explanation* | *Upon meeting specific requirements set out in the CRR, institutions may reflect the mitigating effects of the CRM techniques in calculating their capital requirements for credit risk by decreasing such requirements. The CRR includes different rules for recognising the CRM effects which depend on whether an institution uses:* |

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| | - *Standardised Approach or IRB-Approach*<br>- *funded credit protection or unfunded credit protection*<br>- *within the funded credit protection: Financial Collateral Simple Method or Financial Collateral Comprehensive Method*<br>*Please ensure that your description covers all items mentioned above.* |
| *Legislative reference* | Effects of CRM on capital requirements: Article 193 and 218-241 of the CRR |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **10) Securitisation** | |
| GENERAL PRINCIPLE | The CRR sets out the securitisation framework which specifies *inter alia* conditions associated with off-balance sheet treatment and risk weighting of securitisation exposures. The CRR distinguishes two types of securitisation: (i) “traditional securitisation” which involves the economic transfer of the exposures being securitised by the transfer of ownership from the “originator” institution to a special purpose vehicle (SPV), and (ii) “synthetic securitisation” which occurs when the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator institution. Within the CRR, the “economic content” of the transaction is key when determining which securitisation framework should be applied. |
| **10.1** | **Please describe rules applicable in your jurisdiction for ‘traditional securitisation’ and ‘synthetic securitisation’.** |
| *Brief Explanation* | *With regard to securitisation the CRR provides specific rules for:*<br>a. *Recognition of significant risk transfer (the underlying concept in the CRR is that a risk transfer must actually occur in order for an institution to be able to apply off-balance sheet treatment of securitised assets);*<br>b. *Calculation of risk-weighted exposure amounts (separate rules exist for the Standardised Approach and IRB Approach)* |
| *Legislative reference* | Provisions for securitisation are laid down in Article 242-270 CRR |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction** |
| **11) Counterparty credit risk** | |
| GENERAL PRINCIPLE | Counterparty Credit Risk (CCR) is the credit risk arising between derivatives’ counterparties. Since the credit crisis of 2007 onwards and the failures of large institutions, CCR has been considered by most market participants to be the key |

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| | financial risk. CCR arises on products such as over- the-counter (OTC) derivatives and securities financing transactions (e.g. repo agreements) and may refer to:<br>• Default - CCR or Pre-settlement Risk: the risk that the counterparty to a financial contract should default before settling the transaction and not make all the payments required by the contract itself;<br>While CCR contains elements of market risk and credit risk as well as other elements, its peculiarities call for a separate treatment. A major difficulty in its calculation is indeed the uncertainty of future exposure and the relative complexity of the distribution for different scenarios of market risk factors. |
| **11.1** | **How do you account in your jurisdiction for CCR ? Could you provide us with your definition and your methodology to estimate CCR ?** |
| *Brief Explanation* | *The CRR strengthens the requirements for managing and adequately covering CCR. It includes an additional capital charge for losses associated with deterioration in the creditworthiness of counterparties and higher risk weights on exposures to large financial institutions. The new framework also aims at reducing intrinsic risks to financial stability through higher incentives for clearing OTC instruments through central counterparties (CCP).* |
| *Legislative reference* | The basic definitions for the CCR are laid down in Article 271-272 of the CRR. |
| **11.2** | **The CRR allows four different methods to calculate the capital requirement for CCR. Which of these are specifically implemented in your jurisdiction?** |
| *Brief Explanation* | *The methods for the calculation of CCR are a) Mark-to-Market; b) Original exposure method; c) Standardised; d) Internal Model Method (IMM).* |
| *Legislative reference* | The different methods are described in Article 274-285 of the CRR. |
| **11.3** | **Are contractual netting agreements recognised in your jurisdiction? If so, how?** |
| *Brief Explanation* | *Among the various methods of risk mitigation, contractual netting has by far the greatest impact on the structure of the derivatives market.*<br>*In the EU, the International Swaps and Derivatives Association (ISDA) Master Agreement is usually the contract under which OTC derivative transactions between two counterparties take place: each time that a transaction is entered into, the terms of the Master Agreement do not need to be re-negotiated and apply automatically. The Master Agreement aims to eliminate legal uncertainties, to standardise the rules of netting between the various parties and to provide mechanisms for the mitigation of counterparty risk and specifies the general terms of the agreement.* |
| *Legislative reference* | Requirements for contractual netting agreements are specified in Article 295-296 of the CRR. |
| **11.4** | **The main novelties of the CRR with respect to the previous framework for CCR are related to: EAD calculation; Wrong Way Risk; Central Counterparties (CCP), Asset Value Correlation (AVC). How does your jurisdiction comply with such provisions?** |
| *Brief Explanation* | • *EAD Calculation: based on stressed Effective EPE (Expected Positive Exposure), which in turn should be based on model parameters calibrated over a 3-year period.* |

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| | • *Wrong Way Risk: specific capital charge for "adverse correlation" between the exposure to a counterparty and its creditworthiness. This risk arises from transactions with counterparties whose credit quality is highly correlated with the exposure amount.*<br>• *CCP: Additional requirements for exposures to CCP.*<br>• *AVC: Higher risk weights in the IRB approach through an increase of the asset value correlation, to contain systemic risk.* |
| *Legislative reference* | Please refer to the following articles in the CRR:<br>• EAD Calculation: Article 284 of the CRR<br>• Wrong-way risk: Article 291 of the CRR<br>• CCP: Article 300-311 of the CRR<br>• AVC: Article 142 (1) (4) of the CRR |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **12) Own funds requirement for operational risk** | |
| GENERAL PRINCIPLE | Under the CRR, "operational risk" (OpRisk) means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk. OpRisk is a significant risk faced by institutions requiring coverage by own funds.<br>OpRisk is generally regarded as a highly volatile risk which makes it difficult to model or deliver a reliable prognosis. Nevertheless, it is generally agreed upon that OpRisk is a significant factor in the downfall of institutions. Due to the difficulty in projections, and the accepted heavy-tailedness of distribution, the capital requirement should cover accumulated annual losses that will be exceeded once within 1000 years. In the Advanced Measurement Approach (AMA) this should be achieved through individual risk calculation by the institution's own model. In the other approaches, the calibration of the formula has to be at a comparable risk level.<br>With the implementation of capital requirements for OpRisk the regulator recognised that there are specific risks that are not linked to an institution's portfolio. Therefore, the calculation of a capital requirement is more based on P&L positions as a measure for the business activity, and less on balance sheet positions (like in credit and market risk). This category covers a variety of risk types that are dealt with independently. Legal risk, IT risk, compliance risk, risks from outsourcing and model risk are all elements of OpRisk.<br>For the purpose of the calculation of the capital requirement business risk, strategic risk and reputation risk are not included, although for risk steering purposes they might be managed simultaneously.<br>In addition, sound principles of operational risk management, governance and risk management environment are expected to be in place, depending of the institutions' nature, size and complexity. |

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| **12.1** | **How are the supervisors and institutions in your jurisdiction prepared for OpRisks and its varieties?** |
| **12.2** | **Which kind of approaches are allowed and used for measuring OpRisk within your jurisdiction (formula driven, model driven) and who decides which approach is used for an individual institution?** |
| **12.3** | **Please explain the methodology employed (quantitative approach and qualitative requirements) to measure and cover OpRisk (basic, standard, advanced).** |
| *Brief Explanation* | *The CRR foresees three different approaches:*<br>• *Basic Indicator Approach (BIA), in which the own funds requirement for operational risk is equal to a percentage, on average of three years, of the Relevant Indicator (RI). "RI" is the sum of certain accounting categories from the profit and loss account.*<br>• *Standardised Approach (TSA), in which the own funds requirements are also calculated as a percentage, on average of three years of the RI, but in this case, the RI is calculated separately for each line of business and a different percentage is applied for each of them. TSA also comprises a qualitative operational risk management.*<br>• *Advanced Model Approach (AMA), in which the own funds requirements are calculated in accordance with internal models. AMA also comprises a qualitative operational risk management.* |
| **12.4** | **If you allow model driven approaches, are there reductions of capital requirements like:**<br>- **Expected Loss**<br>- **Risk Transfer Mechanism (including Insurances)**<br>- **Correlations** |
| *Legislative reference* | The provisions for OpRisk are laid down in: in Article 312-324 of the CRR |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with relevant the EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **13) Own funds requirement for market risk, settlement risk and Credit Valuation Adjustment (CVA) risk** | |
| GENERAL PRINCIPLE | Market risk can be defined as the risk that a portfolio, of either investment or trading nature, will decrease in value due to adverse changes in prices on the financial markets. Market risk in the EU is basically calculated via "models". While institutions might opt for a more advanced internal model, the regulatory standard formula also contains model elements. The institution should calculate the capital requirements for different classes of investment separately (interest, equity, commodities, currencies…) and add the results.<br>Settlement risk and CVA risks are specific variations of risk most closely |

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| | connected to the market risk. EU regulation requires these two risk categories to be calculated separately. |
| **13.1** | **Market risk is the risk area where adverse occurrences can be observed with the highest frequency (although the magnitude varies greatly). Thus, the formulas are more advanced and require more input from the institutions with respect to measurement of credit risk. Does your jurisdiction follow a similar approach?**<br>**How do you ensure that the related areas like settlement risk and CVA risk are sufficiently covered?** |
| *Brief Explanation* | *An institution is exposed to several sources of market risk:*<br>• *Position risk (including Interest Rate risk and Equity risk)*<br>• *FX risk*<br>• *Credit Spread risk*<br>• *Default risk*<br>• *Commodity risk*<br>*Value at Risk (VaR) is the maximum possible loss a position can incur into over a certain time horizon (e.g. 1 day) with a certain probability (e.g. 99%). 99%-1day VaR is the basis of the daily monitoring of the trading/banking book portfolio.*<br>*In addition to VaR, a new set or risk measures was introduced in recent years:*<br>• *Stressed VaR (sVaR)*<br>• *Incremental Risk Charge (IRC)*<br>• *Comprehensive Risk Measure (CRM)*<br>• *Standardized Approach for Securitisations*<br>*Therefore, Capital Adequacy for market Risk can be summarised as follows:*<br>*MktRisk Capital = VaR + sVaR + IRC + CRM+ Standardized* |
| *Legislative reference* | Provisions for own funds requirements stemming from Market risk are laid down in Article 325-386 of the CRR. |
| **13.2** | **Is the possibility of offsetting positions between institutions belonging to the same group, under certain conditions, for the purpose of calculating consolidated requirements, allowed in your jurisdiction?** |
| *Brief Explanation* | *Article 325 of the CRR sets out allowances for consolidated requirements. For the purpose of calculating own funds requirements for market risks and under certain conditions, a parent institution within a group may use positions in one institution to offset positions in another, thus effectively reducing own funds requirements for market risk at group level.* |
| *Legislative reference* | See Article 325 (1) of the CRR for the overall approach to offsetting within a group and Article 325 (2-3) of the CRR for the conditions under which such offsetting is allowed. |
| **13.3** | **Are the market risk requirements for the treatment of position risk in specific instruments generally implemented in an equivalent way in your jurisdiction?** |
| *Brief Explanation* | *The own fund requirement for position risk shall be the sum of the own funds requirement for general and specific risk of its positions in debt and equity instruments. The CRR provides details for position risk, including interest rate futures and forwards, options and warrants, swaps, interest rate derivative instruments, credit derivatives.* |

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| *Legislative reference* | See Article 326-333 of the CRR |
| **13.4** | **Are the market risk requirements concerning specific exposures implemented in an equivalent way in your jurisdiction? Specifically, are there specific market risk provisions that can be considered equivalent with respect to:**<br>• **Debt positions**<br>• **Foreign exchange risk**<br>• **Equities**<br>• **Commodities** |
| *Legislative reference* | Specific regulatory references can be found as follows:<br>• Debt positions: Article 334-340 of the CRR<br>• Foreign exchange risk: Article 351-354 if the CRR<br>• Equities: Article 341-344 of the CRR<br>• Commodities: Article 355-361 of the CRR |
| **13.5** | **Within calculations of own funds for market risk, does your jurisdiction allow for the <u>use of internal models</u> under similar conditions than in the CRR, and subject to supervisory review/approval?**<br>**In case you are allowed to use internal models, are the market risk requirements generally implemented in an equivalent way in your jurisdiction?** |
| *Brief Explanation* | *The use of internal models can be granted to calculate general and specific risk of equity and debt instrument, as well as foreign exchange risk and commodity risk.* |
| *Legislative reference* | Article 362-377 of the CRR |
| **13.6** | **Does your jurisdiction envisage a specific provision for Incremental Risk Charge (IRC)?** |
| | *An institution that uses an internal model for calculating own funds' requirements for the specific risk of traded debt instruments shall also have an internal incremental default and migration risk charge (IRC) model in place. IRC captures a broader range of risks beyond default - in particular, credit rating migration, spread widening and equity prices oscillations. The importance of this kind of risk became evident after the 2007-09 financial crisis, when a large part of losses experienced by institutions did not stem from actual defaults, but from credit migrations towards lower rating classes, widening spreads and a lack of liquidity - and as such would not have been captured by a charge focusing only on actual default.* |
| *Legislative reference* | See Article372-376 CRR |
| **13.7** | **Are the requirements for settlement risk and CVA risk implemented in an equivalent way in your national regulation?** |
| *Brief Explanation* | *<u>Settlement risk</u> is the risk stemming from transactions that remain unsettled after their due delivery date, so that there might be a difference between the agreed settlement price and its current market value. If such a difference implies a loss for the institution, it must be accounted for as a capital charge.*<br>*<u>CVA risk</u> is the risk of loss caused by changes in the credit spread of a counterparty, due to changes in its credit quality. CVA aims at quantifying the risk that counterparties to derivatives transactions may be more or less creditworthy* |

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| | *at any given time during the life of such a transaction.*<br>*The calculation of CVA also takes into account certain risk mitigants such as netting and collateral arrangements and certain offsetting hedges. Thus, the actual risk that is taken into account is the one that remains after these other mitigants have been factored in.* |
| *Legislative reference* | Settlement risk is defined in Article 378-380, while CVA risk provisions are laid out in Article 381-386 of the CRR. |
| **13.8** | **In particular, are the advanced and the standardised methods for calculating the appropriate CVA figure contemplated in your regulation? If so, how?** |
| *Brief Explanation* | *The CRR specifies two main methods for the calculation of CVA:*<br>a. *<u>Advanced method</u> – This involves using a firm's internal models to calculate the impact of changes in counterparty credit spreads, taking into account eligible hedges. It does not consider other market factors such as interest rate or currency risk. If a credit spread is not available for a counterparty, a proxy spread should be used.*<br>b. *<u>Standardised method</u> – Should a firm not use an advanced method for the calculation of CVA risk, it should calculate it in accordance with the standardised method taking into account eligible hedges. Being less tailor made, this might turn out as a more capital-intensive option for institutions.* |
| *Legislative reference* | See Article 383 of CRR (Advanced method) and Article 384 of the CRR (Standardised method). |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **14) Large exposures** | |
| GENERAL PRINCIPLE | To protect institutions from significant losses caused by the sudden default of an individual counterparty, the EU regulation does not allow banks to be exposed to each of their individual counterparties beyond a certain percentage of their own funds (25% of their eligible capital). This limit ('large exposure limit' thereafter) applies to the aggregated amount of exposures that a bank has to a same counterparty or a same group of connected counterparties.<br>Eligible capital is defined as the sum of Tier 1 capital and Tier 2 capital within the limit of one third of the Tier 1 capital.<br>The large exposure limit applies to all banks on an individual basis and all banking groups on a consolidated basis. |
| **14.1** | **What kind of a large exposure regime is applied to institutions in your national legislation? Please provide a description of your large exposure regime by specifying the following:**<br>- **Level (in percentage of the capital base) of the large exposure limit;** |

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| | - **Level of application of the large exposure regime (i.e. at consolidated, sub-consolidated or/and individual levels)**<br>**Treatment of connected counterparties (i.e. do you apply the large exposure limit on an aggregated basis to groups of counterparties which are connected through control relationships or economic interdependence?)** |
| *Brief Explanation* | *The large exposure regime is laid down in Article 387-403 of the CRR and based on the Basel Committee on Banking Supervision (BCBS) guidance, Measuring and controlling large credit exposures, published in January 1991 and the Principle 19 of the Core Principles for Effective Banking Supervision, standards published by the BCBS in September 2012. More specifically:*<br>- *'eligible capital' is defined in point 71 of Article 4(1) of the CRR;*<br>- *'group of connected counterparties' is defined in point 39 of Article 4(1) of the CRR;*<br>- *The treatment of group of connected counterparties is specified in Article 390(5) and (7) of the CRR;*<br>- *the level and capital base of the large exposure limit are specified in Article 395 of the CRR;*<br>- *The level of application of the large exposure regime is specified in Articles 6 and 11 of the CRR.* |
| **14.2** | **Does your national regulation require banks to report their largest exposures? If so, please provide a brief description of reporting requirements for large exposure purposes.** |
| *Brief Explanation* | *The EU large exposures regime requires institutions to report to their supervisors all their exposures to clients and group of connected clients exceeding 10% of eligible capital.* |
| *Legislative reference* | The reporting requirements are specified in Articles 392 and 394 of the CRR |
| **14.3** | **Where your national legislation applies a large exposure limit to banks, please specify further the following:**<br>- **types of exposures exempted from such large exposure limit**<br>- **Treatment of exposures on trading book for large exposure purposes**<br>- **Use of credit risk mitigation techniques for large exposure purposes** |
| *Brief Explanation* | *In the EU, all credit risk exposures and counterparty credit risk exposures of the balance-sheet and off-balance sheet irrespective of whether these exposures are included in the banking book or the trading book or both are subject to the 25% large exposure limit except for specific exposures which are or may be exempted from the large exposure limit (e.g. exposures to sovereigns with a 0% risk weight under the Standardised Approach, exposures to central counterparties, intra-group exposures).*<br>*The 25% large exposure limit may be exceeded for the exposures on the trading book under certain conditions.*<br>*The value of exposures subject to the large exposure limit can be reduced by the amount of credit risk mitigation techniques under certain conditions.* |
| *Legislative reference* | The calculation of the exposure value is specified in Article 390 of the CRR.<br>The use of credit risk mitigation techniques for large exposure purposes is specified in Articles 399, |

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| | 401, 402 and 403 of the CRR.<br>The treatment of exposures on the trading book for large exposure purposes is specified in Articles 395(5) and 397 of the CRR.<br>The exemptions to the application of the large exposure limits according to Article 395 (1) CRR are specified in Article 400 of the CRR. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **15) Exposure to transferred credit risk** | |
| GENERAL PRINCIPLE | Transferred Credit Risk has a different nature with respect to common credit risk, so that it needs specifically designed rules, which should prevent moral hazard and misaligned incentives to allow build-up of excessive risk taking along the securitisation chain. Failure to carefully regulate this area might lead to excessive risk-taking, because the originator may have a lower interest to monitor risks adequately, while the investor might not legally have the power to take all the necessary measures of precaution. The regulation then aims at having a fair risk distribution for all involved parties. |
| **15.1** | **Do you have specific requirements for transferred credit risk? Or if not, how do you manage the risk profile that is often different to the common credit risk?** |
| **15.2** | **How are the requirements on transferred credit risk implemented in your national regulation?** |
| *Brief Explanation* | *Today we often characterise securitisation markets prior to the 2007-09 financial crisis as marked by "misaligned incentives" or "conflicts of interest", i.e. situations where certain participants in the securitisation chain - while pursuing their own objectives - had incentives to act against the interests of others or the broader efficient functioning of the market. These misalignments are generally thought to have contributed to the loss of investor confidence in securitisation products and might have prevented an efficient revival of the market itself.*<br>*Thus, the provisions in the CRR aim at removing such misalignments and providing an accurate pricing of credit risk, through the requirement that investor institutions assume exposure to a securitisation only if the originator, sponsor, or original lender has explicitly disclosed that it will retain a material net economic interest of no less than 5%.* |
| *Legislative reference* | Transfer Risk provisions are laid down in Article 404-410 of the CRR. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **16) Liquidity** | |

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| GENERAL PRINCIPLE | Liquidity risk refers to the possibility that the bank may encounter difficulties in meeting expected or unexpected cash payments or delivery obligations, thereby impairing daily operations or the financial condition of the bank. It may refer to the fact that an institution may not be able to meet efficiently any expected or unexpected cash outflows, due to the unavailability of funding sources (funding risk), or to the fact that, when liquidating a sizeable amount of assets, an institution faces a considerable (and unfavourable) price change generated by exogenous or endogenous factors.<br>Prior to the 2007-09 financial crisis, liquidity risk was sometimes overlooked by institutions and regulators. However, the crisis showed that more institutions could fail following a distressed liquidity situation. Therefore, the new regulatory framework requires a more prudent liquidity management. While the CRR creates a general short-term liquidity requirement and liquidity reporting obligations, the Delegated Act[1] 2015/61 specifies in detail the EU Liquidity Coverage Ratio. This Delegated Act defines high quality liquid assets and the detailed outflow and inflow requirements to ensure that the liquidity position is sufficient to meet net outflows under a 30 day liquidity stress horizon. |
| **16.1** | **Are there liquidity requirements in place? Which methods do you use to mitigate the risk of a liquidity driven financial crisis?** |
| *Brief Explanation* | *The requirement differentiates the banks' assets according to their level of liquidity, i.e. according to the ease with which such assets can be transformed into cash at little or no loss value in stressed conditions. A bank should have a sufficient level of liquid assets to cover their stressed net outflows during the following 30 days.* |
| **16.2** | **Are the provisions for liquidity of the CRR implemented in a broadly equivalent way in your jurisdiction? Do you target liquidity risk both in the short and in the long term?** |
| *Brief Explanation* | *The CRR alludes to a liquidity coverage requirement under a 30 day stress horizon, for which it contemplates a reporting framework and a reference to a delegated regulation (Liquidity Coverage Ratio (LCR) Delegated Act) for its specification, and raises the issue of whether a stable funding requirement could be necessary in Europe by referring to potential upcoming legislative proposals if appropriate.*<br>*LCR*<br>*The LCR Delegated Act aims to ensure that a bank maintains an adequate level of unencumbered, High-Quality Liquid Assets (HQLA) that can be converted into cash to meet its liquidity needs for a 30 day time horizon under a significantly severe liquidity stress scenario. From 2018, such a level is required to be 100%; prior to that, a transitional period is available. High Quality Liquid Assets (HQLA) are assets that can be easily and immediately converted into cash at little or no loss of value. Liquidity needs stem from liquidity inflows and liquidity outflows, to be assessed over a 30-day period, assuming a combined idiosyncratic and market-wide stress scenario.*<br>*Stable Funding Reporting* |

[1] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2015:011:TOC

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| | *The CRR requires reporting of those specific items providing and requiring stable funding. The CRR makes a general statement related to a necessary funding position which can ensure that long term obligations are adequately met. It leaves to further considerations the possibility of an upcoming regulation of a specific stable funding requirement.* |
| *Legislative reference* | The main provisions for liquidity reporting are laid down in Article 411-428 of the CRR. A general short-term LCR requirement is established by Article 412 CRR. The detailed LCR rules are determined by the Commission Delegated Act 2015/61.<br>The general longer term stable funding requirement is fixed by Article 413 CRR which applies from 1.1.2016. Detailed rules on a net stable funding requirement would require to be set by a Commission legislative proposal under Article 510.3 of the CRR. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **17) Leverage** | |
| GENERAL PRINCIPLE | The years preceding the financial crisis were characterised by an excessive build up in institutions' exposures in relation to their own funds (leverage). During the financial crisis, losses and the shortage of funding forced institutions to reduce significantly their leverage over a short period of time. This amplified downward pressures on asset prices, causing further losses for institutions which in turn led to further declines in their own funds. The ultimate results of this negative spiral were a reduction in the availability of credit to the real economy and a deeper and longer crisis.<br>Risk-based own funds requirements are essential to ensure sufficient own funds to cover unexpected losses. However, the crisis has shown that those requirements alone are not sufficient to prevent institutions from taking on excessive and unsustainable leverage risk.<br>While specific risk modelling has the benefit of capturing more closely the risk peculiarity of each institutions (although this might pose issues in terms of comparability), certain jurisdictions have tried to limit an excessive lowering of capital requirements that could stem from certain internal models; this has been accomplished by introducing leverage reporting and/or binding minimum leverage ratios. |
| **17.1** | **Does your jurisdiction impose a leverage ratio (LR) requirement on bank (or did you find different methods to reach the same result)?** |
| *Brief Explanation* | *Reporting is in place on the LR (and soon disclosure as well), and next to that supervisors need to look at risk of excessive leverage in a Pillar 2 context. Extensive use of aggressive risk-modelling might have contributed to allow that many institutions accumulated on- and off-balance sheet leverage to a dangerous degree in the run-up to the financial crisis. Competent authorities shall ensure that institutions have policies and processes in place for the identification, management and monitoring of the risk of excessive leverage. Indicators for the risk of excessive leverage shall include the leverage ratio and mismatches between assets and obligations.* |

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| **17.2** | **Are any leverage-related requirements, comparable to those currently specified in the CRR, implemented in your jurisdiction? Specifically, does your regulation follow a particular methodology to detect whether institutions deploy leverage to a level that might endanger the stability of the institution or the market?** |
| *Brief Explanation* | *In general terms, the LR can be summarised as a measure of capital (capital measure) as a proportion of total adjusted assets (exposure measure). The capital measure is Tier 1 capital, while the exposure measure should generally follow the accounting measure of exposure, although on-balance sheet, non-derivative exposures are included in the Exposure Measure net of specific provisions and valuation adjustments; and netting of loans and deposits is not allowed. Also physical or financial collateral, guarantees or credit risk mitigation purchased are not allowed to reduce on-balance sheet exposures. Specific provisions are also envisaged for derivatives, repurchase agreements and securities finance (SFTs) and off-balance sheet items.* |
| *Legislative reference* | Details of the leverage ratio formulas and reporting are laid down in Article 429-430 of the CRR. It is to be noted that Article 429 of the CRR has been amended by means of Delegated Regulation 2015/62 on the leverage ratio http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2015:011:TOC. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **18) Capital buffers** | |
| GENERAL PRINCIPLE | Within the EU the authorities for the supervision of macro-economic risks or Member States might require the compliance with additional capital buffers for defined participants in defined markets. Depending on the nature of the buffer, it may not necessarily reflect a detected risk in a specific institution and may be applicable to all institutions, e.g. in a specific market or institutions above a certain size. The capital buffers in the CRD require the holding of additional capital of the highest quality (CET1) for all institutions subject to them. The buffers are usually defined as a percentage calculated on a predefined risk measure. |
| **18.1** | **Are the requirements for capital buffers implemented in an equivalent way within your jurisdiction? Specifically:**<br>• **Does your designated and/or competent authority within your jurisdiction have the right to require capital buffers to contain financial stability risks?**<br>• **Which kind of buffers are already in place or which are considered possible?** |
| *Brief Explanation* | *While the CRR identifies minimum levels of capital ratios that an institution must maintain at all times, the CRD IV envisages the following capital buffers:*<br>• *capital conservation buffer*<br>• *countercyclical capital buffer*<br>• *systemically important institution (SII) buffer (for globally and other* |

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| | *systemically important banks)*<br>• *systemic risk buffer*<br>*The purpose of the capital conservation buffer, as the name indicates, is to conserve a bank's capital. This buffer corresponds to 2.5% of the total of the risk weighted exposure amounts of a bank that needs to be met with an additional amount of the highest quality of capital (CET1).*<br>*The countercyclical buffer (CCyB) is intended to counteract the effects of the economic cycle on bank's lending activity. The purpose of the CCyB is to ensure institutions have a sufficient capital base, accumulated during periods of credit growth, to absorb losses in stressed periods. The CCyB is aimed at limiting pro-cyclicality, so that a downturn in the economy would not transmit into a feedback loop into the banking system, weakening its capital base and thus the ability to sustain the economy.*<br>*Failure to meet combined buffer requirements will trigger capital conservation measures (restrictions on dividend payments, shares buybacks, payments on AT1 instruments, bonuses and payments of variable remuneration or discretionary pension benefits) and the obligation to submit a capital conservation plan within five days.*<br>*The CRD deals also with the additional requirement for Systemically Important Banks i.e. those institutions whose failure would put the financial system at risk, either at global level (G-SIIs) or at the regional/local level (O-SIIs). Such institutions, at the consolidated level, are required to maintain a buffer of CET1 capital (the SII Buffer), which is meant to compensate for the higher risk that they represent for the financial system. The size of the SII Buffer for a particular G-SII will depend on its systemic importance. In respect of O-SIIs, competent authorities may require the maintenance of a buffer of up to 2% of their RWAs on a consolidated, sub-consolidated or individual basis as applicable.*<br>*Member States may also introduce a further buffer (the Systemic Risk Buffer) for the financial sector or one or more subsets of that sector in order to prevent and mitigate long-term non-cyclical systemic or macro prudential risks with potential negative impact to the financial stability.* |
| *Legislative reference* | Capital buffers are defined in Article 128-142 of the CRD. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |

**19) Macro-prudential tools**

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| GENERAL PRINCIPLE | Systemic risk has the potential to impair financial stability both in individual Member States and within the wider Single Market. Thus, the CRR provides national authorities with the possibility to deal with such risks in a complete and timely manner, through a set of several prudential tools. The macro-prudential provisions make substantial progress towards this goal. |

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| **19.1** | **How could potential situations of systemic risk be addressed in your jurisdiction? Are there dedicated tools/instruments available for supervisors to mitigate excessive risks building up within the financial system as a whole (i.e. not related to a single institution)?** |
| *Brief Explanation* | *Apart from the capital buffers provided in the CRD and the macro-prudential use of Pillar 2, national authorities may use the "macro-prudential flexibility" rules. Under certain conditions they may apply higher requirements on capital / liquidity / large exposures / risk weights. They might ask also more stringent requirements on Public Disclosure aimed at enhancing market discipline and mitigating informational asymmetries. It has to be established that the measure is necessary, effective and proportionate, and that other specified measures cannot adequately address the systemic risk. These measures are subject to a notification and non-objection process, with the EU Council having the final decision on whether to block a measure if objections are raised.* |
| *Legislative reference* | Provisions on macro-prudential tools are laid down in Article 458-459 of the CRR. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **20) Transitional provisions** | |
| GENERAL PRINCIPLE | The implementation of the new capital requirements imposed by the CRR is progressive: it follows a transition period before the full application of the new requirements. Additionally, there are also grandfathering provisions over 10 years that apply to outstanding capital instruments that are used to meet the criteria to qualify as regulatory capital under the pre-CRR regime, but that no longer qualify under the CRR. |
| **20.1** | **Does your regulatory framework envisage a transition period in order for the following elements:**<br>• **Unrealised gains and losses,**<br>• **Capital deductions**<br>• **Minority interest computability**<br>• **Large exposures**<br>• **Own funds requirements**<br>• **Leverage**<br>• **Basel I floor**<br>**In case the above items can be phased-in, how long will it take for the full implementation? Is the phasing-in pattern similar as far as the percentages which apply to the various items are concerned?** |
| *Brief Explanation* | *In order to avoid "cliff-effects" on own funds, the CRR includes the possibility of a smoother transition, with the elements likely to reduce the value of own funds to be introduced progressively, according to a certain transition pattern, which will lead to full implementation as of 1 January 2018.* |

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| *Legislative reference* | See Article 465-473 and 492-500 of the CRR. |
| **20.2** | **Does your legislation include provisions for "grandfathering" of AT1 and Tier 2 instruments? In case it does, how long is the phasing-out period?** |
| *Brief Explanation* | *In the same vein as for the phasing-in period for the items mentioned in Question 53 above, the CRR also includes certain rules for the grandfathering of capital instruments, so that the computation within own funds of capital instruments issued before the CRR could be phased-out progressively, with the transition period ending on 31 December 2021. After that date, capital instruments that are not compliant with the CRR rules cannot count as an institution's own funds.* |
| *Legislative reference* | See Article 474-491 of the CRR. |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |
| **21) Disclosure by institutions** | |
| GENERAL PRINCIPLE | Effective public disclosure enhances market discipline and allows market participants to assess a bank's capital adequacy and prudent liquidity management and can provide strong incentives to banks to conduct their business in a safe, sound and efficient manner. Transparency and disclosure rest at the foundation of the so called "Third Pillar" of prudential regulation as laid down in the Basel II framework and also envisaged in the CRR. Indeed, market discipline can only have a positive effect on the behaviour of market participants if sufficient and standardized (comparable) information is available. The European framework requires disclosure of comprehensive information, which should be sufficient to allow an evaluation of the funds, risk, and management without giving away professional secrets about strategy or information about counterparties. |
| **21.1** | **Among financial market participants, one of the most relevant source of distress stems from information asymmetries arising from opaque disclosure. Instead, market participants should have access to the same amount/quality of information when assessing of the risk taking of a counterparty. Do you regard this problem as relevant and how do you try to solve it?** |
| *Legislative reference* | Provisions on disclosure are laid down in Article 431-455 of the CRR |
| **21.2** | **How are the provisions for disclosure implemented in your jurisdiction? Specifically, does your regulation require all of the following:**<br>**a) Qualitative disclosure of elements**<br>**b) Quantitative disclosure of own funds**<br>**c) Quantitative disclosure of capital requirements** |
| *Legislative reference* | See Article 431-455 of the CRR |
| **21.3** | **Which are the requirements for supervisory disclosure within your jurisdiction?** |

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| *Brief Explanation* | *In order to enhance transparency and market efficiency, competent authorities shall publish the text of laws regulation and administrative rules adopted in the Member States, in order to allow for a meaningful comparison of approaches adopted by each Member State in the field of prudential regulation.* |
| *Legislative reference* | See Article 143-144 of the CRD |
| SELF ASSESSMENT | **Please summarise your opinion to which level, in aggregate, the regulation defined above is equivalent with the relevant EU regulation (the CRR and the CRD).**<br>**Please comment on the main areas of difference with respect to EU regulation and provide a short summary of the rationale, together with the assessment of their materiality for the institutions in your jurisdiction.** |

## Annex C: ‘Consent to Jurisdiction’ and ‘New Regulations’: CFTC Order of Exemption for an Exempt DCO and Order of Registration for a Foreign Board of Trade

**UNITED STATES OF AMERICA**

**Before the**

**COMMODITY FUTURES TRADING COMMISSION**

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**In the Matter of the Petition of**
**ASX Clear (Futures) Pty Limited**
**For Exemption from Registration**
**as a Derivatives Clearing Organization**

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**ORDER OF EXEMPTION FROM REGISTRATION**

ASX Clear (Futures) Pty Limited ("ASX"), has submitted to the Commodity Futures Trading Commission ("Commission"), pursuant to Section 5b(h) of the Commodity Exchange Act ("Act"), 7 U.S.C. § 7a-1(h), a petition for exemption from registration as a derivatives clearing organization ("DCO"). Section 5b(h) of the Act permits the Commission to exempt, conditionally or unconditionally, a DCO from registration for the clearing of swaps if the Commission determines that the DCO is subject to comparable, comprehensive supervision and regulation by the appropriate government authorities in the home country of the DCO ("Home Country Regulators").

The Commission has reviewed the petition and finds that ASX has demonstrated compliance with those requirements of the Act with which it must comply to be eligible for an exemption from registration as a DCO.

In light of the foregoing, **IT IS ORDERED**, pursuant to Section 5b(h) of the Act, 7 U.S.C. § 7a-1(h), that ASX is granted an exemption from registration as a DCO subject to the terms and conditions specified herein:

(1) Cleared Products. ASX is permitted to clear, pursuant to this Order, swaps including, but not limited to, interest rate swaps denominated in U.S. dollars, Euros, Japanese yen, British pounds, Australian dollars, and New Zealand dollars.

(2) U.S. Clearing Services Restricted to Proprietary Swap Positions for U.S. Persons. For purposes of this Order, "U.S. person" is defined as set forth in the Commission's Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292, 45,316–17 (July 26, 2013), as such definition may be amended or superseded by a definition of the term "U.S. person" that is adopted by the Commission with a scope encompassing this Order. ASX must maintain rules that limit swap clearing services for U.S. persons and futures commission merchants ("FCMs") to the following circumstances:

(a) A U.S. person that is a clearing member of ASX may clear swaps for itself and those persons identified in the Commission's definition of "proprietary account" set forth in Regulation 1.3(y);

(b) A non-U.S. person that is a clearing member of ASX may clear swaps for any affiliated U.S. person identified in the definition of "proprietary account" set forth in Regulation 1.3(y); and

(c) An entity that is registered with the Commission as an FCM may be a clearing member of ASX, or otherwise maintain an account with an affiliated broker that is a clearing member, for the purpose of clearing swaps for itself and those persons identified in the definition of "proprietary account" set forth in Regulation 1.3(y).

(3) Open Access. ASX must maintain rules with respect to swaps to which one or more of the counterparties is a U.S. person. Such rules must:

(a) Provide that all swaps with the same terms and conditions, as defined by product specifications established under ASX's rules, submitted to ASX for clearing are economically equivalent within ASX and may be offset with each other within ASX, to the extent offsetting is permitted by ASX's rules; and

(b) Provide that there must be non-discriminatory clearing of a swap executed bilaterally or on or subject to the rules of an unaffiliated electronic matching platform or trade execution facility.

(4) Consent to Jurisdiction; Designation of Agent for Service of Process. ASX must consent to jurisdiction in the United States, and must designate, authorize, and identify to the Commission, an agent in the United States who must accept any notice or service of process, pleadings, or other documents, including any summons, complaint, order, subpoena, request for information, or any other written or electronic documentation or correspondence issued by or on behalf of the Commission or the United States Department of Justice to ASX, in connection with any actions or proceedings brought against, or investigations relating to, ASX or any U.S. person or FCM that is a clearing member, or that clears swaps through an affiliated clearing member, of ASX. ASX must promptly inform the Commission of any change in its designated and authorized agent.

(5) Compliance. ASX must comply, and must demonstrate compliance as requested by the Commission, with the requirements of this Order.

(6) Inspection of Books and Records. ASX must make all documents, books, records, reports, and other information related to its operation pursuant to this Order ("Books and Records") open to inspection and copying by any representative of the Commission; and in response to a request by any representative of the Commission, ASX must, promptly and in the

form specified, make the requested Books and Records available and provide them directly to Commission representatives.

(7) Observance of the CPMI-IOSCO Principles for Financial Market Infrastructures ("PFMIs"). On an annual basis, within 60 days following the end of its fiscal year, ASX must provide to the Commission a certification that it continues to observe the PFMIs in all material respects.

(8) Representation of Good Regulatory Standing. On an annual basis, within 60 days following the end of its fiscal year, the Commission must receive from the Home Country Regulators, at ASX's request, a written representation that ASX is in good regulatory standing. For purposes of this paragraph 8, "good regulatory standing" means that either (a) there has been no finding by the Home Country Regulators of material non-observance of the PFMIs or other relevant home country legal requirements, or (b) there has been a finding by the Home Country Regulators of material non-observance of the PFMIs or other relevant home country legal requirements but any such finding has been or is being resolved to the satisfaction of the Home Country Regulators by means of corrective action taken by ASX.

(9) General Reporting Requirements. ASX shall submit to the Commission the following information, as specified:

(a) A report compiled as of the end of each trading day and submitted to the Commission by 10:00 a.m. U.S. Central time on the following business day, containing:

(i) Initial margin requirements and initial margin on deposit for each U.S. person, with respect to swaps; provided, however, if a clearing member margins on a portfolio basis its own positions and the positions of its affiliates, and either the clearing member or any of its affiliates is a U.S. person, ASX must report initial margin requirements and initial margin on deposit for all such positions on a combined basis for each such clearing member; and

(ii) Daily variation margin, separately listing the mark-to-market amount collected from or paid to each U.S. person, with respect to swaps; provided, however, if a clearing member margins on a portfolio basis its own positions and the positions of its affiliates, and either the clearing member or any of its affiliates is a U.S. person, ASX must separately list the mark-to-market amount collected from or paid to each such clearing member, on a combined basis;

(b) A report compiled as of the last day of each fiscal quarter of ASX and submitted to the Commission no later than 17 business days after the end of ASX's fiscal quarter, containing the following information:

(i) The aggregate clearing volume of U.S. persons during the fiscal quarter, with respect to swaps. If a clearing member is a U.S. person, the volume figure shall include the transactions of the clearing member and all affiliates. If a clearing member is not a U.S. person, the volume figure shall include only transactions of affiliates that are U.S. persons.

(ii) The average open interest of U.S. persons during the fiscal quarter, with respect to swaps. If a clearing member is a U.S. person, the open interest figure shall include the positions of the clearing member and all affiliates. If a clearing member is not a U.S. person, the open interest figure shall include only positions of affiliates that are U.S. persons.

(iii) A list of U.S. persons and FCMs that are either clearing members or affiliates of any clearing member, with respect to the clearing of swaps, as of the last day of the fiscal quarter;

(c) Prompt notice regarding any change in the home country regulatory regime that is material to ASX's continuing observance of the PFMIs or with any of the requirements set forth in this Order;

(d) As available to ASX, any assessment of ASX's or the Home Country Regulators' observance of the PFMIs, or any portion thereof, by a Home Country Regulator or other national authority, or an international financial institution or international organization;

(e) As available to ASX, any examination report, examination findings, or notification of the commencement of any enforcement or disciplinary action by a Home Country Regulator;

(f) Immediate notice of any change with respect to ASX's licensure, registration, or other authorization to act as a clearing organization in its home country;

(g) In the event of a default by a U.S. person or FCM clearing swaps, with such event of default determined in accordance with ASX's rules, immediate notice of the default including the name of the U.S. person or FCM, a list of the positions held by the U.S. person or FCM, and the amount of the U.S. person's or FCM's financial obligation; and

(h) Notice of action taken against a U.S. person or FCM by ASX, no later than two business days after ASX takes such action against a U.S. person or FCM.

(i) Any other information that the Commission deems necessary, including, but not limited to, information for the purpose of the Commission evaluating ASX's continued eligibility for exemption from registration, reviewing ASX's compliance with any conditions of the exemption, or conducting oversight of U.S. persons and their affiliates, and the swaps that are cleared by such persons through ASX.

(10) Swap Data Recordkeeping and Reporting Requirements. If a clearing member clears through ASX a swap that has been reported to a Commission-registered swap data repository ("SDR") pursuant to Part 45 of the Commission's regulations, then ASX must report to an SDR, pursuant to this Order, data regarding the two swaps resulting from the novation of the original swap that had been submitted to ASX for clearing. In order to avoid duplicative reporting for such transactions, ASX shall have rules that prohibit the Part 45 reporting of the two new swaps by the original counterparties to the original swap.

(11) Reservation of Rights. This Order is based upon the representations made and supporting material provided to the Commission by ASX. In the event of any changes to or omissions in the material facts or circumstances pursuant to which this Order is issued, or for any reason in its own discretion, the Commission may condition, modify, suspend, terminate, or otherwise restrict the terms of this Order, as appropriate and as permitted by law, on its own motion.

Issued in Washington, D.C. this 18th day of August, 2015.

By the Commission

Christopher J. Kirkpatrick
Secretary of the Commission

UNITED STATES OF AMERICA

Before the

COMMODITY FUTURES TRADING COMMISSION

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In the Matter of the Application of the London Metal Exchange for Registration pursuant to Section 4(b)(1) of the Commodity Exchange Act and Part 48 of the Regulations of the Commodity Futures Trading Commission in order to permit direct access to its order entry and trade matching system

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# ORDER OF REGISTRATION

Pursuant to Section 4(b)(1) of the Commodity Exchange Act (the Act), 7 U.S.C. § 6(b)(1), and Part 48 of the Commission's regulations, the London Metal Exchange (LME), a derivatives exchange recognized by and subject to regulation by the Financial Conduct Authority in the United Kingdom, submitted an application dated August 14, 2012 and including supplemental submissions filed through September 21, 2016 (the Application), requesting registration in order to permit identified members and other participants located in the United States to enter trades directly into its order entry and trade matching system.

The Commission has reviewed the Application along with the exhibits, supplemental documents, and other supporting information and representations, and finds that LME has demonstrated its ability to comply with the requirements of the Act and applicable Commission regulations thereunder, including the requirements for registration as set forth in Part 48 of the Commission's regulations.

In light of the foregoing, **IT IS ORDERED**, pursuant to Section 4(b)(1) of the Act, 7 U.S.C. § 6(b)(1), that LME is granted an Order of Registration to permit direct access, as that term is defined in Section 4(b)(1)(A) of the Act, subject to the terms and conditions specified herein:

(1) Compliance with the Act and Commission Regulations. LME shall comply, and shall demonstrate compliance as requested by the Commission, with all sections of the Act and the Commission's regulations thereunder applicable to LME as a foreign board of trade registered pursuant to Part 48 of the Commission's regulations, as may be amended or adopted from time to time. LME shall comply with the applicable conditions of registration specified in Commission regulation 48.8 and any additional conditions that the Commission deems necessary and may impose, in its discretion, after appropriate notice and opportunity to respond. LME shall fulfill each of the representations it has made in support of the Application for registration.

(2) New Regulations. Should the Commission promulgate a regulation addressing or otherwise affecting any aspect of this Order, then such regulation will apply and supersede the applicable terms in this Order.

(3) Reservation of Rights. This Order is based upon the representations made and supporting material provided to the Commission by LME as part of the Application. In the event of any changes to or omissions in the material facts or circumstances pursuant to which this Order is issued, or for any reason in its own discretion and after appropriate notice and opportunity to respond, the Commission may condition, modify, suspend, terminate, or otherwise restrict the terms of this Order, as appropriate and as permitted by law, on its own motion.

Issued in Washington, D.C. this 31st day of October, 2016.

By the Commission

Christopher J. Kirkpatrick
Secretary of the Commission

## Annex D: ESMA response to IOSCO

European Securities and Markets Authority

**The Chair**
Date: 23 February 2015
ESMA/2015/422

**Greg Medcraft**
**Chair of the IOSCO Board**
**Address**
**Country**

## Ref: ESMA Comments on the Task Force on Cross-Border Regulation

Dear Mr Medcraft,

The European Securities and Markets Authority (ESMA) welcomes the opportunity to comment on the Consultation Report (the "Report") of the Task Force on Cross-Border Regulation (the "Task Force") issued by IOSCO on 25 November 2014. ESMA is an active member of the Task Force and the purpose of this letter is not to address each of the issues mentioned in the Report but to highlight several key challenges.

ESMA is committed to working collaboratively with IOSCO to support its leadership efforts aimed at addressing cross-border regulatory challenges. It believes that IOSCO should play a prominent role in promoting international coordination and cooperation, developing tool kits to address cross-border issues related to regulation and supervision, facilitating early dialogue at policy-making stage and coordinating the implementation process in order to identify and solve areas of conflict.

ESMA believes that several issues could be further considered and discussed by the Members of the Board of IOSCO regarding cross-border cooperation.

## Overview of the Tools and Key Features: the benefits of "Recognition" and "Passporting" versus "National Treatment"

The application of the laws of one country in the jurisdiction of another has become an important topic of debate following the implementation of G20 standards and the further globalisation of financial markets.

To improve matters from where they currently stand, it would seem important to find ways to facilitate passporting, mutual recognition or substituted compliance by the different authorities while at the same time avoiding any gaps in the legislation of different countries. Care must also be taken to ensure that the approach to determining mutual recognition or substituted compliance does not require "direct equivalence, clause by clause, of the foreign legislation" but instead that it ensures "consistency of goals and comparability of outcomes".

Without minimising the difficulties of developing these tools, as passporting, mutual recognition and substituted compliance are processes which require time and analysis (e.g. developing a common methodology, analysis of the legal and supervisory framework of jurisdictions, establishment of a high degree of confidence between national competent authorities, promotion of cooperation arrangements, etc.), they appear to be the most appropriate way to address regulation and supervision issues in a global financial market. Against this framework, IOSCO should play a central role as regards the promotion of these tools, the development of standard methodologies, in developing internationally recognized and consistent standards of regulation, oversight and enforcement and in facilitating dialogue and mutual trust between competent authorities.

## A higher degree of granularity of international standards

One of the cross-border regulatory challenges identified in the Report is insufficient granularity in international standards. Having granular standards available on time will help reduce the development of differences when an activity becomes subject to regulation across the globe. This will not make regulations identical but it should facilitate the second step which is the reliance on foreign regulatory systems when they achieve the same regulatory outcomes.

## Early involvement and upfront engagement of regulators in G 20 policy discussions

To develop at international level sufficiently granular standards, a first important step is for policy makers and regulators to be more proactive in identifying, in a timely way, broad risk areas which potentially require future regulatory action.

Moreover, ESMA is of the view that more progress could be made regarding assessment of different existing regulatory frameworks worldwide before new rules are proposed in different jurisdictions. Ideally, harmonised rules at global level are agreed upon before national rules with cross-border impact are enacted.

An early dialogue between policymakers and regulators in the legislative process is also essential to ensuring consistency in the implementation of agreed international standards in a coordinated manner and in a coherent timeframe.

### New tool for supervisory purposes

Improvements in cross-border regulatory and supervisory coordination form a cornerstone to meet regulatory objectives such as investor protection, stability and avoiding regulatory arbitrage. IOSCO should strive to develop a new Multilateral Memorandum of Understanding

(MMoU) for supervisory purposes. This work should be based on the principles and the template developed by IOSCO in 2010.

The purpose of this new MMoU (which would be complimentary to the existing IOSCO MMoU on enforcement) would be to provide a global and general framework for cooperation and the exchange of information between national regulators in relation to the supervision of securities markets. The cooperation and exchange of information between competent authorities would be designed to facilitate the provision of mutual assistance between them to better enable the carrying out of their supervisory responsibilities.

The possibility to sign up to a multilateral framework for supervisory purposes would be much more efficient for IOSCO members, especially from smaller jurisdictions, than negotiating multiple bilateral MoUs. In that context ESMA's MMoU between competent authorities (and between competent authorities and ESMA where ESMA has supervisory responsibilities) is a good example of a multilateral arrangement which focuses on supervisory cooperation and exchange of confidential information regarding supervisory matters. It is also to be noted that a multilateral memorandum regarding supervisory cooperation at global level already exists in the insurance sector.

ESMA looks forward to continuing to work with you on these important challenges.

Yours sincerely,

Steven Maijoor

Cc: Ashley Alder, Chairman, IOSCO Task Force on Cross-Border Regulation

## Glossary

| Defined Term | Meaning |
|---|---|
| **Legislation** | |
| AIFMD | Alternative Investment Fund Managers Directive (Directive 2011/61/EU) |
| Benchmark Regulation | Benchmark Regulation (Regulation (EU) 2016/1011) |
| CRD IV | Capital Requirements Directive (Directive 2013/36/EU) |
| CRR | Capital Requirements Regulation (Regulation (EU) 575/2013) |
| EMIR | European Market Infrastructure Regulation (Regulation (EU) 648/2012) |
| FSMA | Financial Services and Markets Act 2000 |
| GDPR | General Data Protection Regulation (Regulation (EU) 2016/679) |
| Insurance Mediation Directive | Insurance Mediation Directive (Directive 2002/92/EC) |
| Mortgage Credit Directive | Mortgage Credit Directive (Directive 2014/17) |
| MiFID | Markets in Financial Instruments Directive (Directive 2004/39/EC) |
| MiFID II | Markets in Financial Instruments Directive (Directive 2014/65/EU) |
| MiFIR | Markets in Financial Instruments Regulation (Regulation (EU) 600/2014) |
| RAO | The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 |
| Solvency II | Solvency II Directive (Directive 2009/138/EC) |
| TEU | Treaty on the European Union |
| TFEU | Treaty on the Functioning of the European Union |
| Third Money Laundering Directive | Third Money Laundering Directive (Directive 2005/60/EC) |
| UCITS IV | Undertakings for Collective Investment in Transferable Securities Directive (Directive 2014/91/EU) |
| **Other Definitions** | |
| AIF | Alternative Investment Fund |
| ASIC | Australian Securities and Investment Commission |
| BoE | Bank of England |

| Defined Term | Meaning |
|---|---|
| Brexit | the exit of the UK from the European Union |
| CCP | Central Counterparty |
| CETA | the Comprehensive and Economic Trade Agreement between the EU and Canada |
| CFD | Contracts for Difference |
| CFTC | Commodity Futures Trading Commission |
| Commission | The European Commission |
| DCO | Derivatives clearing organisation |
| EBA | European Banking Authority |
| ECJ | European Court of Justice |
| EEA | European Economic Area |
| EEC | European Economic Community |
| EFTA | European Free Trade Association |
| EIOPA | European Insurance and Occupational Pensions Authority |
| ESA | European Supervisory Authority |
| ESMA | European Securities and Markets Authority |
| EU | European Union |
| FATF | Financial Action Task Force |
| FCA | Financial Conduct Authority |
| FLMC | Financial Law and Markets Committee |
| FSA | Financial Services Authority |
| FSB | Financial Stability Board |
| FT | Financial Times |
| IMF | International Monetary Fund |
| IOSCO | International Organization of Securities Commissions |
| MAS | Monetary Authority of Singapore |
| MoU | Memorandum of Understanding |
| OECD | Organisation for Economic Co-operation and Development |

| Defined Term | Meaning |
|---|---|
| OTC derivatives | Over-the-counter derivatives |
| PRA | Prudential Regulation Authority |
| SEC | Securities and Exchange Commission |
| SIB | Securities and Investment Board |
| TR | Trade Repository |
| UK | United Kingdom |
| US | United States of America |
| WTO | World Trade Organisation |

## ABOUT THE AUTHORS:

## Norton Rose Fulbright LLP

**Peter Snowdon**
**Partner, London**
Tel +44 20 7444 3912
peter.snowdon@nortonrosefulbright.com

**Jonathan Herbst**
**Partner, London**
Tel +44 20 7444 3166
jonathan.herbst@nortonrosefulbright.com

**Anushka Herath**
**Senior Associate, London**
Tel +44 20 7444 5104
anushka.herath@nortonrosefulbright.com

**Financial Services Negotiation Forum**

The FSNForum is a neutral, not-for-profit membership organisation which seeks to facilitate leading advocates from both sides of the Referendum debate to work together to secure a pro-business negotiation outcome that is in the best achievable interests of the UK.

Moreover, while we may be leaving the EU, we remain firmly in Europe, so the FSNForum is strongly supportive of the need for the negotiations to sustain an open and competitive European marketplace.

## DISCLAIMERS:

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